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INTERNATIONAL
FEDERATION OF
THE PHONOGRAPHIC
INDUSTRY
[HONG KONG GROUP]
LIMITED

15th August, 2005

Ms Mary Chow
Deputy Secretary for Commerce, Industry and Technology
Commerce, Industry and Technology Bureau
Level 29, One Pacific Place,
88 Queensway, Hong Kong.

By fax and post

Dear Ms Chow,

Re: Parallel Import

We refer to your meeting with the representatives from film and record industries held at the office of Commerce Industry and Technology Bureau ("CITB") on July 29, 2005 regarding the proposed amendment to certain provisions of the Copyright Ordinance.

During this meeting, it was brought to our attention that some members of the Legco Panel on Commerce and Industry consider that the criminal liability for parallel importers and the commercial endusers of the parallel imported copies¹ of records be reduced from 18-month period which, as the law now stands, commences on the first day of the publication of the records to the public in Hong Kong or elsewhere².

We have made it categorically clear that the criminal remedy against parallel importers is the most effective deterrence to the parallel importers during the initial and expensive phase of the promotion and advertising stage in the first part of a product life-cycle of a newly released record.

The record industry is of the view that there is no reason and indeed no justification to bring this issue up every time a review on certain provisions of the Copyright Ordinance is made despite that in the previous occasions, the Government was of the view that there was no such need for any change and it did not recommend to make such a change in the December 04 public consultation³ which simply followed the recommendation made by

¹ Parallel imported copies of copyright work refer those which are not made by a Hong Kong copyright owner or an exclusive licensee of that copyright work and the making of these copies in Hong Kong would have constituted a copyright infringement of that work or in breach of the exclusive licence in respect of that work albeit such copies are lawfully made and sold in the country by different copyright owner of the same copyright work from which the copies are subsequently exported into Hong Kong.

² Section 35 (4) of the Copyright Ordinance refers.

³ See the public consultation paper on "The Review of Certain Provisions of The Copyright Ordinance" as published on 9th December, 2004.



CITB of Hong Kong Government in its submission to the Legco Bills Committee on Copyright (Amendment) Bill 2001 on 6th September 2002⁴.

It did surprise everybody who attended that meeting that the criminal remedy available to the copyright owners or exclusive licensees against the parallel importers and the commercial endusers in Hong Kong for a period of 18-month commencing from the first day of the publication of a copyright work save and except computer program (hereinafter defined as the "18-month protection period") has now been brought up again. It simply defies the long standing of the government policy on this important issue.

Any reduction of the 18-month protection period will simply allow parallel importers to take a free-ride of the investment made in making and promoting of a record which is the combined effort of composers, lyricists, arrangers, producers, musicians and artistes. This is not any easy undertaking but only a handful will be a hit and many songs fail to get into the market.

The record industry strenuously opposes and is prepared to strongly contest against any proposed reduction of 18-month protection period. In fact, the record industry would invite the Government to extend the 18-month protection period to 24 months as our members do wish to work with the industry of information technology for digital on-line publication. Needless to say, the price of a parallel imported copy from the neighbouring developing countries (their per capita income is substantially less than what we have here in Hong Kong) will discourage the record industry to make its musical sound/visual recordings available on-line.

For the avoidance of doubt, we hereby reiterate our views on the parallel importation in our earlier submissions made to you. After careful analysis of what we discussed in the said July 29 meeting, it transpires that perhaps the record industry has not been able to present its view on this important issue in the way the Government understands it and we would therefore make further comments and observations on this issue of 18-month protection period as follows-

A. The Legal Framework

1. The Agreement on Trade-Related Aspects of Intellectual Property Rights ("TRIPS Agreement")

- i. The Uruguay Round negotiations in respect of the establishment of a legal framework of the General Agreement of Tariffs and Trade ("GATT") were commenced in 1988 and finally concluded in 1994. This led to the agreement in establishing the World Trade Organisation ("WTO") and

⁴ Letter dated September 6, 2002 from Ms. Laura Tsoi for Secretary for Commerce Industry and Technology addressed to the Bills Committee on Copyright (Amendment) Bill 2001



other specific agreements in which TRIPS Agreement is one of them. These agreements were signed on April 15 1994 in Marrakech. Marrakech agreements form one package and every member who joins WTO must be bound by all other agreements including TRIPS Agreement. The WTO was formally established in January 1995 but the TRIPS Agreement only came into force in January 1996. Hong Kong is a founding member of WTO.

