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Competition Policy and Convergence – Is there a Need for Industry Specific Regulation?

The recent Productivity Commission inquiry has raised the perennial question in telecommunications: is there a need for industry specific competition regulation? Telstra's Mitchell Landrigan argues the no case.

This paper considers the relationship between convergence and competition policy, with particular reference to the Productivity Commission's current review of the industry specific telecommunications arrangements.

It provides an overview of the state of competition in Australian telecommunications, noting that, while competition is strong in all sectors, there is relatively little competitive investment in critical infrastructure, such as the customer access network.

A number of conventional competition policy justifications for telecommunications specific market conduct regulation are considered; and it is contended that deviation from the Government's original intent to remove industry specific market conduct regulation of telecommunications is not warranted according to any of these criteria. The implications of convergence for competition policy and market conduct regulation are examined. Rather than demonstrating the need for industry-specific regulation, convergence suggests the need for extreme caution in the application of regulatory instruments to the telecommunications industry.

THE CURRENT PRODUCTIVITY COMMISSION INQUIRY

The Productivity Commission is currently inquiring into whether to amend or repeal the provisions of the *Trade Practices Act* 1974 (Cth) ("Act") that apply industry specific competition regulation of the telecommunications industry.

When enacting the industry specific arrangements in 1997, the clear and specific policy intention of the Australian Commonwealth legislature was that industry specific regulation was a transitional measure, with general competition law to apply to telecommunications as soon as possible. In part, this was because the Parliament realised that after a period of transition (almost a decade now) it would no longer be credible to claim that telecommunications was somehow exceptional. Moreover, the process of convergence was widely anticipated and viewed as a mechanism for ameliorating many of the market power concerns in telecommunications.

The effect of convergence is increasingly apparent. Broadcast media are now routinely used to deliver communications services, while telecommunications networks are increasingly seeking to compete in the delivery of broadcast services. As a consequence, erstwhile bottlenecks such as the local loop are increasingly facing competitive constraints from alternative access technologies, particularly in metropolitan areas.

This paper addresses two key questions confronting policy makers and regulators:

- does the merging of market boundaries between telecommunications and other industries benefit in any way from continuation of industry specific market conduct regulation in telecommunications? and
- does this development require deviation from the Government's path of removing industry specific regulation for telecommunications?

In the author's view, the answer to both these questions is simple: there is no benefit whatsoever.[1]

REGULATION AND COMPETITION

It is trite to say that regulation is only necessary where there is demonstrable evidence of market failure. Furthermore, when regulation applies, there is a need to ensure that any potential benefits of regulation outweigh the costs of

INSIDE THIS ISSUE

CONTENTS

regulatory error.[2] In assessing the effectiveness of regulation, any potential benefits from penalising anti-competititive conduct need to be measured against the possibility that regulation may harm the competitive process, by deterring genuine, vigorous conduct, or penalising commercial conduct that brings genuine, long term benefits to consumers.

These warnings apply with considerable force to industry specific regulatory regimes, such as those applying in Australian telecommunications. "Special" laws apply to the telecommunications industry, such as an effects-based test for market conduct regulation; and an access regime which sets a much lower threshold for declaration and subsequent pricing regulation than the generic access regime in Part IIIA of the Act.[3]

STATE OF THE MARKET

The strength of competition in the Australian industry points to the absence of any policy justification for continuation of industry specific regulation. Competition is strong in all sectors of the Australian telecommunications industry. Australia has more than 50 licensed carriers. IDD prices for major streams (eg US,NZ,UK) have fallen to approximately one third of their January 1998 levels; national long distance tariffs have more than halved over a similar period; local call prices have come down from 25c standard price to a maximum price of 22c GST inclusive, with many carriers pricing well below this. Average prices for mobile services have declined in excess of 10% over the past two years, while take up continues to increase to the point that mobile penetration in Australia represents one of the highest rates of take up anywhere in the world.

Further, many of Telstra's competitors are large, vertically integrated players, often with market capitalisation far greater than Telstra itself. For example:

- Vodafone is capitalised at about $430 billion
- Hutchinson Telecommunications: $110 billion
- C&W, parent of Optus: $70 billion
- AAPT/Telecom NZ: $10 billion

This compares to Telstra's capitalised value of around $90 billion.

Competition to date has been provided in a variety of ways - covering the full spectrum of resale, interconnect, use of service providers' own infrastructure, and ULL just became an alternative means of local service provision. Facility-based competition has occurred in certain areas; for example:

- CBD fibre loops.
- Investment by service providers on thick transmission routes, e.g. inter-capital transmission between the major east coast cities and to some large regional centres.
- Investments have been made by some service providers in switching equipment.
- Significant investments have also been made, and are expected to continue, in the provision of mobile telephony.

At the same time, it is of some concern that competition for local services continues to be provided largely on a

resale basis. Apart perhaps from the Cable & Wireless Optus HFC network, competing local loop infrastructure is confined to major CBDs; and investment by other carriers in the critical customer access network is not occurring at all.

POLICY JUSTIFICATION FOR INDUSTRY SPECIFIC REGULATION

Given the nature of competition and the presence of well-established competitors, it is clear that the standard policy justifications for the telecommunications specific market conduct regime do not withstand close scrutiny. A number of potential policy justifications are now considered.

First, it may be contended that the substantial presence of an incumbent warrants industry specific market conduct regulation. Yet, the existence of a large-scale operation or substantial market power in an incumbent is no justification for an industry-specific regime. The general competition laws have been specifically designed to prevent anti-competitive behaviour by entities with substantial market power. Telstra's size, and the relative size of its competitors, should not alter this assessment. In any case, the general competition laws have provided adequate protection for small firms confronting anti-competitive behaviour by very large firms (for example, Queensland Wire Industries successfully took on BHP, and Pont Data successfully took on the Australian Stock Exchange). In addition, Telstra's competitors are not small by the standards of Australian firms generally, and many have substantial global financial backing. As noted, all of Telstra's major competitors are substantially owned by global telecommunications carriers, including some that are much larger than Telstra.

Second, the complexity of telecommunications may be used as a justification for industry specific regulation. Complexity, however, is also no justification for industry-specific competition laws. Many industries are as complex as the telecommunications industry, such as software and biotechnology, and departures from the general competition laws have not been considered necessary for these industries. Indeed, the prosecution of Microsoft Corporation under a 19th century piece of US legislation, demonstrates the effectiveness of general competition policy, or antitrust law, in preventing anti-competitive conduct.

Third, horizontal and vertical integration are said to warrant industry specific regulation, but these are features common to many industries; and indeed characterise the businesses of many of Telstra's competitors. Interestingly, they usually exist due to commercial drivers to increase efficiency, and in this sense are pro-competitive.

