Chapter 18

Importation and Rental Rights

Introduction

18.1 This chapter examines controls on the importation of copyright material. It also looks at the ability of the copyright owner to restrict the rental of his work: the so-called "rental right". Hong Kong, like any advanced economy, trades heavily in goods which are subject to copyright. Among its most vital imports is computer software. Hong Kong purchases from abroad considerable quantities of educational literature and is a valuable market for overseas sound recordings, films and television programmes, though locally created material dominates the media.

18.2 Copyright is divisible both horizontally and vertically. The rights that make up copyright may be separated and, in turn, each of the rights may be geographically divided. The original copyright owner may assign any of his rights outright or, more commonly, he may license that right for a given period, perhaps on payment of a royalty. An exclusive licence is one which entitles the licensee to the exclusion of all other persons, including the copyright owner, to exercise any of the rights conferred by the licence[1].

18.3 Overseas copyright owners can choose to meet the market demand by manufacturing in Hong Kong or importing goods manufactured elsewhere. Importation and distribution of copyright materials is usually undertaken through established distribution networks. The wholesaler, and in some cases the retailer, may be the holder of an exclusive distribution agreement. Contractual arrangements may be buttressed by further protection given by the 1956 Act against importation and publication. In similar fashion Hong Kong authors may commercialise their work outside the territory by licensing manufacture in other jurisdictions.

(A) IMPORTATION

The present law

18.4 The 1956 Act sets out the restricted acts for the different descriptions of copyright work[2]. The right of the copyright owner extends far beyond the obvious rights

---

[1] Under section 19 of the 1956 Act the exclusive licensee may sue in his own name to restrain infringement. His rights are concurrent with the owner. Section 19(3) requires the licensee to join the owner to proceed with an action, unless the court dispenses with this requirement. This does not prevent the licensee obtaining interlocutory relief.

[2] For literary, dramatic or musical works, in section 2(5), for artistic works, in section 3(5). The restricted acts for sound recordings, cinematographic works, broadcasts and typographic arrangements are set out in sections 12(5), 13(5), 14(4) and 15(3) respectively. Infringement by importation, sale and other dealings in Part I works are set out in section 5, for Part II subject matter in section 16.

of authorising reproduction, public performance or broadcasting. While nobody can seriously challenge the copyright owner's powers to control counterfeiting or unauthorised performance, his rights to publish and his rights to control importation and distribution, given through sections 5 and 16, give him a great measure of control over distribution. The extent to which his power should continue to include the rights to control the importation and distribution of copyright material which has been lawfully manufactured or marketed outside Hong Kong is the subject of considerable controversy.

18.5 Under the 1956 Act, "publishing" a literary, dramatic, musical or artistic work is a restricted act (sections 2(5)(b) and 3(5)(b)). This is a primary or direct act of infringement actionable without the need to prove guilty knowledge on the part of the defendant. "Publishing" is not defined but has been interpreted by the House of Lords to mean making public that which has not been previously made public in the United Kingdom, or any country to which the 1956 Act has been extended[3]. The restricted act of publishing hence does not mean simply the issuing of copies to the public.

18.6 Importation is restricted otherwise than for private or domestic use[4]. The copyright is infringed by any person who, without the licence of the owner of the copyright, imports (which includes goods in transit)[5] the article into Hong Kong, if he knows the making of the article was an infringement of that copyright, or would have been an infringement if the article had been made in the place into which it is imported. It should be noted that this not only prohibits the importation of goods which are counterfeit copies, commonly referred to as "pirate copies", but also copies lawfully manufactured elsewhere, commonly known as "parallel imports", or "grey-market goods".

18.7 The provisions have been interpreted to the effect that exclusive licensees of copyright do not own the copyright, and any owner who subsequently acts in breach of any agreement he may have with a licensee is therefore only liable for breach of contract, not for infringement of copyright. Hence, an overseas copyright owner who grants an exclusive licence to a Hong Kong manufacturer does not act in breach of copyright if he chooses subsequently to manufacture in Hong Kong himself the articles which are the subject of the licensing agreement. The hypothetical manufacturer in section 16(2) and (3) has been held to be the person who actually made the article in question abroad[6]. The net effect is that the exclusive licensee has no right to prevent importation of reproductions of copyright works manufactured abroad by the copyright owner, irrespective of who actually imports the goods. This is said to be a severe handicap to the exclusive licensee.

---

3 *Infabrics Ltd v Jaytex Shirt Co Ltd* [1982] AC 1 (HL).

4 For literary, dramatic, musical or artistic works, section 5(2), and, for sound recordings and cinematographic films, section 16(2).