- ii. The TRIPS Agreement provides substantive norms on the protection of, among others, copyright and related rights.
- iii. GATT/WTO agreements aim for the removal rather than erecting trade barriers world-wide, however, Article 6 of the TRIPS Agreement is an important exception to the international free trade principle.

There was a strong and prevailing view among the developed countries that prohibition of parallel importation of intellectual property goods was necessary in order to protect the economic rights of the creators of their right of production and the right of distribution of their products during the negotiation of the drafting of the TRIPS Agreement.

Article 6 of the TRIPS Agreement was drafted as the result of such prevailing view which leaves to each member of WTO as to whether it will adopt an international exhaustion of rights or national exhaustion of rights model in order to meet with its obligations on social and economic welfare⁵.

- iv. World Trade Organization allows each member to erect a trade barrier to intellectual property goods. It is against this background that members have made the exhaustion regime subject to consideration of trade and economic policies.

Obviously, the creative centre will favour national treatment as it will market aggressively its innovative/creative products and services to other countries which rely on foreign innovation and creative products. The consumer oriented country will favour international exhaustion of rights model as it imports the cheapest goods lawfully made and sold in other country and there is no incentive to invest, create and export intellectual property goods in these countries as their social and economic

⁵ Paragraph 5 (d) of the Doha Declaration on the TRIPS Agreement and Public Health adopted on 14 November 2001, confirms that "the effect of the provisions in the TRIPS Agreement that are relevant to the exhaustion of intellectual property rights is to leave each member free to establish its own regime for such exhaustion without challenge, subject to the MFN and national treatment provisions of Articles 3 and 4."



development are not catered for creativity and innovation and therefore is different from that of those adopted for national exhaustion of rights model.

- v. In fact, the creator will exploit its innovative/creative product to those countries which adopt the national exhaustion of rights model first before it will make the products available to those which adopt the international exhaustion of rights model. That is why some countries have always been behind in getting the products available to them as there is no incentive to promote or invest in these countries which simply rely on the supply of the cheapest price products available in the world market.
- vi. Under Article 14 of the TRIPS Agreement, producers of phonograms have the right to authorize or prohibit the direct or indirect reproduction of their sound recordings and the rental of their recordings.

2. The Positions of the United Kingdom

- vii. The position of the United Kingdom copyright law has always been that any importation of copies of a copyright work into the United Kingdom will infringe the copyright owner of the United Kingdom if the making of these copies in the United Kingdom would have constituted an infringement of copyright or a breach of an exclusive licence agreement relating to that copyright work⁶ if the importer has a knowledge thereof.
- viii. Therefore, it is not relevant to consider whether a parallel imported copy was legitimately made outside the United Kingdom as long as its making was an infringement of the copyright owner or in breach of the exclusive licence relating to that copyright work of the United Kingdom under its copyright law⁷. Needless to say, the making of the copy will have been an infringement if the reproduction right was thereby infringed⁸.
- ix. The United Kingdom copyright law considers the fact that the copy made abroad was legitimate purchased there does not carry an implied licence to import and sell this copy to the United Kingdom. United Kingdom copyright law has never recognized the principle of international exhaustion⁹ but it is now bound not to do so under the European Directives¹⁰.

⁶ Sections 5 (2) (3) and 16 (2) (3) of the Copyright Act 1956 and also sections 22 and 27 (3) of the Copyright Designs and Patents Act 1988.

⁷ Paragraph 12-009 of Intellectual Property 2nd Edition by W.R. Cornish 1989

⁸ Paragraph 8-04 of the Copinger on Copyright 5th Edition, 2005.

⁹ The United Kingdom is bound by European Directive for sale within the European Community. See paragraph 8-05 of the Copinger on Copyright, 5th Edition, 2005

¹⁰ See section 27 (5) of the Copyright Designs and Patents Act 1988.



- x. Therefore, the United Kingdom copyright law prohibits parallel import in order to protect the reproduction right and the distribution right of the copyright owner or exclusive licensee of the United Kingdom¹¹.

