The Interface between Intellectual Property Rights and Competition Law and Policy: An Australian Perspective*

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ABSTRACT *The interface between intellectual property and competition policy is a difficult one. Both aim to correct for market failure in the pursuit of economic efficiency. However, in correcting for one market failure, we may exacerbate another. This article raises a number of specific issues which have arisen at this interface, at both the policy and enforcement levels. It discusses the Australian response to questions of spare parts, journalists copyright, parallel imports, databases and collecting societies, all issues which have arisen internationally in recent years.*

Keywords: collecting societies, competition, intellectual property, journalists, parallel imports, spare parts.

Competition Policy and Intellectual and Industrial Property

Intellectual and industrial property rights (IPRs) have a pervasive influence on the economy. Few markets are unaffected by such rights. Copyright, patents, designs, circuit layout and plant variety rights are provided to overcome problems of market failure. The potential for 'free riding' on inventions and creative activity, whereby assets are used without payment and transactions bypass the market process, could result in insufficient remuneration to those investing in such intellectual and industrial capital and a misallocation of resources. If the social return from additional investment exceeds the private return, investment is likely to be suboptimal. Similarly, trademarks prevent free riding on investments in product promotion and reputation, conveying information about the products to which they attach, so that consumers are able to make more informed choices. To correct for these market failures, property rights are granted in intellectual and industrial property.

While this rationale for IPRs has been part of economic orthodoxy for many years, it has not been held universally. Some have argued that little, if any, additional investment in intellectual property is generated by IPRs.[1] Certainly there is no consensus concerning how much additional creative and inventive activity is induced by IPRs which would not otherwise occur, and there are some potentially negative effects on innovation, particularly secondary innovation,[2] from extensive patent rights and the

*This article is an amended version of a paper originally prepared for an OECD Competition Law and Policy Committee Roundtable on Intellectual Property Rights, October 1997. The views contained in it are those of the author and not necessarily those of the ACCC.

0810-9028/98/030383-11

possibility of preemptive patents.[3] It is not clear that more extensive IPRs will necessarily result in more creative and inventive activity, nor that this is necessarily an efficient use of society's resources, which have an opportunity cost. Further, in correcting for the market failure associated with free riding, other market failures may be created or exacerbated.

Intellectual and industrial property often has 'public good' characteristics, that is there are often no opportunity costs associated with its use or consumption. Songs and novels can be sung or read by an infinite number of people at one time and they do not 'wear out' over time, only their physical carriers are subject to such limitations. Similarly the use of a particular drug formulation by one pharmaceutical manufacturer does not prevent its use by another, either simultaneously or subsequently. Hence the marginal cost of a particular user is zero. In the absence of IPRs this is the price paid for copying. The granting of IPRs, by facilitating exclusion and pricing above the marginal cost of the physical carrier, tends to restrict access and use of these assets below their optimal level. Indeed they could have the perverse effect of encouraging excessive production of new intellectual property, e.g. songs and books, while existing ones are underutilised. However, marginal cost pricing would not deliver any return to the investors in intellectual and industrial property and thus may restrict the range of goods and services available over time. It should also be noted that intellectual and industrial property is not necessarily (or purely) a public good. For example, the value attached to a particular design of clothing may be inversely related to the number of people wearing such clothes. Similarly trademarks are not generally public goods. Consumers often place a high value on the status and limited availability of goods carrying particular brand labels.

The ability of IPR owners to charge above marginal cost derives from the exclusive rights which they are granted. This is not necessarily a monopoly in an economic or antitrust sense, but it does limit competition to some degree. The effect on competition depends on the *nature* and *extent* of IPRs granted and the extent to which close substitutes are, or are likely to be, available. For example, patent rights provide exclusive rights over *ideas*, whereas copyright only provides protection against *copying* particular *expressions* of ideas; copyright does not provide protection against independent creation of an identical expression, or different expression of the same ideas. In this regard, patents are likely to have a much greater impact on competition than copyright. For example, it is likely to be much more difficult and require considerably more sunk costs to produce a substitute pharmaceutical product without breaching existing patent rights than it would be to produce substitute cookery books without breaching copyright. Of course it is the extensive sunk cost requirement associated with invention and innovation which also justifies the extent of patent rights as a necessary incentive. Over time this may be pro-competitive in a dynamic sense. Other relevant issues are the life of IPRs, disclosure requirements, e.g. patents, and compulsory licensing requirements, e.g. musical works.