Fourth, foreclosure is said to justify (or necessitate) industry specific regulation. Foreclosure is an issue of particular concern in all network industries. It is for this reason that access to essential facilities legislation is a central part of Australian economic regulation. Any deficiency in the supply of access to essential services provided by a vertically integrated firm with substantial market power to competitors in upstream or downstream markets is best addressed through an access regime and certainly does not justify the introduction of telecommunications-specific competition laws dealing with anti-competitive conduct.

Finally, the potential for predatory cross subsidies are said to justify industry specific market conduct regulation. Yet, concerns regarding the scope for predatory cross-subsidies are not particular to the telecommunications industry and are adequately provided for under the general competition law.

IMPACT OF CONVERGENCE

In light of the weakness of these policy justifications, it is instructive to consider convergence as an additional potential policy justification for continuing the industry specific arrangements.

Rather than increasing the need for industry specific regulation, it is submitted that convergence demonstrates the need for a very cautious application of any form of regulation.

Convergence occurs when firms that were previously in different markets begin to compete in the same market, usually by the process of technological and subsequent demand change. This can occur because of the erosion of the boundaries between what were once distinct markets creates a single market, or because new markets emerge that are supplied by firms from different existing markets. As the Productivity Commission detailed in its recent reports on broadcasting, convergence is occurring between:

- Traditional broadcast markets, which delivered content to end-users (essentially a one-way form of transport) via various broadband media, and
- Telecommunications, which allowed end-users to communicate with each other (two-way transport) over voice circuits, a narrowband transport medium.[4]

Convergence between telecommunications, broadcasting and the Internet will reduce the extent to which parts of the access network remain as bottlenecks and increase the scope for regulatory failure.

Convergence and market power

Convergence is bringing dramatic changes to markets that may have once been supplied by firms with market power. Traditionally, copper wire only competed with broadcast media in the delivery of information via the Internet. In all other cases, copper wire was essentially in a separate market from the other media. Broadcast media did not provide two-way communications and could not be said to be in the same market as two-way communications provided over the telephone. Mobile telephony to some extent competed with copper wire, but in this period the two were likely in separate markets given the different pricing and functionality of these services.

As a result of convergence, the delivery medium for broadcasting and telecommunications is increasingly indistinguishable. All the existing electronic and electromagnetic delivery systems – copper pair, HFC, LMDS and satellite, and the next generation of cellular networks – are capable of supplying both broadcast services (one-way content delivery) and telecommunications services (two-way broadband). As such, the market power that may have existed in markets pre-convergence is being eroded.

In addition, two-way broadband over cellular systems is likely to become available in 2002 or 2003, and new sources of two-way broadband can be expected to come on line over the next few years, including delivery from new suppliers via LMDS, geo-stationary and low-earth-orbiting satellites, spread spectrum and other innovative suppliers. All two-way broadband systems can deliver content traditionally broadcast, as well as allow two-way communication.

Furthermore, as market boundaries become blurred and more services become substitutes for others, firms can more quickly obtain minimum efficient scale in different markets by reaping new economies of scale and scope in the converged technologies. Thus, entry into what were once natural monopolies becomes much simpler. For example, CWO could justify investing billions in an HFC cable network because from the same investment it could reap revenues from the provision of Internet access, voice telecommunications services and subscription television services.

In short, convergence increases the number of alternative sources of supply, decreases the degree to which services are bottlenecks and the providers of these services have market power, and thus diminishes the need for regulation.

Convergence and regulatory failure

Conversely, the process of convergence greatly increases the scope for regulatory failure. To begin with, regulators often ignore the new competitive dynamics that convergence brings. Instead they continue to regulate incumbent firms as if they were no longer facing additional competitive constraints. For example, despite the presence of CWO's competing access network and ongoing investment in new access technologies such as LMDS (in metropolitan areas), access continues to be heavily regulated. Indeed, the ACCC has recently extended such regulation through the declaration of the unbundled local loop service.

Convergence can often result in competing firms being subjected to separate regulatory regimes. A fundamental precept of regulatory policy is that regulation should not arbitrarily have a material impact on one competing firm and not on another. To do otherwise is to inefficiently distort choice. The ACCC declaration of analogue cable transmission serves to illustrate. If it is the case, despite the increasing number of actual and possible sources of broadcasting transmission supply, that Australian consumers need protection from market power in multi-channel transmission, then Australian consumers are ill served by rules that are not technologically neutral.

It is indefensible to uniquely apply an access regime only to analogue HFC cable, which is neither unique nor dominant among transmission modes.[5] To regulate a single technology in this manner will inefficiently distort investment and consumption choices in a number of ways. It is likely to delay an efficient shift to digital transmission (because the regulator, having declared analogue access, which downstream firms rely on, may find it difficult to allow the analogue access provider to withdraw that service), biased investment and consumption decisions between the various technologies, and distort the volume of investment undertaken in the industry.

Finally, regulation is not a perfect science. As a result, regulation always carries with it unintended consequences. These are likely to be particularly pronounced in markets characterised by uncertainty. For example, recent work has demonstrated that in a very simple environment open access can be harmful or efficiency-enhancing depending on two parameters: the degree to which fixed costs per subscriber are higher in closed as compared with an open access market, and the relative competitiveness in the access market under the two regimes.[6] The paper's author concludes:

> *The SP [service provider] industry is changing rapidly... This makes it very difficult to determine exactly what the future market structure of a stand-alone SP industry will be. Since the success or failure of open access regulation depends on that hypothetical market structure, the FCC's "wait and see" policy seems entirely justified.*

In such circumstances, regulatory caution and even forbearance seems to have significant merit.

NETWORK EFFECTS, TIPPING AND POLICY

In association with the claim that convergence demands the need for industry specific laws, the concepts of network effects and tipping are said to raise special issues that cannot adequately be dealt with under general competition law principles.

Network goods and network effects are relatively new terms in economics,[7] and while there is no doubt that networks deserve special attention in economic analysis it remains the case that network effects are due to phenomena long discussed in undergraduate textbooks—network externalities and economies of scale and scope (the latter was once called joint production).

Unfortunately, a lack of understanding of these effects has led to unjustified claims of possible market failure, originally based around ideas of externalities, augmented by discussions of tipping and path dependency.[8] This section of the paper addresses similar concerns, including claims about an additional reason for fear—the possible leverage of market power by an incumbent in a network market to emerging network markets. This section outlines what network effects and tipping are, and then debunks these as likely sources of market failure in the context of the leverage argument.

Network effects

A network good increases the value gained by purchasers as the number of purchasers of the good rises. This network effect can arise in two ways and while only one of these effects is necessary for a network good, both often occur at the same time:

- On the demand-side, value to consumers can rise with additional purchasers even holding prices constant. For example, if a family member or friend purchases telephone access then I get an immediate benefit, even though I played no part in this transaction. This effect, called a network externality, involves a positive spillover or externality.[9] Consumption by one party benefits a third party without any contractual relationship existing between them.