5 See *Mattel Inc v. Tonka* HCA No. A1918/91, 11 July 1991. It was held that the word "import" in section 5(2) should be given its ordinary meaning, ie "bringing into Hong Kong". Goods in transit are goods brought into Hong Kong voluntarily and for a deliberate reason and therefore goods in transit fall within the meaning of "import" under the section. The judge preferred to adopt the literal meaning of "import" which means to bring into Hong Kong. Goods in transit have not been specifically excluded from the Interpretation and General Clauses Ordinance Cap 1 and the Trade Description Ordinance Cap 362. Only the Import and Export Ordinance Cap 60 has specifically excluded articles in transit.

6 *CBS Ltd v Charmdale Record Distributors Ltd* [1981] Ch 91.

18.8 The subsequent sale of, or other commercial dealing in, an infringing copy also constitutes an infringement if the dealer knew that the making of the article constituted an infringement or, in the case of an imported article, would have constituted an infringement if the article had been made in the place into which it is imported[7].

18.9 As a complement to the civil remedies, criminal penalties are faced by dealers in infringing copies, which will include goods which may be parallel imports[8]. Furthermore, section 22 of the 1956 Act permits the owner of the copyright in any published printed literary, dramatic or musical work to give notice to the Customs and Excise Department to treat copies of the work as prohibited goods. The offence provisions are widely employed against pirate copies, but their worth against parallel imports is much less. Section 22 has never been used in Hong Kong, though as a device available to copyright owners it has a deterrent value.

The international position

18.10 Neither the Berne Convention nor the UCC appear to impose an overall obligation upon their members to grant to the author or copyright owner the right to restrict importation, distribution or rental of their works. Article 14 of the Berne Convention gives authors of literary or artistic works the exclusive right of authorising the distribution, public performance or communication to the public of cinematographic adaptations of their works. Article 16(1) of the Berne Convention requires that infringing copies be liable to seizure in any country of the Union where the work enjoys legal protection, and Article 16(2) applies this obligation to reproductions coming from a country where the work is not protected or has ceased to be protected. The possibility of including in a Berne Protocol an explicit reference to the copyright owner's right to prevent parallel imports was discussed by a Committee of Experts under the auspices of the world Intellectual Property Organisation in June 1993. The report issued by the Committee summarises the discussion on the issue of parallel imports thus:

> *"The proposed right of importation[9] has limited but substantial support ... among governmental delegations, and most of the non-governmental organisations have argued in support of such a right. However, opinions are divided on this issue; many delegations reserved their position, and some delegations opposed the right of importation for various reasons. The International Bureau should study the issues, as well as the question of whether the right of importation could be ensured through an appropriate limitation on the application of the principle of exhaustion of the distribution right."*

In short, future developments on the international scene are uncertain, though it is clear that at present most jurisdictions impose a restriction on parallel imports.

---

7 Section 5(3) for literary, dramatic, musical, or artistic copyrights, section 16(3) for cinematograph films and sound recordings.

8 Section 2(1) and 5 of the Copyright Ordinance (Cap 39).

9 The somewhat perverse terminology used by copyright experts to mean the right *to restrict* importation.

The 1988 Act

18.11 Importation of an infringing copy remains a restricted act (section 22), as does possession in the course of a business or other dealings (section 23). The Act strengthens the position of the exclusive licensee regarding copies made by the copyright owner. Section 27(3)(b) describes an infringing copy as one whose making in the United Kingdom would have constituted an infringement of the copyright in the work in question, or a breach of an exclusive licence agreement relating to that work. An infringing copy would hence include an article manufactured by the copyright owner in breach of an exclusive licence agreement. Protection at the point of entry is also increased. Section 111 of the Act broadens the existing list of prohibited goods to include infringing copies of sound recordings and films. It should be noted that the prohibitions are subject to the laws of the European Economic Community which effectively forbid the barring of imports where the work has been put onto the market within the Community with the consent of the owner of the intellectual property rights in the article[10]. The Act preserves the right to import infringing copies for private or domestic use[11].

18.12 The 1988 Act also significantly changes the position regarding the restricted act of "publishing". It introduces instead the restricted act of "issue to the public of copies of a work" for every description of copyright work. This is described as "the act of putting into circulation copies not previously put into circulation, in the United Kingdom or elsewhere"[12]. The new restricted act is wider in scope than the restricted act of "publishing" under the 1956 Act. Under the 1988 Act, the copyright owner of a work in respect of which copies have already been put into circulation can still restrain the issue to the public of other copies of the work which have not previously been put into circulation. Copyright owners of sound recordings, films and computer programs are given the right to restrict rental by including rental within the restricted right of issuing copies to the public (section 18(2)).