The nature of the competition problems arising from IPRs include excessive prices, price discrimination and raising barriers to entry in both the immediate and downstream markets, through licensing arrangements, brand loyalty, preemptive patenting and restrictions on access. Particular problems arise when network externalities are involved, as for example in computer software.

While an individual IPR may have several substitutes and not pose competition problems, the aggregation of IPRs may create market power. This is particularly likely to occur in a country such as Australia, where the original IPRs are located overseas and ownership may be dispersed, but a single company acquires the licenses to (manufacture and) distribute a range of competing products in Australia. Another area of concern regarding the aggregation of IPRs occurs where rights are collectively administered. The operation of copyright collecting societies has been the focus of antitrust attention in the US, UK and EC as well as Australia.[4]

A balance needs to be drawn which will promote the achievement of economic efficiency, taking account of all market failures, including issues of both free riding and competition. The *extent* of rights granted in legislation should be determined on the basis of maximising the net benefit from the prevention of free riding and provision of incentives to invest in intellectual property compared to the costs from reduced competition as well as the administrative and compliance costs of the law. This will generally not mean that more protection is always better. Firstly, more protection may not always promote more investment. Secondly, more investment is not always better. Resources invested in new intellectual property have an opportunity cost. If the private returns from such investment exceed the social returns, because IPRs restrict competition and allow rights owners to charge excessive prices, then investment is likely to be excessive, such that the opportunity cost exceeds the social return, and resource allocation will be impaired.

Unfortunately IPRs are often not determined on this basis. Even where IPRs are provided under economic (rather than moral) regimes, the economic interests promoted often tend to be those of IPR owners rather than the public at large. The benefits from greater protection accrue to a relatively small group of owners who have an incentive to organise and lobby government, as opposed to the dispersed benefits from greater competition.

While core IPRs have not been the subject of substantial debate relating to the costs and benefits for competition and innovation, a number of policy debates have arisen in Australia in recent years, or are ongoing, as regards the extent of those rights and where the boundary should be drawn.

Motor Vehicle Spare Parts

The Australian Law Reform Commission (ALRC) undertook a 3-year inquiry into the Designs Act.[5] A number of issues arose during that inquiry as regards the nature of rights (exclusive versus anti-copying) and the innovation threshold, but one of the most hotly debated issues, both before, during and since has been the issue of protecting spare parts. The same issue has been debated in the US, the UK and the EC, in relation to both policy and the application of competition law.

The question which has arisen is whether the market for spare parts is a separate market from the market for original equipment. If consumers consider the relative price of spare parts (as well as the frequency of breakdown etc.) when buying the original equipment, then the two should properly be considered part of the same market; the price of spare parts would not reflect the exercise of any more market power than the manufacturer possessed as a supplier of original equipment, since to do so would adversely affect sales of the latter. However, to the extent that consumers do not make fully informed purchasing decisions (reflecting the high cost of acquiring the information), the price of spare parts may reflect the exercise of a much higher degree of market power in the 'derivative market' for spare parts for that particular brand of original equipment. To the extent that the spare parts are not interchangeable with those used for other brands and if independent suppliers are not able to enter the market, the manufacturer may have an effective monopoly over the supply of those spare parts. While motor vehicle spare parts have been the major focus of attention in relation to designs, the issue is relevant to other products, some of which have been the focus of antitrust cases, e.g. photocopiers[6] and cash registers.[7]

Two types of problems may arise from the provision of design protection for spare parts—high prices for parts, and restricted competition for the repair and servicing of original equipment. The policy question arises as to the extent of the problems which arise when rights are granted versus the extent of any dampening of the incentive for innovation which the removal of rights may induce.

The ALRC proposed a regime under which spare parts would be protected except where competition objections were raised and sustained by the Australian Competition and Consumer Commission (ACCC), which would be required to evaluate those problems and balance them against any public benefits arising from protection. Protection would only be sustained where there was a net public benefit to be gained. The government is currently considering its response to the ALRC report.

Publishers and Journalists

The Australian Parliament is currently considering the Copyright Amendment Bill 1997. One element of this Bill concerns a shift in the location of copyright ownership in the work of employed journalists from those journalists to their publishers. Not all rights are proposed to be shifted; journalists will retain rights over hard-copy reproduction, although publishers will also have certain veto rights in this regard. While the extent of copyright will not change, the proposed change in its location still raises competition issues.