- On the supply-side of the market, value to consumers can rise with additional purchasers if these result in economies of scale and scope that are expected to be passed on to consumers. Such economies may be industry-wide, as can occur with open standards, or firm-specific, but if they are reaped, then even a monopolist can find it profit-maximising to lower prices. Of course, if firms in the industry face competitive pressures, then the likelihood of substantial prices falling as costs drop is even higher.

Network effects cause potential purchasers and suppliers of a good or service to be concerned about whether other potential purchasers have made or are likely to make a similar purchase. When there is a network externality, purchasers are directly interested in how many other network participants there are. The network becomes more valuable

as network participants rise. Again for example, the number of people on a telephone network matters. If I can call just about anyone I know, then the network is more valuable to me than one that can only be used to reach a small fraction of these people. This can have an important impact on decisions to supply and to join such networks.

Even in the absence of a network externality, a similar effect can occur due to economies of scale and scope. In such a case, a potential purchaser does not directly gain any benefit from a third party joining the network, but the potential purchaser knows that if many people use the network prices are likely to fall. Indeed sometimes network providers signal this by charging earlier users below cost prices knowing that as usage increases costs will fall below this level. In any case, the presence of scale and scope mean both suppliers' and potential customers' decisions will be strongly influenced by beliefs about network participation, that is, about how many customers are likely to join.

Tipping

When market participants are concerned about participation rates, a phenomenon called tipping can take place. Tipping occurs when the number of customers purchasing a network good reach a critical mass. At this point demand begins to strongly favour this network good, often at the expense of competitors. A classic example of tipping was the competition which occurred between the VHS and Betamax formats. Despite Betamax's 2 year head start, within 5 years of its US launch VHS became the dominant consumer-market taped video standard.[10]

Tipping need not occur and if it does it may not raise regulatory concerns

It is important to realise that tipping is not an all powerful force, nor is it necessarily rapid or a particularly powerful dynamic, and even when market dominance occurs this may not imply any market power on the part of supplying firms. Network goods do not necessarily result in tipping, and even when tipping occurs, tipping typically does not create policy concerns.

Tipping need not occur simply because a product is a network good. There are several reasons for this:

- Competing networks can exist side-by-side. Phillips and flat-head screw drivers are competing network products, but one shows no sign of displacing the other.
- Many networks have an optimal size that is quite small relative to the market. As a result, tipping simply cannot occur.
- Tipping is often constrained by niche demands. Audio cassettes and the vinyl record co-existed side-by-side, in part probably because in certain niches each met different consumer needs. CDs largely displaced records and sapped the cassette tape market—a tipping phenomenon—but cassette tapes still managed to find a profitable niche in portable devices and in cars and also because they were recordable. Note also, the supply of cassettes and cassette players would have placed a constraint on the price of CDs and CD players if these were to be monopolised (though they were not as is seen shortly).

Even when tipping occurs it typically presents no competition law concerns, for at least two reasons:

- The process of tipping can also take so long it becomes irrelevant.
- Tipping, even when it occurs rapidly, does not imply the emergence of monopolist or even market power. Instead standards can emerge. For example, CDs and CD players are produced by a plethora of manufacturers. VHS cassette tapes and players provide a similar example in recorded video. GSM is the major mobile telephony standard in most countries in the world, and in many places has virtually replaced analogue service. However, competition in GSM equipment manufacturing has flourished as it has where it was allowed in the supply of mobile service. Indeed in all cases it is arguable that it was exactly the willingness of the relevant patent owners to commit to an open standard and reasonable licensing terms that allowed the tipping to take place.[11] A similar story can be told about computer platforms,[12] and the CBS/RCA colour television standards war in the 1950s where such a war is repeating itself today between digital television standards.[13]

In short, therefore, network effects do not automatically imply tipping, and tipping does not imply the emergence of a dominant firm-indeed the opposite is not uncommon.

CONCLUSION

This paper has considered whether deviation from the Government's intent of removal continuation of industry specific market conduct regulation is justifiable in view of convergence. The answer this paper provides is that convergence demands a very cautious application of regulatory instruments; and that convergence itself provides no justification for the continuation of the industry specific market conduct provisions in the Act.

Moreover, rather than fostering the natural evolution of potentially competitive convergence between telecommunications and other industries, there seems to be every likelihood that such instruments will perpetuate artificial industry distinctions between industries and ultimately inhibit the benefits to consumers that convergence may otherwise bring. Since convergence, by definition, both blurs the boundaries between industries and strengthens the competition between them, it is vital that regulation not inhibit the competitive benefits that convergence can achieve.

This paper has identified two further important principles of general application.

First, convergence narrows the scope of the current regulatory regime, if applied correctly. The effect of convergence on reducing market power in the telecommunications industry, coupled with the increased scope for regulatory failure, strongly suggests that regulation should be tightly constrained. Reductions in the number of sources of market power and the uncertainties associated with any intervention necessitate regulatory forbearance.

Second, the uncertainties associated with the process of convergence necessitate the maintenance of a high degree of flexibility in the services that are subject to the telecommunications regime. Detailing in legislation the specific services that are to fall within the regime runs the risk of locking in regulation of services that are increasingly subject to competitive disciplines.

1 In considering these issues, it is assumed that there is a legitimate role for access regulation of essential telecommunications services, such as PSTN and the local loop. That is, it is *not*

contended that there should only be general market conduct regulation (say, under section 46 of the Trade Practices Act) to regulate the terms and conditions of supply of access to essential services. The central contention of this paper is that, with such regulation in place, convergence does not provide a convincing policy justification for the application of any additional industry specific laws.

2 The costs of regulatory error include the potential deterrent effect of regulation on competitive conduct. See generally Landrigan M. & Warren T., *Administrative costs and error costs in market conduct regulation: two case studies*, 7(3) (2000) *Competition and Consumer Law Journal* 224-239.

3 For a discussion of the ACCC's application of the access regime in Part XIC of the Act to telecommunications, see generally Warren T. & Landrigan M. (2000), *The Long Term Interests of End Users or Competitors?*, paper presented to Industry Economics Conference, UNSW Graduate School of Economics and Management, 7 July 2000.

4 For more detail on these technologies and their commercial supply see Little, Ralph and Wong *Regulation and convergence of the telecommunication and content industries* NECG Papers, November 1999, pp. 3 and beyond, which has an Australian perspective, and Speta, J. *Handicapping the Race for the Last Mile?: A Critique of Open Access Rules for Broadband Platforms* Yale Journal of Regulation Vol. 17 (1) Winter 2000.