3. The Position of the Hong Kong Copyright Law

- xi. The Hong Kong Copyright Ordinance is modeled on the United Kingdom Copyright Designs and Patents Act 1988 and therefore the concept of the copyright law is basically the same.
- xii. The Hong Kong copyright law only recognises and protects the Hong Kong copyright owner of a work and not the copyright owners of other countries in respect of the same work.
- xiii. The Hong Kong copyright owner has an exclusive right of copying or reproduction under Section 22 (1) (a) of the Copyright Ordinance and right of distribution under section 22 (1) (b). It further provides that if, to the knowledge of the parallel importer, it imports copies of a copyright work and their making would have been infringed the reproduction right of Hong Kong copyright owner or in breach of the exclusive licence relating to that work, will be liable to civil remedy under section 30 and will attract criminal liability under section 118 if the parallel imported copies are imported into Hong Kong within 18 months from the first day of the publication of that work in Hong Kong or elsewhere¹².
- xiv. The issue is simply that if free flow of copies were to be allowed unconditionally on the world wide basis, this will drive the investors/producers of the phonogram into insolvency as the world-wide market will be dominated by the cheapest copies. However, on the other hand, this will not be to the advantage of the developing countries if the producers of phonograms simply shut off these markets and let the maker of the pirated copies to be profited therefrom which in turn will provide finance to the criminal activities.
- xv. The threat of piracy and parallel imports and the reality of the market situation to the phonogram industry which plays a special cultural role in Hong Kong is a strong reason for not judging the issue by the narrow view of competitive effectiveness¹³.

¹¹ See notes 7 and 9 above

¹² Section 35 (4) the Copyright Ordinance.

¹³ See paragraph 12-031 of Intellectual Property by W.R. Cornish, 2nd edition, 1989.



B. The Record Industry of Hong Kong

1. The Role of 18-month Protection Period

- i. In Hong Kong, the content industry is the building block for creating a knowledge-based society and economy and the driving force for establishing Hong Kong as a regional creative centre. We must have an effective protection legal system of our intellectual property rights and an efficient enforcement for any violation of such intellectual property rights.
- ii. Hong Kong's Canto Pop plays a very crucial cultural role for Hong Kong and Chinese aboard including the Mainland China. As the Mainland China has not opened its media industry to foreign entities, it is more important for Hong Kong to take on this role.
- iii. Our members have managed to get approval for marketing some of their musical sound/visual recordings in the Mainland China and this represents a very important cultural exchange between the people of Hong Kong and Mainland China.
- iv. As the per capita income of the Mainland China is very much lower compared to that of Hong Kong, the economic structure of Mainland China dictates that the price of domestic repertoire compact disc could not be more than 20 RMB. The record companies which venture to take on business in China are in an investment/testing market phase and are of the view that the Mainland China should not be deprived of the supply of legitimate copies of the Hong Kong made musical sound/visual recordings. It still represents a potential market for the Hong Kong record companies.
- v. However, it is clearly against the interest of the record companies if any export of these copies of a musical sound recording from Mainland China to the world market were to be allowed. The whole world market would then be flooded with the supply of the cheapest product. This clearly interferes the production right and the distribution right of the different copyright owners or exclusive licensees of the same musical sound recording in different markets divided geographically.
- vi. Therefore, it is not surprising to observe that Japan has also introduced the parallel import law effective from 1st January, 2005 in order to protect its own market against the flooding of the cheapest products into Japan while the Japanese Company may set up different distribution channels in different markets in order to capitalize the effort of their creativity and innovation.



- vii. The investment/promotion cycle of the record industry has always been based on the 18-month protection period and any shortening of the 18-month protection period simply encourages the importation of the product (be it a legitimate or otherwise an infringing copy) from the Mainland China before the investor/producer of the musical sound/visual recordings can recoup its investment.
- viii. The main purpose of the building a knowledge-based economy is to foster the economic development in creative/content industry and Hong Kong becomes an exporter of intellectual property goods and services. Furthermore, copyright rewards the enrichment of cultural life in Hong Kong.
- ix. Any proposed shortening of 18-month protection period will simply discourage the investors of the creative/content industries and the end result is that our Cantonese pop music culture will be gradually disappeared and replaced by foreign cultures. Our next generation will be deprived of an opportunity for their contribution of any creativity towards the music and the audience at large will be deprived of the opportunity to appreciate the product from Cantonese pop music culture which used to be the creative endeavours of Hong Kong talents.

2. The Parallel Import and the Market Segmentations

Any argument on having parallel import prohibition in law that affects choice and price is a moot argument after the 1997 Copyright Ordinance has been put in place. Prices of domestic music and film products have declined despite arguments predict having parallel importation protection in law increase prices.