Currently competition concerns may arise in relation to the collective exercise of rights by journalists. With the shift of rights to publishers different competition concerns may arise. Problems may arise in relation to access, or the terms and conditions of access, to newspapers and periodicals for the production of value-added media monitoring services. In order to provide a comprehensive product, such downstream service providers need to have access to the full range of publications. Of course access problems could potentially arise where the copyright is owned by journalists, particularly where rights are collectively administered, but particular problems arise when the copyright is owned by publishers who also participate in downstream markets in competition with those seeking access. Where monitoring services can still obtain access to hard-copy from journalists, even the production of a comprehensive hard-copy service requires the use of electronic transmission to collate and distribute clippings around the country. Furthermore, veto powers for publishers contained in the Bill could require that access be obtained from both journalists and publishers.[8]

A further competition problem could also arise where copyright resides with publishers who are also involved in the production of value-added monitoring services. In order to provide a comprehensive service, each publisher would need access to other publishers' rights. This could potentially have spillover effects on competition and coordination in both upstream and downstream markets.

Parallel Imports

The former Prices Surveillance Authority (PSA)[9] raised the question of restrictions over parallel imports in its inquiries into books, records, computer software and farm chemicals.[10] The PSA took the view that copyright and patent protection in the sphere of reproduction could be justified on the basis of 'free rider' problems, but not in the sphere of distribution of articles legally marketed. While it is necessary to restrict imports of pirate and counterfeit goods in order to make reproduction rights effective, it is not necessary to restrict 'parallel imports' of goods legally marketed overseas with the copyright or patent owners permission.

With a lack of effective price competition between Australian rights owners, the importation provisions, through preventing international arbitrage, have allowed price discrimination between different national markets. Australia, as a small and isolated market, has been the loser in this discrimination. For many years Australian consumers have paid significantly higher prices for books, records, computer software and some farm chemicals than their peers in Europe and North America. These high prices have been reflected in both high costs (e.g. inefficient multiple distribution of books and rivalrous advertising of records) and in excessive profits.

Exclusive dealing may be justified to prevent free riding on investments in distribution and marketing, and in some instances price discrimination can be justified as a 'second best' solution to declining unit costs, but these are not characteristics which are either unique to, or universally associated with, products covered by IPRs. They reflect market failures of a different type, which will occur in some markets subject to IPRs but not in others. Hence, it is inappropriate to provide blanket statutory exclusive importation rights for all intellectual and industrial property regardless of the particular market context.

As a result of the PSA reports and reports by the Copyright Law Review Committee (CLRC),[11] the government has considered and implemented various changes to the Copyright Act. In 1991 amendments were made to the parallel import provisions as they relate to books which focused on improving the availability of titles. A review of the provisions 3 years later revealed that new titles were generally available more quickly and there had also been some benefits for prices of bestsellers and in the efficiency of distribution systems, but that significant price discrepancies remained.[12] By meeting the availability requirements of the Copyright Act, copyright holders have largely retained control over parallel imports and have therefore been able to maintain prices.

The previous government initially adopted a proposal to open the record market to parallel imports for recordings of non-Australian artists, but subsequently dropped this proposal. The current government's Copyright Amendment Bill (No. 2) 1997, currently before the Senate, would open the sound recordings market to parallel imports from all countries with copyright protection. The Bill has met with significant opposition from vested interests in the music industry and its fate is far from certain.

The CLRC report also drew attention to an overlap between the Copyright Act and the Trade Marks Act, whereby the Australian owners or licensees of trademarked goods were able to claim copyright in brand labels and thereby gain protection against parallel imports which is not necessarily available under the Trade Marks Act. The CLRC proposed that this overlap be removed from the Copyright Act and that proposal is currently being considered by Parliament as part of the Copyright Amendment Bill. The proposal has attracted outraged submissions from importers claiming that such provisions allow them to protect the health, safety and reputation of their products. The Copyright Act would seem to be a particularly blunt instrument to attack this problem, which is neither universally associated with, nor restricted to, goods which are covered by trademarks. Parallel imports have been legitimately marketed in their country of origin and importers and retailers supplying these goods are subject to the same consumer protection and other relevant legislation as the licensed importer. Rather, the protection against parallel imports has served to support excessive prices and prevented legitimate competitive importers offering consumers a better deal.