5Satellite coverage dominates the reach of HFC cable in Australia. Cable is also sharply less flexible than both satellite and fixed wireless, having very few alternative uses. It has an advantage over both in that it does not need a line of sight.

6 Hogendorn, C. *Broadband Internet: Open Access* TPRC, 24-25 September 2000.

7 Katz, ML and Shapiro, C (1985) *Network externalities, competition and compatibility American Economic Review*, 7, June, 424-40, provides an early discussion of network goods; for an overview from these proponents see Katz, ML and Shapiro, C (1994) Systems competition and network affect, *Journal of Economic Perspectives*, 8 (2) Spring, 93-115.

8 Liebowitz, SJ and Margolis, SE (1994) *Network externality: an uncommon tragedy*, *Journal of Economic Perspectives*, 8 (2), Spring, 133-50.

9 Liebowitz and Margolis use slightly different language. For them a network externality is a network effect that leads to market failure. I use the term to mean a standard externality, but one that arises due to joining a network. As is well known, but often forgotten (see Liebowitz and Margolis, 1994), the mere presence of an externality does not lead to market failure. Most externalities are infra-marginal, that is, they do not effect choice at the margin, and hence do not lead to inefficient outcomes. For example, the network externality associated with telephone subscription can only cause market failure if it is optimal for someone to subscribe to the network but they do *not*. While an externality exists when a person makes a choice to subscribe (since third parties benefit from the decision) no market failure occurs because the optimal decision – subscribe - is made.

10 Liebowitz, SJ and Margolis, SE (1995) *Path dependence, locked-in and history*, *Journal of Law, Economics and Organization*, 11 (1) 205-226, at 221. This paper also notes the visual and audio quality of the Betamax tapes were only marginally better than the VHS format, but that the longer recording length of the VHS format, and JVC's ability to partner with large VHS recorder manufacturers, were key in the success of the VHS standard. See also Sutton, J (1998) *Technology and Market Structure: Theory and History*, MIT Press, at 103.

11 See, for example, Sutton (1998, at 412, note 5) on VHS; Garrard, GA (1998) *Cellular Communications: Worldwide market Development*, Artech House Publishers, 164 ff, on GSM; and Bresnahan and Greenstein, 1999, on computer platforms.

12 Bresnahan, TF and Greenstein, S (1999) *Technological competition an the structure of the computer industry*, Journal of Industrial Economics, 47 (1) March 1-40, at 3 and *passim*.

13 Shapiro, C. and Varian, H. (1999) *Information Rules*, Harvard Business School Press: Boston, Massachusetts, at 214 and *passim*.

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Competition in Converging Markets

In our second article dealing with telecommunications competition regulation, Dan Lloyd and Peter Waters examine the phenomenon of convergence in shaping regulatory policy.

The hype generated in the capital markets and the press over "convergence" seems to be infecting regulators and policymakers. Policy decisions are increasingly based on the promises of this phenomenon.

It is undeniable that convergence of electronic communications industries is not only proceeding, but delivering very real outcomes and benefits for consumers. The digitisation of communications technologies has, for example, enabled greater inter-operability and intelligence of networks and end-user devices. This has allowed consumers to receive email via their mobile phone, to listen to the radio on their PC, or run broadband data systems over their ordinary copper telephone line.

However, when dealing with "converging markets", analysts and policy-makers can mistakenly assume that convergence is a coherent, uniform process; overestimate its pace; or assume that it is an inherently pro-competitive process. This overly simplified view of convergence can lead policymakers:

- To abandon sector-specific regulation in favour of generic "lowest common denominator" schemes covering telecommunications, media, broadcasting and information technology;
- To employ increasingly wide market definitions, and thus underestimating incumbents' market power;
- To confuse the convergence of technologies, industries and networks with the convergence of markets; or
- To ignore the very real potential for anti-competitive conduct that some forms of convergence exhibit – particularly the expanded scope for cross-market leverage.

These misplaced assumptions have potentially serious consequences for competition in converging markets, especially for continuing effective regulation of vertically-integrated incumbents. It is surprising, therefore, that this fundamental policy shift has not been preceded by a comprehensive examination of the fundamentals of convergence: What exactly is it? How fast is it proceeding in different markets? What are the actual regulatory implications of different forms of convergence, and at different times?

DEFINING AND "UNPACKING" CONVERGENCE

Much of the confusion surrounding convergence arises from the fact that the term "convergence" is not used to describe a single homogenous process, but a range of processes operating at a variety of levels. In making recommendations about how to regulate converging markets, policymakers often rely on generic definitions of convergence which amount to little more than "we know it when we see it". A recent expert report prepared for the New Zealand

Ministerial Inquiry into Telecommunications, for example, recommended against the introduction of a telecommunications-specific regulatory regime, primarily on the basis of convergence, on little more than the following assertion:

> *"Convergence is a desirable phenomenon because of its ability to increase the level of competition in the market... convergence is not only a substitute for regulation, it is a phenomenon that can be placed at risk by regulation."*[1]

It is also often assumed that the term "convergence" inevitably denotes the convergence of *markets*, and is therefore unquestionably a wholly pro-competitive force. Indeed the terms "convergence" and "competition" are increasingly used as synonyms:

> *"Convergence increases competition, indeed by definition it does so by bringing different industries together."*[2]

When these generalisations are examined and "unpacked", convergence appears to be comprised of a number of distinct forms and trends:

- *network level technology convergence*, for example, involves the merger of underlying transport technologies (eg circuit-switched and packet-switched networks), such as the migration of circuit-switched voice networks to packet-switched data networks;

- *gateway convergence*, on the other hand, involves separate services, usually delivered over one transmission pathway, which are accessed by the customer through a single user interface. For example, access to voice telephony and e-mail via the same mobile handset;

- *service convergence* involves the delivery of multiple services through a single "pipe" to the customer, such as pay TV *and* Internet over xDSL;

- *substitutional service convergence* emerges where an existing service "encroaches" on a separate existing service and becomes substitutable for that service. For example, the gradual emergence in some markets of the substitutability of mobile for fixed voice services;

- *bundled convergence*, on the other hand, emerges where services continue to be delivered over their traditionally separate platforms, and continue to be used separately, but are marketed, priced and billed as a single retail package. For example, fixed telephone and pay TV access offered as a single, cut-price package;

- *new converged services* emerge where new technologies and functionality are used to develop entirely new services, which may or may not substitute for existing services. For example, unified mailboxes that operate over a variety of networks; and

- *the convergence of markets*, on the other hand, is a quite distinct development which involves the development of services to such an extent that they become genuinely substitutable for other services, as far as both suppliers and consumers are concerned, so that two previously separate markets have effectively merged into one. For example, it is often claimed that HFC cable and xDSL over copper are fully substitutable in the market for broadband Internet services.

