

CB(1)1244/06-07(01)

26th March, 2007

Clerk to the Bills Committee on
Copyright (Amendment) Bill 2006
Legislative Council
Legislative Council Building
8 Jackson Road
Central, Hong Kong

Dear Sir/Madam,

Re: Parallel import

We, the undersigned industries, wish to make this joint submission to the Bills Committee on the Copyright (Amendment) Bill in respect of the submission of the Hong Kong Record Merchants Association Ltd dated 8 March 2007 (the "Submission").

The Submission has nothing new if it comes from other organizations or party representing consumers or traders of commodities as they are hardly an entrepreneur of our copyright industry. The fact that it comes from the Record Merchants which deals with intellectual property right goods reflects the failure of our economic policy on the protection of the copyright and also their desperate appeal to the survival of the Hong Kong copyright industry and in particular the films and music industries.

We would wish to make the comments and observations in respect of the Submission by two parts. In the first part, we suggest that their views obscure the real issue; and the second part, we venture to look at Hong Kong parallel importation policy from the economic perspectives of the copyright/creative industry as a general reply to those who have query about this policy.

Part one:

1. The main contention as raised by the Submission is that, as there is a price discrimination between those available in the vicinity area and Hong Kong, people might choose to shop there and not Hong Kong. The retail record shops are now getting the hardest hit due to the slow turnover of the genuine copies in Hong Kong. As we cannot do anything about it, we may as well open up the parallel import market for the copyrighted goods in line with the other commodities such as mobile phones etc. The issue is that why we need to restrict parallel import of a commodity which Hong Kong does not produce but relies heavily on the import such as cars, TV sets, printers etc.

2. **The Hong Kong Copyright Law only restricts parallel import of any copy of a copyright work if there is a copyright owner or an exclusive licensee who has the exclusive right of reproduction of (to copy) that work¹ in Hong Kong.²**
3. **The objective of the copyright protection of a copyright is to protect a person who has, among other rights, an exclusive reproduction right in respect of that work in Hong Kong. Allowing parallel import means that Hong Kong will protect the reproduction right of other person who resides outside Hong Kong Jurisdiction and does not have an exclusive reproduction right here in Hong Kong.**
4. **If that is the case, why Hong Kong people should invest in the copyright industry as Hong Kong Government denies the relevant protection of their reproduction rights here in Hong Kong.**
5. **Hong Kong copyright investors may well be better off to invest in an oversea market say, a developing or least developed country, as the licensing fee of the copyright in a least developed country is just a tiny fraction compared to that of Hong Kong cost. They may simply take a free ride by shipping the products to Hong Kong.**
6. **Economic efficiency dictates that nobody would invest in any industry or business or trade if he is unable to recoup his investment with a reasonable return. Every surviving or newly emerged industry would find its niche market at an appropriate time and at an appropriate place. The fact that our textile industry has moved the manufacturing base from Hong Kong (high cost centre) to China (low cost centre) in the 80's testifies the change of the economic structure of a particular industry due to the change of the business ecosystem of Hong Kong. Hong Kong people have now tried to open retail shops in China under CEPA arrangement is another example.**

There is no dispute that intellectual property goods are the product of the creativity and innovation which requires substantial investment both in education and infrastructure.

¹ Section 22 (1) (a) of the Hong Kong Copyright Ordinance.

²Section 22 of the Hong Kong Copyright Ordinance. Mega Laser case confirms that, if there are many owners of the same copyright work in different geographical regions, Hong Kong Copyright law protects Hong Kong Copyright owner only (CRIMINAL APPEAL NO. 453 OF 1998-judgment delivered on 10 June 1999)

6. One must agree with us that the piracy market is the alternative to the legitimately produced products and the market is flourished due to the consumer demand and the suppliers (infringers) attempt to satisfy that demand. We all know that the end-user piracy is the most pervasive form of piracy as the users of the pirate products believe that "the prices are too high and that IP protection for the goods is not warranted."³ This is exactly the same argument advanced in the Submission which suggests that as the price of the product supplied by the vicinity of Hong Kong is relatively lower; we may as well let the parallel imported products⁴ "flood" into the Hong Kong Market. Based on these premises, people may argue that **as we cannot fight against the piracy on price in street, we may as well allow the retailers to sell pirated products.**

Their views obscure the real issue that it is the effective enforcement of our parallel import law is the key.

7. The business of the Record merchants would usually deal with the films and musical sound/visual recordings. We believe that Hong Kong repertoires represent a high percentage of the turnover of record sales in the retail Record shops. No doubt, it is the fruit of the investment made by the record companies, our talents who compose good music which enriches our cultural life, the talent of our artistes who sing good songs for our enjoyment for years to come, the technical staffs who produce high quality musical recordings of the artistes, the CD plant who produces CD for Hong Kong and overseas markets, the advertising company who creates attractive promotional materials, the media who can exploit the works in their programmers and the retail sectors who bring the products to the market. **The record merchants are part of and at the end of the supply chain of our record industry.**
8. One would wonder if the record merchants really can make a living by simply selling cheap and low margin imported product (one-third of the price of Hong Kong) as the costs of doing business such as rental, utility costs, transportation and labour are much higher compared to those of the China. Their turnover will be shrunk by one-third for the sale of the equal number of units as the size of Hong Kong market is small. Obviously, **any retail shop can always swift from selling the low margin product such as the imported cheap CD to other high margin products.**
9. The fact of the matter is that, they have the benefit of the investment of the local industry. If there is no music industry in Hong Kong, what they can sell are the cheap imported copies of musical works not created and produced by Hong Kong

³ Tanya Poth, *The Computer Piracy Superhighway*, 28 *Denv. J. Int'l L. & Pol'y* 469, (2000), 480.