The case for and against restricting parallel imports

18.13 The arguments advanced for continuing the present restriction on parallel imports include the following:

(i) the restriction allows the copyright owner to maximise the return on his creative investment in the work;

(ii) the parallel importer unfairly receives the benefit of the licensee's advertising, etc, to which he has contributed nothing;

---

10 Section 27(5), and articles 30 - 36 of the Treaty of Rome. See also *Musik Vertrieb Membran GmbH v. GEMA* [1981] F.S.R. 433.

11 Section 22.

12 Section 18(2).

(iii) a manufacturer may legitimately choose to price his product lower in a developing market to encourage sales, perhaps at an initial loss to himself. The parallel importer takes unfair advantage of that strategy by buying in the low cost centre and selling in the higher cost centre;

(iv) restriction on parallel imports conforms with widespread international practice;

(v) parallel imports cut profit margins and therefore discourage licensees from providing less profitable specialised interest recordings, etc;

(vi) where films are concerned, parallel importers are under no time restriction on the introduction of laser or video versions may therefore precede a film's release on the cinema circuit, with a consequent loss in revenue to cinema owners and the danger of reduced cinema choice in the future;

(vii) if licensees are to be able to devote adequate investment to local manufacture and marketing, restriction of parallel imports is essential; and

(viii) copyright is not supranational. It exists only by virtue of the domestic laws of each jurisdiction. It is unreasonable to suggest that because a copyright owner has authorised the commercial exploitation of his copyright work in country A, he should be regarded as having abandoned his rights under the laws of country B.

18.14 The arguments for lifting the current restriction on parallel imports include the following:

(i) the restriction on parallel imports distorts the market and restricts free trade. If a product can be produced more cheaply in country A than country B, free trade principles dictate that the market should be allowed to encourage the shift of production from country B to country A;

(ii) the restriction artificially reduces consumer choice. A prime example is the exclusion of US editions of books from Hong Kong;

(iii) allowing parallel imports would prevent over-inflated pricing by Hong Kong distributors by injecting competition into the market;

(iv) the present restriction allows manufacturers to sell older models in Hong Kong and to delay introduction of the latest stock;

(v) an author can control importation of his works by contractual means and a restriction on parallel imports is therefore superfluous; and

(vi) once copies of a work have been made with the authorisation of the copyright owner and placed on the market, wherever that may be, the right of distribution should be considered exhausted and not subject to a further right to control the importation of such copies.

Views on consultation

18.15 A range of views were expressed forcefully to us by those responding to the earlier consultation document. On the one hand, copyright owners and producers were generally in favour of continuing the restriction on parallel imports for the reasons set out above, while on the other hand consumers argued that the existing restriction distorted the market and enabled prices to be held artificially high.

Comparative law

18.16 While the international position appears generally to have been to impose a restriction on parallel imports, there are signs that this is changing in some jurisdictions. Recently, for instance, there has been some criticism of the existing restriction on parallel imports in the United Kingdom. *The Economist* reported on 25 May 1993 that the operation of copyright law in relation to parallel imports in the music industry in the United Kingdom is likely to be the subject of a reference to the Monopolies and Mergers Commission. It was argued that the disparity in prices between compact discs in the United States and the United Kingdom was difficult to justify. The National Heritage Committee of the House of Commons concluded that "the operation of the Copyright, Designs and Patents Act 1988 as it relates to parallel imports could work against the public interest." The Committee recommended that the Department of Trade and Industry should re-examine current copyright legislation "with particular reference to its anti-competitive effects in the recorded music industry."

18.17 In Australia, the Prices Surveillance Authority considered the rule against parallel importation in the music industry and found that:

> *"the import provisions are not related to the need to protect composers and performers from free copying of their product, they merely restrict competition in the distribution of legitimately made products"* (quoted at page 32 of "Designs", Issues Paper 11 of the Australian Law Reform Commission, April 1993).

On 10 June 1992, a joint press statement by the Treasurer and Attorney General of Australia announced in response to the Prices Surveillance Authority's report that the Federal Government had decided to open up the Australian market to imported records of foreign performers released after 1 July 1994.

18.18 In 1991, the Australian Copyright Amendment Act introduced a number of important copyright changes in relation to books. Firstly, the Act provides that, if a work is not first published in Australia (which includes publication in Australia within 30 days of first publication elsewhere), a "non-infringing book" can be legally imported into Australia for commercial purposes without the licence of the Australian copyright owner. There is thus no right to prevent parallel importation. A "non-infringing book" is a book made, other than in under a compulsory licence, without infringing the copyright subsisting in any work or published edition of a work in a country listed in the Regulations.