There are obvious dangers associated with assuming that the first six forms of convergence outlined above inevitably mean the last-convergence of *markets*. A critical omission in analysing convergence often lies in the failure to undertake a careful examination of the substitutability of services, and to inform this assessment with a thorough consideration of demand side factors – how customers use services – as well as supply side factors such as the transmission technologies used to deliver services. If services remain merely complementary or additive and *not* substitutable, it is a clear indication that markets have not yet converged, although other forms of convergence may well have taken place.

THE PACE OF CONVERGENCE

There is no doubt that all forms of convergence, as outlined above, will eventually be significant drivers of change in telecommunications markets throughout Australia and the world. The pace at which each form of convergence is proceeding is, however, another fundamental issue that policy-makers must come to grips with.

There are many examples of over-enthusiastic predictions of the pace of various forms of convergence. In 1982, for example, the UK Minister for Information and Technology predicted that *"by the end of the decade multi-channel cable television will be common place countrywide.... TV will be used for armchair shopping, banking, calling emergency services and many other services."* Over 20 years later, this is still not a consumer reality, indeed it may never happen.[3]

There are continuing signs that various forms of convergence are proceeding far more slowly than is predicted or assumed. Many dot.coms, for example, which were expected to shake traditional media and telecommunications companies to their Old Economy foundations, have collapsed in recent months. Digital Entertainment Networks, one of the largest new "converged" businesses, which planned to distribute interactive television over cable and xDSL networks in the US, claimed that it would put the "boob tube zombie television" out of business. It recently filed for bankruptcy. Events such as these led the president of the Interactive Properties Group at AOL to remark that *"to date digital entertainment has been a failure"*[4].

As a UK consultancy has commented:

> *"The overall picture is complex and uncertain. In some instances convergence has already occurred but the true erosion between separate markets has still not happened. In other instances, convergence is either beginning to happen now or can be envisaged but, once again, it is difficult to foresee the genuine meeting of previously separate markets. A review of forecasts for various convergent products and services made five years ago and compared to what has actually happened illustrates the difficulty for anyone to predict the eventual form of convergence... Our view is that, for the most part, the drivers of convergence develop over generations (particularly in the case of infrastructure, wealth, skills and attitudes) not year by year."*[5]

Regulatory decisions must be built upon careful and thorough examinations of the forms of convergence in question, and the pace at which they are

proceeding in the market in question. Otherwise regulators risk applying the right policies at the wrong time with potentially detrimental results for competition in communications markets and consumers of communications services.

THE ANTI-COMPETITIVE IMPLICATIONS OF CONVERGENCE

It is tempting to regard convergence, regardless of its particular manifestation or the pace at which it is occurring, as a panacea for competition concerns in communications markets. At first glance, convergence appears not only to foster competition by lowering barriers to entry for new entrants, but also to facilitate price competition and innovation from which flow a range of consumer benefits.

It is easy, therefore, to assume that it is therefore not only safe to roll back industry-specific regulatory regimes, but that it is imperative to do so since industry-specific regulation will inhibit the process of convergence itself.[6] Incumbent telecommunications, broadcasting and media companies have encouraged this view of convergence for obvious reasons - it allows them to escape sector-specific regulatory controls on their exercise of market power.

Convergence clearly does have pro-competitive effects on electronic communications markets. The convergence of services, for example, allows operators to deliver a wider variety of services over the same network. This facilitates entry by increasing potential economies of scope for new entrants. But this does not necessarily mean that convergence is inherently pro-competitive on balance, as the following examination shows.

The economies of scope a new entrant derives from convergence must be weighed against the economies of scale and density the incumbent operator derives from its existing narrowband PSTN services and networks. The fixed costs of the incumbent's network have been spread across a long time period, as well as a large number of customers and calls. The incumbent is therefore able to serve customers at a much lower incremental cost, and has few incentives to interconnect with the entrant's network since this would allow the entrant to share in the incumbent's economies. These economies enjoyed by the incumbent are likely to substantially outweigh the economies of scope a new entrant derives on its newly built digital network.[7]

Once the incumbent begins to offer broadband services over the copper local loop using xDSL technologies the situation will become more difficult for entrants using any network since the incumbent will enjoy the same economies of scope in broadband services as new entrants. The incumbent can "marry" these economies of scope from new services with the existing powerful economies of scope, scale and density it enjoys on that copper network.

Convergence also offers many new opportunities for incumbents to leverage their market power in new ways and into new markets. The potential for anti-competitive cross-market leverage in converging industries was clearly identified by the ACCC as a basis for rejecting the proposed Telstra/OzEmail merger.[8] As the ACCC recognised, it is no accident, that Australia's vertically-integrated incumbent tele-communications operator is also the largest Internet Service Provider, and that this pattern has been reproduced in most other developed markets.

The networked nature of electronic communications markets makes them particularly sensitive to such leverage. Economic theory has recognised that in many high technology industries there is a "tipping point", where an operator reaches a particular market share which allows network effects, in the form of positive and negative feedback cycles, to rapidly accelerate that operator's market share growth at the expense of competitors and consumers:

> *"... if technology is on a roll, as is the Internet today, positive feedback translates into rapid growth: success feeds on itself. This is a virtuous cycle...."*[9]

In networked industries, therefore, companies can quickly achieve dominance, and the same processes which allowed it to do so ensure that their market dominance is unassailable:

> *"... [A company] once it achieves dominance through network efficiencies, can preclude competition for extended periods.... Once a network monopoly is in place, it is often a simple matter for the monopolist to exclude would-be challengers."*[10]

A pattern of tipping has been exhibited repeatedly in the high technology markets, for example the video recorder market; the computer hardware market and the computer software market. In each case, a company that gained a significant initial edge crossed the tipping point and grew exponentially to arrive at a position of unassailable dominance. The *Microsoft* case combined the dynamic of tipping in a new market with the exercise of cross market leverage from a dominant position in an adjacent market. Similar combined risks of tipping and cross market leverage arise in the telecommunications industry between traditional voice telephony markets and new services markets, such as the Internet, and were at the core of the ACCC's decision not to clear the Telstra-Ozemail merger. Such tipping occurs rapidly in telecommunications markets due to low marginal costs and rapid distribution. Some of the forms of convergence outlined above exacerbate this problem by allowing incumbent's easier access to, and leverage into, related markets.