⁴ Under section 35 (3) of the Copyright Ordinance, a parallel imported copy is an infringing copy.

people. It is apparent that they want to be the free riders of the Hong Kong investment and promotional expenditures of our record industry and of the authorized distributors. The disincentive effect of free riding only diminishes the incentives to incur further money for the creating intellectual property including films and records industries.

10. There must be a trade-off between the need to foster investment in innovation and creativity and the absence of well-defined intellectual property rights and of the effective legal remedies. Free-riding will reduce the value of our investment and will result in slower rate of economic progress and also in reducing consumer welfare.
11. We suggest that the records merchants should work closely with the record industry together in the fight against the parallel imported goods and on-line piracy by working closely together with the government enforcement agency.

Part Two:

12. **The 18 month criminal sanction period is the minimum period which allows the copyright investors (*entrepreneurs*) to recoup their investment in Hong Kong.** The longer the protection period, the larger the size of the investment for a single project (say for a production of a local film). Any further reduction means that extra resources would be needed to enforce their rights through civil litigation. It will be worse off for Hong Kong in this situation as both the transaction costs (detection, monitoring and enforcement costs) and the social costs (the impact of the business of the infringing retail shop in litigation, the livelihood of its staff, less investment in the cultural industry etc.) will be high. It is obviously better off if the resources will be allocated for the creation of the intellectual property rights which will create wealth for the society. That is the dynamic benefit of the creation of the intellectual property rights
13. The socially desirable investments (investments that yield social benefits in excess of their social costs) may be deterred if the creators of intellectual property cannot recoup their sunk costs.
14. If the economic policy of the Hong Kong Government is to promote and foster the creative and innovation industry in Hong Kong, it must provide the effective legal framework which bears the welfare benefit of such public policy. This includes but not limited to parallel importation policy which aims to reduce the transaction costs of enforcement and to make the allocation of resources efficient. This involves the trade-offs of different interests.

15. The basis of the trade-off is clear:
 - a. In the interest of static efficiency –the aim is to maximize output through product dissemination and user access.
 - b. In the interest of dynamic efficiency- the aim is to provide adequate incentives to invest copyright where the social benefits exceed its development costs. Hong Kong will have the potential longer term gains in consumer welfare through protecting copyright works and providing adequate incentives for and supply of innovation/creativity.
16. Perhaps, if we may, we would like to point out that **the economic reality of the high investment costs on the creation and development of the copyrighted goods and of the free-riding problem would lead to the copyright owners to exploit their products by practicing price discrimination on the basis of the relative demands for a work and a relative ability to pay for it by different countries of different levels of economic development.**
17. Obviously, if the owner imposes one price for all markets, that price would exceed the discriminated price which may go beyond the reach of a particular country. Also the owner will naturally less willing to supply to any country which has a lower demand and is less profitable of its intellectual property goods. Therefore the general view is that if the international exhaustion were to lead to higher average prices, lower demand and lower product availability for developing countries, the welfare impact on them would be negative.
18. On further reflection, the separation of the ownership or of the exploitation rights of copyright works in different regions might be the preferred business model of choice in HK situations because the copyright investors/entrepreneurs might not have the resources to exploit their copyright on a global level. By assigning and licensing the rights to different regions, the copyright investor would generate more revenue without incurring substantial marketing costs. The revenue received often in the form of one-off fees or minimum guarantee from these different regions will then be used for the creation of more copyrighted works in Hong Kong. This is a form of economic efficiency based on the division of labors in different markets. Each contributes its best expertise knowledge and effort in the exploitation of the copyrighted materials as long as the free riding problem can be solved.
19. **The fact that the US and English (and other leading English Speaking Countries) publishers of the leading textbooks for schools and professionals have published the special much cheaper version of the International Student Edition of the same textbooks for Hong Kong and other part of the world is the testament of the**

benefit of the price discrimination due to the difference of the economic development of different nations and of the different demand for these leading textbook. This International Student Edition of the textbooks is not allowed for sale in their respective home countries, and therefore in this case, **it is cheaper to get a copy of a US textbook in Hong Kong than in US.**

- 20. The price discrimination policy only works if there is an appropriate policy on parallel importation. The policy decisions are inter-related with the economic and social policy of the intellectual property rights of a country.
A country that is a net importer of creative goods will design a trading system aimed at reducing its trade imbalance.

Thank you for your kind attention.

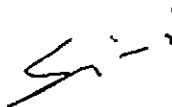
Signed, individually on behalf of individual organizations :

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



Mr Ricky Fung
Chief Executive Officer

For and on behalf of Hong Kong Publishing Federation Ltd



Mr Simon Li
Vice Chairman

For and on behalf of Hong Kong Video Development Foundation Ltd



Ms Clera Chu
Vice Chairman