Importation rights were also addressed by the ALRC in its report on the Designs Act.[13] It recommended that parallel imports should continue to be permitted.

Parallel imports are also permitted under the Circuit Layouts Act and this provides an example of the effects of allowing, or not allowing, such restrictions, namely video games used in amusement centre. Following the 1992 Full Court decision in *Avel v. Wells*,[14] parallel imports of video games under the Circuit Layouts Act enabled a competitive market for amusement centres to flourish. Avel was the exclusive distributor of the most significant video games used in amusement centres and also a major operator of such centres. Parallel imports allowed Avel's downstream competitors to gain access to these games on competitive terms and conditions. However, the 1996 decision in *Galaxy v. Sega*,[15] recently affirmed by the Full Court,[16] has made video games subject to the Copyright Act rather than the Circuit Layouts Act, and hence to restrictions on parallel imports. The operators of independent amusement centres have complained that they are no longer able to gain access to 'must have' games on reasonable terms and conditions which allow them to compete in the downstream market.[17]

The Interaction of IPRs and Competition Law

The preceding sections have considered the policy issues of the appropriate *extent* of IPRs in order to maximise economic welfare, trading off effects on innovation and competition. However, a second question arises as to the extent to which competition law should impinge on the use of rights once granted. As previously mentioned, while one particular IPR may not convey significant market power, the aggregation of a number of rights may do so. Similarly, particular conduct by a rights owner without market power may have no effect on competition, while the same or similar conduct by a rights holder with market power may have a substantial effect on competition.

Section 51(3) of the Trade Practices Act (the Act) currently provides a limited exemption from Part IV of the Act (which deals with restrictive trade practices) for the owners of IPRs. The exemption does not cover section 46 (misuse of market power) or section 48 (retail price maintenance) and it is limited to conditions of licences and assignments insofar as they 'relate to' the IPR. The effect of the exemption is open to debate and has not been the subject of extensive litigation. Restrictions on licensees' ability to trade in competitors' products, price fixing between suppliers of competing goods protected by IPRs, refusal to supply for one of the prohibited purposes in section 46 by a rights holder with a substantial degree of market power, or an assignment of rights resulting in a substantial lessening of competition[19] might all breach the Act. Furthermore, the exemption is limited to existing rights and does not extend to an agreement to assign future rights, e.g. 'grant back' provisions. However, price and output restrictions imposed on licensees and the enforcement of importation rights would seem to 'relate to' the IPRs and hence would be covered by the exceptions in section 51(3).[20]

The exemptions in section 51(3) were considered by the National Competition Policy Review (The Hilmer Review).[21] As part of its submission, the Trade Practices Commission[22] recommended the removal of section 51(3). It was argued that the use of IPRs should be subject to the same competition rules as any other property, and that arguments regarding offsetting public benefits, such as correcting for market failures or increased efficiencies, could be considered under the authorisation and notification provisions of the Act.[23]

In August 1993 the Hilmer Report was completed. The Committee concluded that the general conduct rules of a national competition policy should, in principle, apply to all business activity in Australia. Exemptions for any particular conduct should only be permitted when a clear public benefit has been demonstrated through an appropriate and transparent process. In relation to the specific exemption for intellectual property matters, the Committee 'saw force in arguments to reform the current arrangements, including the possible removal of the current exemption' but concluded that there should be a separate review by appropriate experts.[24]

The Competition Principles Agreement, signed by the various State, Territory and Commonwealth governments requires, amongst other things, all parties to review legislation that restricts competition.[25] The 'guiding principle' of the review is that legislation should not restrict competition unless it can be demonstrated that the benefits to the community outweigh the costs, and that the objectives of the legislation can only be achieved by restricting competition. In accordance with the Competition Principles Agreement, the Commonwealth government issued its legislative review schedule in June 1996. A review of the exemptions in section 51(3) of the Act is due to commence in 1997–8 and a general review of intellectual and industrial property legislation is due to commence in 1998–9.