The incumbent's main source of leverage remains the copper local loop. New technologies, such as xDSL, have given the copper a new "lease of life" which makes it the most likely candidate for the primary delivery channel for converged services. As the European Commissioner responsible for communications has remarked this will remain a key competition concern for some time:

> *"High telecoms prices are a major factor explaining Europe's low Internet penetration, and the shorter connection times of Internet users. The 1998 telecoms liberalisation has already delivered positive results on this account. But obviously, this is not enough. The main reason is that the local access market is still largely dominated by incumbent operators. And this, in spite of the development of new and alternative networks. Access to the local loop is therefore a pressing issue for new entrants."*[11]

CONCLUSION

While it is easier to subscribe to the hype of convergence, policymakers must take a much more rigorous approach before substantial policy decisions are built on assumptions regarding convergence. A closer examination of convergence reveals that convergence is not a homogenous force with a consistent impact on electronic communications

markets, but rather a series of processes, enabled by digitisation of communications networks, which effect technologies, gateways, services and *markets* in different ways.

The anti-competitive possibilities raised by convergence also must be recognised, and regulators must maintain a strong interest in anti-competitive behaviour in communications markets. Rather than scrapping the current industry-specific regulatory regimes in broadcasting and communications, convergence regulation, at this early stage, should focus on three issues - ensuring that like issues are regulated in a similar manner, addressing the risks of cross market leverage, and ensuring adequate regulatory tools for monitoring and intervention.

Converging industries are increasingly important to our lives and economies. We must ensure that inappropriate regulatory decisions based on the promises of convergence do not squander their very real potential.

1 Arthur Andersen Consulting, *Report on Issues Raised in Submissions*, New Zealand Ministerial Inquiry into Telecommunications, 29 June 2000 at 5.

2 NECG, *Regulation and the Convergence of the Telecommunications and Content Industries*, November 1999.

3 There are a number of other examples from the UK - in 1979/80 BT introduced a consumer videotext service called Prestel, which was intended to revolutionise the way customers accessed information in the UK. By the mid 1980's Prestel only had a 100,000 subscribers and in 1994 BT eventually sold it. In the UK, teletext has been very successful with over 60% of households having teletext capability. This service is used daily by 9.4 million people and weekly by nearly 20 million people. It is the largest holiday advertising medium in the UK. By contrast, teletext has been largely unsuccessful in Australia, with the Seven Network being the only remaining terrestrial broadcaster to offer teletext services.

4 Ted Leonsis, *The Failure of New Media*, The Economist, August 19, 2000.

5 Spectrum, *The Scope, Pace and Consequences of Convergence*, November 1999, at 3

6 *"Convergence is a desirable phenomenon because of its ability to increase the level of competition in the market... convergence is not only a substitute for regulation, it is a phenomenon that can be placed at risk by regulation."* Arthur Andersen Consulting, *Report on Issues Raised in Submissions*, New Zealand Ministerial Inquiry into Telecommunications, 29 June 2000 at 5.

7 *"Fixed costs are frequently associated with economies of scale. Specifically, where a firm faces both a fixed cost and a constant or declining variable cost, the firm's average unit cost will fall as output increases, and the firm's cost structure is said to exhibit economies of scale. For example, the costs a competitive LEC incurs to construct its own fibre transport ring would constitute a fixed cost, because, at least in the short run, this cost would not vary as the competitive LEC's output changed. If a competitive LEC incurs significant fixed costs when it uses a particular facility, in its early stages of development it would have a significantly higher average unit cost than the incumbent LEC, which has a significantly larger output and customer base over which to spread the fixed costs.*

Certain network facilities also involve sunk costs, because the facilities cannot be easily redeployed or sold should the competitor decide to cease offering service over those facilities. For example, the cost of the loop serving a customer's home is largely a sunk cost because it cannot be recovered if the carrier ceases serving the customer. It is generally recognised that the need to incur sunk costs can constitute a barrier to entry. Specifically, where an incumbent has already deployed sunk facilities to serve all customers, a competitive LEC may be unwilling to sink the costs of duplicative facilities, either because it may be unable to lure customers away from the incumbent and generate enough revenue to cover those sunk costs, or because resulting competition between itself and the incumbent LEC would drive prices so low that, even if the competitive LEC won a significant number of customers, it would still be unable to recover its sunk costs. In such situations, the incumbent has a "first mover" advantage." FCC, Third Report and Order, FCC 99-238, 1999, pp 40-41.

8 The Commission stated in its preliminary advice that:

"The impact of this proposed acquisition could be further compounded by the fact that Telstra is the major provider of infrastructure services to other ISPs. This acquisition coupled with Telstra's strength in the wholesale provision of Internet services could give it the capacity to distort and hinder the competitive process. It is possible that Telstra would attain dominance through this acquisition in the provision of residential Internet subscriber services which could have a significant flow-on effect into other markets. It is possible that the proposed acquisition could have a detrimental impact on the competitive dynamics for Australian online content, online advertising and electronic commerce. These Internet markets are still in the early stages of development in this country. The emergence of a dominant Australian ISP could retard competition and stifle innovation in these evolving markets". ACCC, Telstra/Ozemail Preliminary Advice, Press Release, 28 January 2000.

9Carl Shapiro and Hal Varian, *Information Rules: A Strategic Guide To The Network Economy*, Harvard Business School Press, Boston, Massachusetts, 1999 at p 176.

10 Robert Pitofsky, FTC Chairman, *"Antitrust Analysis in High-Tech Industries"*, Speech to ABA Antitrust Issues in High Tech Industries Workshop, 26 February, 1999.

11 Erkki Liikanen, Member of the European Commission for the Information Society, Speech, 21 January 2000. Available at: http://europa.eu.int/comm/information_society/speeches/liikanen/athens01_en.htm

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Internet Television and Radio Services -The Streaming Controversy

There has been plenty of bluster but little legal analysis of the Internet streaming controversy. Raani Costelloe provides a thoughtful analysis of the legal issues.

Question: Are television and radio services delivered or accessed using the Internet or Internet protocol regulated as *broadcasting services* under the *Broadcasting Services Act 1992* ("**BSA**")?

Answer: Yes and no. Yes, if they are delivered over the broadcasting services bands, which is the part of the radio-frequency spectrum allocated by the Australian Broadcasting Authority ("**ABA**") to broadcasting and datacasting licensees under the BSA. No, if they are delivered outside of the broadcasting services bands.

This article explains why this differentiation exists and also examines the regulation of video on demand services.

DIGITAL TV AND DATACASTING

A section of the Second Reading Speech to the *Broadcasting Services Amendment (Digital Television and Datacasting) Bill 2000* relating to Internet streaming created a great amount of controversy within the Internet industry following the recent enactment of the Bill. It raised the issue of whether television and radio

programs delivered over the Internet come within the definition of *broadcasting service*.

With respect to broadcasting services, the BSA imposes various requirements in relation to licensing and licence fees, the ownership and control of licences, Australian content, advertising and restrictions on the times at which particular classified programs may be shown. Of particular importance is the present moratorium on the issue of new commercial television licences until 2007 and restrictions on the issue of radio licences. Also, it is an offence under the BSA to provide a broadcasting service without a licence. There is a concern within the Internet industry that an extension of the BSA to the regulation of Internet radio and television services would effectively prohibit the operation of such services within Australia.