<u>HK market in Year</u>	<u>Average price of local album in HK\$</u>
1997	80.24
2000	77.18
2002	78.37
2004	76.59

- x. As the record industry would very much like to make their works available on-line to the public by way of digital publication, this will benefit both the industry of information technology and the record industry, however, any relaxation of allowing the importation of cheapest parallel imported copies will make such a joint venture unattractive. We propose that we must have at least 24 months in such protection period if we are to build a digital publication centre in Hong Kong. This allows and encourages the endusers to download the music rather than to get a cheap parallel imported copy during the first 24 months of the product life-cycle of a



musical sound recording. The longest possible prohibition period is essential to foster this new business to success thereby reducing on-line music theft.

3. Local recording industry's role in fostering cultural works that turn into a multi-billion dollar business benefiting Hong Kong's economy.

- xii Prior to year 1973, Hong Kong audience had little choice but to look towards an influx of overseas music repertoire for their enjoyment. However, a handful of creative people took on the mission to create a truly Hong Kong music repertoire that later became the global music repertoire popular among all Chinese communities. This is now known as Canto Pop to the music world.
- xiii Through the establishment of a local repertoire market, such music had not only entertained millions but led the way to a multi-latitude development of other sectors that are related to such music. The birth of Canto pop led to the maturity of the music industry not just benefiting the artistes and record companies, but everything that is connected with it including the establishment of a Karaoke entertainment industry that ran the size of over HK\$250 million annually during its peak in the late '80s, and is dependant predominantly on the popularity of Canto Pop.
- xiv According to a SRH study on local music market circa 1995-1996, the recording industry consists of a core industry and a partial core industry.

The Core Industries

Record Companies
 Artists and Artist management
 Composers/lyricists, Music Publishing Companies
 Record Studio
 Video / Karaoke production
 Wholesalers/Retailers
 CD manufacturers, printers
 Concert Organisers/production
 Trade Organisation

The Partial Core Industries

Entertainment venues (Karaoke entertainment Industry, discotheques)
 Media
 Advertising /Promotion Agencies

The Related Industries

Sale of personal music playback device, A/V equipment, media for recording etc.



- xv The economic contribution of the music industry was found to be as follows:

<u>Sector</u>	<u>HK\$m</u>
Core Industry	2,652
Partial Core Industry	1,750
Related industries	10,650.

This figure represents an economic contribution of 1.7% of the total Hong Kong GDP according to the report during mid 90's.

- xvi To illustrate what music repertoire had the most influence on the economy of Hong Kong, the IFPI Hong Kong sales statistics had the following:

<u>Year</u>	<u>% in Domestic Repertoire turnover</u>
1992	69.6
1994	67.4
1996	53.0
1998 ¹⁴	42.0
2000	48.0
2002	48.0
2004	35.0

4. The Overseas Market.

- xvii The Record Company anywhere in the world must test and promote its domestic repertoire in its home market first. It would only become of value to overseas market if a musical sound recording has been successful and becomes a hit in the home market. Then the distributor of records from overseas market is willing to pay and acquire the licence for its right of distribution and/or the right of reproduction.
- xviii As the success rate is not high¹⁵, new talents have to struggle and work hard in order to be successful before a successful talent may command a special status for overseas market. For example, for Mainland China, a Hong Kong artiste must carry some sort of titles such as the best rising artiste etc before he/she may tackle the Mainland China market. The stake and investment of the Record Company is high. It takes a lot of

¹⁴ Piracy usually impacts large volume titles more. Domestic repertoire is usually victim of such attacks. 1998 was the peak of physical piracy, the figure in 2004 reflects rampant Internet p2p piracy.

¹⁵ As a general norm, only 1 or 2 new recordings may draw attention of the public as hit titles despite promotion. High failure rate cost the Return from Investment per annum usually falls below 10%.



effort and money to groom an artiste and make a song popular both in Hong Kong and Mainland China and other Chinese markets. Any shortening of the 18-month protection period will only benefit the overseas distributor which only pays a fraction of the cost and then takes a free ride of the marketing effort made by that Record Company¹⁶ here in Hong Kong. That distributor would get the fruit of the "selection of the fittest" out of the investment of that record company.