In addition to the intergovernmental agreements, the Commonwealth, in June 1995, enacted the Competition Policy Reform Act (CPRA).[26] The CPRA is intended to 'usher in a new era in national competition policy'[27] by creating an integrated and complete approach to national competition policy, which balances economic efficiency and broader elements of public policy ...'[28] The CPRA resulted in substantial legal and policy changes including the addition of Part IIIA to the Act. The new Part establishes a legal regime to facilitate access to services provided by certain essential facilities of national significance.[29] 'Service' is expressly defined to exclude 'the use of intellectual property ... except to the extent that it is an integral but subsidiary part of the service'.[30] The intellectual property exemption arose due to concerns that Part IIIA might override copyright, patent and other intellectual and industrial property laws. The section is intended to permit a limited use of intellectual property (e.g. manuals or instructions) which are necessary for access.[31]

As a result of this exception, issues relating to access to intellectual and industrial property must be dealt with on a case by case basis under section 46 of the Act. This requires that issues of market power, use of that market power versus use of IPRs, and whether its use was for a proscribed purpose are addressed. While these tests would not be insurmountable in appropriate circumstances, they would certainly be open to extensive legal and economic debate and there have not been any successful cases to date.

An issue likely to arise with increasing frequency is that of access to databases. A draft treaty on the protection of databases was prepared for consideration by the World Intellectual Property Organisation (WIPO) diplomatic conference in December 1996. Current international conventions (Berne and TRIPS) give databases some protection where a database is 'original', a term which has been given different interpretations in different countries. The draft database treaty met with considerable controversy because it proposed to grant protection to databases without the originality requirement. Reichman and Samuelson conclude that:

> ...the proliferation of poorly conceived, hybrid intellectual property rights has cumulatively begun to undermine the competitive ethos on which market economies depend, and the current database proposals represent the most recent (and perhaps the most extreme) instance of this trend ... [and] ... the current database schemes represent a low point in the history of intellectual property law[32]

The proposal was held over and a special information meeting on intellectual property in databases was held in September 1997. At the conference further development of a treaty was delayed to allow for more consultation on the need for and impact of such a treaty.

Currently, in line with the general scheme of copyright, Australian law provides protection for particular compilations of databases but not for the data itself. However, it is not always straightforward to make this distinction and it may be impossible to access the data without copying a particular compilation.

The *Magill* case in the European Court of Justice,[33] which has attracted considerable international attention, while acknowledging that copyright subsisted in the weekly programme listings of television stations, found that they had a monopoly over the information used to compile those listings and that their refusal to grant a licence was an abuse of a dominant position in breach of Article 86 of the EC Treaty. Two matters which have been investigated by the ACCC in Australia similarly concerned access to monopoly sources of information or data underlying meteorological forecasts and telephone directories.

In December 1995 the ACCC commenced legal proceedings against the Commonwealth Bureau of Meteorology (BoM) alleging that it had taken advantage of its market power to prevent competition in the market for specialised meteorological services. In particular, it was alleged that BoM had refused to provide basic meteorological information to the Meteorological Service of New Zealand Limited (MetService). The ACCC asserted that the refusal to supply direct access to MetService and the provision of specialised services on a non-commercial basis was done to disadvantage a potential rival in contravention of section 46 of the Act. In May 1997, following Court-sponsored mediation, a settlement was reached which both parties believe promotes the public interest. By providing a means of direct access for an Australian-registered subsidiary of MetService and establishing an access policy and model licence agreement, the settlement negotiated facilitates competition in the market for specialised meteorological services, at the same time recognising the benefit in maintaining the free international exchange of information and the provision of consistent and comprehensive weather forecasts to the public through the media.[34]

In February 1997, Telstra gave legally enforceable undertakings to the ACCC to ensure access for third parties to the data it collects for inclusion in its business telephone directories. As part of Telstra's current licence as a general telecommunications carrier, it collects, maintains and verifies Telstra business and government customer names, addresses and telephone numbers on a database. Telstra will now give interested third parties access to that business data for a cost not exceeding $0.18 per entry, a job execution charge for the initial supply and a supply fee for each subsequent supply. This level of charges, agreed to by Telstra, were significantly lower than those which the carrier was first proposing. The ACCC considered that Telstra risked breaching section 46 of the Act by refusing to supply the data on reasonable terms to a number of participants in the market.[35] There has been no Australian decision about whether copyright covers telephone directories, but Telstra has a case pending against a producer of CD ROM directories in which such copyright is claimed. Hence, it has been suggested that the undertakings could legally compel Telstra to licence its copyright.[36]