Senator Alston, Minister for Communications, Information Technology and the Arts, released a statement on 21 July 2000 which sought to clarify the Government's position ("**Statement**"). On 27 September 2000, the Minister issued a determination under the BSA which makes it clear that services which make television and radio programs available using the Internet (other than services using the broadcasting services bands) do not fall within the definition of broadcasting service ("**Determination**"). However, the Determination doesn't resolve the conceptual weaknesses in the definition of broadcasting service which have been exposed by new technical means of communication.

By way of background, the type and quantity of audio-video content delivered over the broadcasting services bands by datacasting licensees under the BSA will be highly regulated. The Government has restricted datacasters from providing any services which are similar to television and radio broadcasting services on the basis that existing broadcasting licensees must be protected from new entrants due to the costs of the upgrade to digital broadcasting in terms of both the cost of producing content in digital format and the infrastructure costs of digital transmission. Instead, datacasting licensees will be able to provide Internet-like services via terrestrial transmission.

Notwithstanding the provisions in the BSA which regulate objectionable Internet content, up until recently it had not been thought that Internet content providers may have to obtain either radio or television broadcasting licences for transmitting or making available audio-video content over the Internet, particularly using Internet streaming technology.

THE CONTROVERSY

The Second Reading Speech states that:

> *The moratorium in the BSA on new commercial television services applies to services delivered by any technological means including the Internet. However, there is currently some uncertainty whether services such as streamed audio and video obtainable on the Internet are, legally, broadcasting services. This is a generic issue relating to the convergence of broadcasting with other services, and it is therefore proposed to refer the matter to the [Australian Broadcasting Authority] for their detailed consideration over the next twelve months.*

This element of the Second Reading Speech provoked an outcry from the Internet industry which saw such a line of inquiry leading to the regulation of Internet streamed audio and video services in the same manner as datacasting services. The Internet Industry Association of Australia ("**IIA**") warned that a Government finding which concluded that video streaming over the Internet was illegal under present law, or a policy that made it illegal, would cause investment in broadband infrastructure to stall and drive Internet video content providers offshore.[1]

Ultimately the Minister resiled from the proposed twelve month detailed inquiry and issued the Statement shortly after the enactment of the Digital TV Bill. The Minister said that a non-public review had been completed and the Government had decided that Internet video and audio streaming should not be regarded as a broadcasting service except for such streaming which occurs over the broadcasting services bands (ie. over the radiofrequency spectrum allocated to datacasting licensees and incumbent commercial television licensees). The Minister also stated that the Government would consider whether any further action is necessary to give effect to this position and to clarify any legal uncertainties under the BSA. The subsequent Determination highlights that such clarification was necessary.

Some saw the Second Reading Speech as evidence of the Government being captive to traditional commercial television interests seeking to stifle competition from all forms of new media.[2] Further, it is thought that such an attempt to restrict locally based Internet radio and television services would be futile given the ready access to streaming services operated outside Australia. The Minister responded to such views in his Statement:

> *It was never the Government's intention to consider Internet video and audio streaming outside the broadcasting services bands as broadcasting...and embark on any new policy exercise about the desirability or otherwise of defining streaming as broadcasting.*

This episode highlights the present uncertainty within the Government as to how new forms of media should be regulated. The ambit of the BSA has widened over the past year to encompass Internet content and the delivery of Internet-type services over the radio-frequency spectrum. For the present time, the Government has decided that cable, basic telephony and digital subscriber line ("**DSL**") delivered Internet radio and television services should not be subject to the same regulation and licensing requirements as broadcasting and datacasting services. In basic terms, DSL technology allows a greater quantity of information to be passed over the existing basic copper telephony network and is of relevance given the limited coverage of broadband networks and the exclusive arrangements that are in place with respect to cable networks.

DEFINITION OF BROADCASTING SERVICE AND THE DETERMINATION

Broadcasting service

The licensing regime of the BSA only applies to broadcasting services. A *broadcasting service* is relevantly defined as:

a service that delivers television programs or radio programs to persons having equipment appropriate for receiving that service, whether the delivery uses the radiofrequency spectrum, cable, optical fibre, satellite or other means or a combination of those means, *but does not include:*

(a) a service (including a teletext service) that provides no more than data, or no more than text (with or without associated still images), or

(b) *a service that makes programs available on demand on a point-to-point basis, including a dial-up service; or*

(c) *a service, or class of services, that the Minister determines, by notice in the Gazette, not to fall within this definition.*[3]

The Determination

The Determination, made under paragraph (c) of the definition of broadcasting service[4], provides that *the following class of services does not fall within that definition:*

> *a service that makes available television programs or radio programs using the Internet, other than a service that delivers television programs or radio programs using the broadcasting services bands.*

INTERNET STREAMING

As noted above, audio-visual content delivered or made available over the Internet has until recently been thought to fall outside the definition of broadcasting service because of the dial-up and point-to-point nature of the Internet. That is, most Internet users dial-up to access a server and receive the content through a dedicated line between the user and the server. Conversely, broadcasting services are point-to-multipoint in nature, with a broadcaster transmitting its service in real time to a multitude of viewers or listeners with television or radio sets. The definition of broadcasting service is technology-neutral to the extent that it encompasses the delivery of services using any means of carriage. However, it excludes certain types of end user-content provider relationships which traditionally were of less mass appeal and usage such as teletext and dial-up services.

What is Internet Streaming?

Internet streaming is a method of transferring content so that it can be processed as a steady and continuous stream allowing the end user's browser to start displaying data before an entire file has been transmitted from its source.[5] The end user requires a player which is a program which decompresses and sends video data to the display and audio data to speakers.[6]

Streamed audio and video content can be sent from prerecorded files or distributed as part of a live feed. In live "netcasts", video signals can be converted into a compressed digital signal and transmitted from a special multicasting Web server which sends the same file to multiple users at the same time.[7] Multicasting is discussed in more detail below.

The quality of the streaming experience depends on the complexity of the content and the type of Internet service used. For example, an end-user with a broadband Internet service provider will receive streamed content much better than an end-user accessing its Internet service provider over the copper telephony network with a standard modem. Also, static talking head content uses less capacity than feature film content and is easier to receive.

Internet radio and television streaming is in a developmental stage, whether it be traditional radio and television stations re-transmitting their services or third parties re-transmitting their services without their consent; or entirely new services.

Regulatory Issues

The narrow regulatory question is how does Internet streaming potentially constitute a broadcasting service under the definition prior to the Determination. The broader regulatory and policy question is whether streaming services should be regulated in the same way as traditional broadcasting services or in other ways.