18.19 Secondly, if a book is first published in Australia (including one published in Australia within 30 days of first publication elsewhere), the copyright owner can continue to restrict parallel imports, subject to two exceptions. These are where a single non-infringing book is imported without the licence of the copyright owner to fill a customer's written order or verifiable telephone order, and where multiple copies of a non-infringing book are imported to fulfil a library's written order or verifiable telephone order. The effect of these changes is that, at least as far as books are concerned, the restriction on parallel imports has either been removed or reduced in scope.

18.20 The previous restriction on parallel imports in Malaysia also appears to have been modified in recent years. Section 41(1) of the Malaysian Copyright Act 1987 made it an offence for a person to import "into Malaysia, otherwise than for his private and domestic use any copy which if it were made in Malaysia would be an infringing copy." The Copyright Amendment Act 1990 has amended this to read "into Malaysia, otherwise than for his private and domestic use, an infringing copy." The effect is that while the importation of infringing copies remains an offence, there is no longer a prohibition on parallel imports of non-infringing copies.

18.21 The legal position in the United States is not altogether clear. There is an apparent conflict between section 109(a) of the Copyright Act (which entitles the owner of a lawfully made copy, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy) and section 602 (which provides that it is an infringement to import copies into the United States without the authorisation of the copyright owner). It is as yet uncertain how this conflict will be resolved should a suitable case come before the Supreme Court.

Our recommendations

18.22 The sub-committee debated long and hard as to whether or not the present restriction on parallel imports should be maintained. They concluded that, on balance, continued regulation of parallel imports would better serve Hong Kong's interests than deregulation. Like the sub-committee, we have found this issue a difficult one on which to reach a conclusion. We have considered carefully the arguments for and against the continuation of the present restriction on parallel imports, set out at paragraphs 18.13 and 18.14, and the submissions which were made to us. In particular, we have considered whether the existing regulation regime is a barrier to free trade. We have noted that the effect of the prohibition on parallel imports is to elevate a contractual right (a licence) to a

right that can be exercised against the world, and enforced by the criminal law. There appeared to be obvious potential for abuse, both in the ability of the licensee to overcharge where he possesses an exclusive right to import, and in the possibility that the rights are used to prevent a work being made available commercially in Hong Kong. Computer programs present a special problem. The present controls could be used to prevent access to important technology. There is only one theoretical safety valve: the permitted import for private use.

18.23 The question of whether or not parallel importation should be allowed in Hong Kong is an important and controversial issue. On the one hand, it is argued that the removal of restrictions on parallel imports would benefit the consumer by allowing enhanced competition and preventing the artificial price constraints which, for instance, protect United Kingdom books from competition from lower priced American editions. On the other hand, licensees argue that the restriction of parallel imports is essential if the licensee is to receive a fair return on his investment. The parallel importer would, for instance, obtain a "free ride" on any marketing carried out by the licensee.

18.24 We have noted the assertion made by a number of those we consulted that if restrictions on parallel imports were lifted, Hong Kong would be particularly vulnerable to a flood of imported lower-priced products from neighbouring countries, to the detriment of the copyright owner. It seems to us that this, and many of the other arguments presented to us, are largely speculative and without empirical supporting evidence. Indeed, it could equally be argued that in some cases the existing restriction on parallel imports operates to the copyright owner's disadvantage. A textbook priced at $600 in Hong Kong may be available for $100 in India. Hong Kong students unable to afford the $600 book will not purchase the book at all under the present law. Without the restriction on parallel imports they might purchase the affordable Indian edition, so giving the copyright owner royalties he would not otherwise have had.

18.25 While the negative effects for copyright owners of lifting the restriction on parallel imports appear to us to be largely speculative, we are concerned that the disadvantages for the consumer of the present regime are clearly apparent, notably in relation to books. Those problems are not unique to Hong Kong. As we have seen, the Australian legislature has already taken steps to redress the balance in favour of the consumer as far as the book business is concerned and is looking to extend those provisions to the recording industry. Similar concerns have been expressed in the United Kingdom in relation to the differential pricing of compact discs in the United Kingdom and the United States. It was argued forcefully to us that the difficulties which copyright owners and licensees claimed would result from the removal of the restriction on parallel imports were largely a matter of contract, or of incorrect pricing. That said, it seems to us reasonable to suppose that parallel importers would benefit from the marketing expenditure of the legitimate licensee, to which they had contributed nothing.