Authorisation and the Operation of Collective Licensing

A unique feature of Australian and New Zealand competition law is the authorisation and notification provisions.[37] These provisions allow the ACCC, and the Australian Competition Tribunal (the Tribunal) on review, to exempt conduct from the Act where it can be justified on public benefit grounds. While not defined in the Act, public benefit has principally, but not exclusively, been recognised in relation to efficiencies, both allocative (e.g. correcting free rider effects), cost (e.g. economies of scale) and dynamic (e.g. innovation) efficiencies. These provisions are particularly useful at the interface of competition law and IPRs, where a case by case evaluation of the appropriate degree of competition (with benefits for all types of efficiencies) or restrictions on competition to maximise net public benefit would seem appropriate.

The number of intellectual property matters considered by the ACCC under these provisions has been limited, probably because of actual or perceived exemptions under section 51(3). However, there have been three decisions relating to the collective administration of IPRs.[38] Most recently, the ACCC considered an application for authorisation and a notification relating to the collective licensing of musical works for broadcasting and public performance by the Australasian Performing Right Association (APRA).

The ACCC took the view that there were both costs and benefits associated with the collective licensing of musical works. On the benefit side there were considerable efficiencies to be gained in the administration and enforcement of copyrights for both owners and users and the 'blanket licence' offered by APRA provided a new product which was particularly useful for users with spontaneous and unpredictable requirements, e.g. shops and restaurants. On the cost side, APRA essentially enjoyed a monopoly over performing rights, since members had to assign all current and future works to APRA, replacing potential competition between composers. This has the effect of inflating prices and restricting access to works while encouraging excessive production of new works. Some users, particularly those with planned and predictable requirements for musical works, e.g. broadcasters, would benefit from direct dealing with composers.

The ACCC considered that a better balance could be struck between the costs and benefits of the scheme if it allowed for such direct dealing and blanket licence fees were appropriately adjusted. APRA would not agree to amend their licensing arrangements to meet the ACCC's requirements, hence authorisation was denied for all but the overseas arrangements. This decision has now been referred to the Tribunal for review.

Summary and Conclusions

The interface between competition law and policy and IPRs is an important and often neglected subject. Too often the extent of IPRs is determined by the interests of owners, rather than the public at large. This article has drawn attention to a number of specific issues which have arisen in this context in Australia in recent years and some of the conflicting costs and benefits of IPRs for competition and economic efficiency.

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7. *Hugin v. Commission of the European Communities* (1978) 1 CMLR D19, and (1979) ECR 1869.
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15. *Sega Enterprises Ltd & Anor v. Galaxy Electronics Pty Ltd & Anor* (1996) 761 FCA 1.
16. *Galaxy Electronics Pty Ltd & Anor v. Sega Enterprises Ltd & Anor* (1997), 403 FCA.
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18. In the case of trademarks, only the licensing of rights is covered by the exception.
19. Note that the test for acquisitions which breach the Act was changed from 'dominance' to 'substantial lessening of competition' in 1993.
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23. Trade Practices Commission, *Submission to the National Competition Policy Review*, April 1993, p. 138. Authorisation and notification allow the ACCC, and the Australian Competition Tribunal (the Tribunal) on review, to exempt conduct from the Act where it can be justified on public benefit grounds.
24. The Hilmer Report, *op. cit.*, Ref. 21, p. 151.
25. Competition Principles Agreement, 1995, clause 5. The Conduct Code Agreement sets out the processes for amendments to the competition laws of the Commonwealth, States and Territories.
26. Between June 1995 and July 1996 the States and Territories adopted application legislation.
27 Competition Policy Reform Bill 1995. Senate Second Reading Speech, p. 9.
28. *Ibid.*
29. Competition Policy Reform Act 1995, section 59.
30. Competition Policy Reform Act 1995, section 44B. The 'supply of goods' and the 'use of a production process' are also excluded from the definition of 'service'.
31. The Explanatory Memorandums prepared for the Senate and the House of Representatives refer to the definition of 'service' but provide no explanation for the exclusion of intellectual property from the national access regime. The exemption was included in the Bill that was presented and read for the first time and does not appear to have been the subject of parliamentary debate (although the government moved an amendment to omit 'an intellectual property right' and substitute 'intellectual property').
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