- xix. It is vital that the 18 month or longer protection period is needed to protect the interest of the home market against the parallel imports in order to enable the investor/record company to recoup its investment based on the relatively low success rate and to be able to capitalize the overseas market without hurting its own domestic market. This is how developed market works. In the United Kingdom where parallel import is restricted, UK is the biggest producer of popular recordings besides the U.S. The huge return from overseas success allows U.K. Record companies to invest more than anyone else for the size of its domestic market as they are looking at a much larger market. Hong Kong remains an epicentre for source of repertoire in the Mainland. Hong Kong should adopt the similar model as the U.K. and set Mainland as its target for marketing Hong Kong music.
- xx. Any shortening of the 18-month protection period will upset the delicate balance and a new business model would have to be tested (and there is no guarantee that the Government may shorten the period next year and then again the year after next year) and the end result of the uncertainty of the success of the new business model ensures that Hong Kong is an un-attractive place to invest and make new recordings and initiates the slow and painful death of Hong Kong Canto pop culture. The first to suffer is new potential artiste and the top selling artiste would be more likely to go overseas.

5. Hong Kong music pop culture in the Mainland

- xxi. Local music pop culture is not just about moving the production inland, the pool of creative talents in Mainland China are mostly non- Hong Kong residents, it cannot be said that it is Hong Kong repertoire.
- xxii. Any thought of moving the investment base into the Mainland China is simply not practicable as the Mainland China is not opened to Hong Kong investors, at least not for now and perhaps some distant future due to its

¹⁶ The Hong Kong copyright law allows Hong Kong residents to get a legitimate copy of a musical sound/visual recording from an overseas market for its own private and domestic use. Section 30 of the Copyright Ordinance refers.



strict control over its media and its restricted access to foreigners of such media and the related publication right. The option of building a Mainland Canto repertoire is simply not open unless and until the media and music publication are widely open to foreign investment in Mainland China.

- xxiii. Hong Kong investors will be in a disadvantage position against Mainland investors, Hong Kong repertoire has only a flimsy and flickering future life for still having Canto repertoire as its , option

C. Summary

- i In summary, we submit that domestic repertoire is the driving force of music related economy in Hong Kong. One should not judge from the mere record sales alone but the effect of domestic repertoire on the whole world market and on the cultural role played by the local record companies in Hong Kong and aboard, which is a much larger picture directly driven by Canto music recordings than a very narrow view of effective competition.
- ii The landscape of the record industry has changed substantially. In 1997, there was no Internet privacy. China market at that time could only afford music in cassette tape format while compact disc was the most preferred media in Hong Kong. In the year of 2005, compact disc format is the most preferred media in China but as a developing country, it could only afford the price of about 20 RMB for domestic repertoire.

Hong Kong enjoys the status of a developed country and is one of the richest regions in the world, the price of regular goods reflects such status as the people in Hong Kong do have much higher salary or income than the counterparts in China. Any suggestion that Hong Kong should follow the pricing of the Mainland China for most goods is misconceived. One simply does not understand or appreciate that the costs of doing business and the cost of living in Hong Kong are much higher.

Perhaps, without appearing to be too contentious, on reflection, any person who favours Hong Kong should follow the pricing of China should consider hard if his income or earning should also be adjusted or reduced down to the scale of the China or Philippines. Hong Kong should be proud to be compared with the status of the developed countries such as Sweden, Japan, U.S. United Kingdom and Australia. The mindset of Hong Kong people should strive and work harder to excel the development of the most developed Countries in the world and contribute to the economic growth of China but certainly not to content with what we have



by comparing with those of the underdeveloped countries or developing countries.

- iii. Literally, figuratively, effectively, shortening the 18-month protection period kills the Hong Kong phonograms and films¹⁷ of the Record Industry, along with its heritage of an acclaimed Hong Kong culture.

We are sorry of not writing this submission in a more tactful manner but as you may appreciate, this is a life and death situation of our industry and we must write clearly and strongly about our views on this issue. We do invite you to consider to extend the protection period from 18 months to 24 months in order to enable the digital publication of the record industry to take off here in Hong Kong.

We hope to make further submission in order to clarify some of the issues not raised in this letter and we shall be grateful if you will grant us any opportunity to do so in future.

Yours truly,

For and on behalf of the International Federation of the Phonographic Industry
(Hong Kong Group) Limited


Ricky Fung

c.c. IFPI (HKG) Committee
IFPI Asian Regional Office
IFPI
DIP (Attn. : Ms Finnie Quek)
CCE (Attn. : Mr Y K Tam)

¹⁷ A musical visual recording is defined as a film work under section 198 (1) the Copyright Ordinance.