18.26 The decisive factor in our deliberations has been the international copyright framework within which Hong Kong must operate. We note that the rights granted under the Berne Convention have always been construed as territorial rights (that is, rights existing separately and independently country by country). Wek. There is no international obligation which requires copyright articles in transit to be subject to control. We are not aware of copyright legislation in any other jurisdiction which includes goods in transit withirmity with the copyright law of many countries with which Hong Kong has an ongoing trade. There have undoubtedly been moves in some jurisdictions to modify or

remove the parallel imports prohibition, and we are in no doubt that the present restriction acts to the consumer's detriment in many cases. Nevertheless, we take the view that, unless there are compelling reasons to the contrary, Hong Kong should follow the international copyright standards. Those standards in general favour continued regulation of parallel imports. We note in this regard that, as we indicated at paragraph 18.10, there has been pressure in some quarters for the international community to reaffirm its stance in regulating parallel importation.

18.27 Taking all these factors into account, we have come to the conclusion that, on balance, continued regulation of parallel imports will better serve Hong Kong's interests than deregulation. **We accordingly recommend that parallel importation of copyright articles should be subject to continued regulation. At the same time, we express our concern that the present regime frequently results in the consumer paying prices higher than would otherwise be the case. We note in this regard in particular the cost of books in Hong Kong as compared with, for instance, the United States. We believe that, in a free trade environment such as Hong Kong's, this is an issue that deserves attention.**

18.28 On the question of the sanction that should apply in relation to parallel imports, the sub-committee were divided. Half of the sub-committee were against any criminal liability attaching to dealing in parallel goods. They regarded it as objectionable that the sanction of criminal penalties should arise from the contractual arrangements of third parties. They argued that civil remedies should be sufficient to safeguard the proprietary interests of both rights owners and exclusive licensees. Accordingly, they proposed that section 107 of the 1988 Act, which deals with criminal liability for making or dealing in infringing articles, should be modified so that it would not apply to unauthorised parallel imports.

18.29 The other half of the sub-committee took the view that dealing in parallel imported copyright articles should attract both criminal and civil sanctions. They pointed out that the cost of pursuing a civil remedy would often outweigh any financial benefit which the rights owner or licensee might recover. Nevertheless, the cumulative effect of a significant number of small infringements which did not individually justify the legal costs of civil litigation might be substantially to the detriment of the rights owner or licensee. **We have considered these arguments with care and are unanimous in our view that criminal sanctions should not apply to parallel imports.** There seems to us no justification for the intervention of the criminal process in the enforcement of contractual rights.

18.30 **We have considered the suggestion which was made to us that certain types of works such as computer software and books should be deregulated but have rejected this option.** In our view, no such special treatment for particular categories of work should be introduced without first undertaking an in-depth study of the pricing situation in question. It also seems desirable to us that a clear policy for partial deregulation or exemption should first be formulated, as the introduction of an exception in one sector would inevitably invite demands for exemption in other sectors. One possibility might be to introduce enabling provisions in the proposed copyright legislation empowering the Governor in Council or an appropriate authority to exempt or suspend the application of the restriction

on parallel imports to a particular sector where there is a clear case to do so. We are inclined to think, however, that the introduction of such special treatment for certain categories of work would only serve to cause confusion and uncertainty. We are satisfied in any case that, as far as education is concerned, the private and domestic use, fair dealing, education and library copying exceptions have already facilitated the public's access to educational works to a considerable extent.

18.31 We take the view that the object and purpose of restricting parallel importation is to protect local manufacture and to allow the copyright owner to maximise his profits through the commercialisation of his work. There is no international obligation which requires copyright articles in transit to be subject to control. We are not aware of copyright legislation in any other jurisdiction which includes goods in transit within the definition of "import". We also note that vessels or aircraft frequently transit through Hong Kong en route to their final destination in another jurisdiction. We conclude that extending the meaning of "import" to include goods in transit would not achieve the object and purpose of copyright regulation, but would adversely affect Hong Kong's operation as a trading port. It would also create unnecessary and insurmountable enforcement difficulties for the Customs and Excise Department. **In view of the recent decision in *Mattel Inc v. Tonka Corporation* (HCA No. 1918/91) that the meaning of "import" includes goods in transit, we recommend that any new copyright legislation should make it clear that "import" does not include goods in transit. By "goods in transit" we mean goods genuinely passing through Hong Kong and the term should be extend to goods off-loaded and transferred to a go-down for export from Hong Kong at an indeterminate future date. As to how the definition of "import" is framed, we are content to leave that as a matter for decision by the Government. We would add that our recommendation applies only to parallel imports: where pirated goods are concerned, we believe that even goods in transit should be subject to seizure.**