The Narrow Regulatory Question

It could possibly be argued that Internet streaming is a not a point-to-point service due to the fact that the content, once accessed, is similar to a traditional broadcast in the sense that all end users receive the transmissions in real time and cannot otherwise control their viewing of the content whether it be at the time the content commences or pausing, forwarding or rewinding the content. As noted above, live streaming may be provided by way of multicasting Web servers. According to one dictionary of Internet technology,[8]

> *Today's routers mostly are unicast, [the] future trend is IP [Internet Protocol] multicast: Rather than duplicating data, multicast sends the same information just once to multiple users. When a listener requests a stream, the Internet routers find the closest node that has the signal and replicates it. Multicasting follows a push model of communications. That is, like a radio or television broadcast, those who want to receive a multicast tune their sets to the station they want to receive. In the case of multicasting, the user is simply instructing the computer's network card to listen to a particular IP address for the multicast. The computer originating the multicast does not need to know who has decided to receive it.*

While such services are accessed by dial-up, it is possible to characterise them as a service that makes programs available on a point-to-multi-point basis. It is also possible that the dial-up aspect of Internet service access will become of less relevance, particularly in relation to broadband Internet services. These services which use Internet protocol are "always on" and do not require a dial-in connection through Telstra's local loop.

The Determination has undermined the conceptual integrity of the definition of broadcasting service by not addressing the issue of whether Internet delivered services are better characterised as falling outside the dial-up, point-to-point exclusion. The implication of the Determination is that, but for the express exclusion of Internet delivered television and radio programs which are not delivered using the broadcasting services bands, such services would meet the conceptual criteria of the definition.

For example, a datacasting licensee who functions as an Internet Service Provider and facilitates terrestrial transmission of Internet content to an end-user will have to ensure that such content comes within the datacasting content rules and does not constitute a television or radio program. By contrast, the same end-user could access streamed television and radio programs via wire or cable Internet access which would be prohibited under the datacasting service.

The Broader Regulatory and Policy Question

The broader regulatory and policy question was not substantially dealt with in the Statement and Determination, apart from the implication that the Government is concerned with de facto broadcasting over the airwaves but not over wire and cable. The rationale for the moratorium on new free-to-air commercial television licences and the creation of the restrictive datacasting service was to allow incumbent broadcasters to recoup the cost of the upgrade to digital television without advertising revenue being diluted by new entrants.

The general policy rationale of the BSA for regulating some broadcasting services

more than others is the intention that different levels of regulatory control be applied across the range of broadcasting services and Internet services according to the degree of influence that different types of broadcasting services and Internet services are able to exert in shaping community views in Australia.[9]

It appears that the Government is prepared to allow wire and cable delivered Internet radio and video services to develop largely unregulated for the time being. Perhaps this will be revisited when broadband cable and/or DSL services are more widespread and Internet radio and video services become technically more viable and competitive with existing free-to-air and subscription service providers.

VIDEO ON DEMAND

Regulation under the BSA?

A related issue which should be discussed in the context of the regulation of audio and video services is whether video-on-demand services ("**VOD**") are regulated by the BSA. Again, this is an important issue given that the BSA imposes restrictions on the number of licensees of certain broadcasting services and such licences are subject to a range of conditions relating to ownership, Australian content and advertising.

This is particularly relevant to many businesses presently planning to offer video-on-demand services using DSL technology over the local telephony loop. Most video-on-demand DSL business models involve accessing Telstra's unconditioned local loop at local exchanges and installing DSL technology which allows end users using a set-top-box to access video content provided by the VOD business.

Pay TV operators, who hold subscription broadcasting and narrowcasting class licences under the BSA and deliver their services over broadband networks, may conceivably offer VOD services in the future.

A VOD service where an end user is able to start, stop, rewind and forward the video content would not constitute a broadcasting service because it is a service that makes programs available on demand on a point-to-point basis. This is true VOD.

It is important to distinguish between true VOD and near VOD. Near VOD, where multiple streams of a program are delivered to end users at staggered intervals so that a consumer could watch the start of a program within a reasonable time frame (but without the start/stop/forward/rewind functionality of true VOD), would constitute a broadcasting service because it is being delivered simultaneously to multiple end users. Pay television channels which are delivered continuously on a point to multi-point basis to subscribers' set-top-boxes are broadcasting services and are subject to the BSA.

Whether DSL delivered VOD services become widespread is both a technical and commercial issue which involves a number of factors including the pricing of access to the unconditioned local loop; the cost of DSL and set-top-box technology; and the availability and cost of video content within the established industry windows of theatrical, home video, pay television and free-to-air television release.

In any event, such a service would not be regulated by the BSA.

Regulation under the Telecommunications Act

The *Telecommunications Act 1997* ("**Telco Act**") provides for a category of service provider called a *content service provider*.

A *content service* is relevantly defined as:

- a broadcasting service; or
- an on-line information service (for example, a dial-up information service); or
- *an on-line entertainment service (for example, a video-on-demand service or an interactive computer game service...* (s 15)

A *content service provider* is a person who uses or proposes to use a listed carriage service to supply a content service to the public (s 97(1)). A content service is provided to the public if, and only if, at least one end user of the content service is outside the immediate circle of the supplier of the content service (s 97(2)).

VOD operators are content service providers for the purposes of the Telco Act. A content service provider, as a service provider (s 86), must comply with the service provider rules set out in Schedule 2 of the Telco Act or any rules set out in service provider determinations of the Australian Communications Authority (s 98).

At present, there are no rules or determinations relevant or specific to content service providers. Note that there is presently some uncertainty as to whether VOD operators may be *carriage service providers* under the Telco Act after the recent decision of the Federal Court in *FOXTEL Management Pty Ltd v Seven Cable Television Pty Ltd.*

General Classification Law

Irrespective of whether VOD is regulated by the BSA or Telco Act, Federal and State censorship classification laws require that films be classified with respect to their sale, exhibition and advertising

CONCLUSION

The delivery of video and audio content over new delivery platforms is challenging the existing regulatory framework of broadcasting laws. In the past, the radiofrequency spectrum was limited in its ability to carry analog television and radio services. Digital technology has practically reduced spectrum scarcity and increased the efficiency of existing telephony networks to deliver audio-video content.
Notwithstanding this, the Government has sought to limit the number and type of new services that may be offered over the broadcasting spectrum. However, this has not stopped new business models emerging for the delivery of services which are similar to television and radio over the Internet, whether by the existing copper network or broadband.

The recent controversy over Internet streaming is an example of the tensions between, on the one hand, the policy rationale of traditional broadcasting regulation and the rise of new services and, on the other hand, traditional broadcasters and the Internet industry.

1 Quoted in Anne Davies, *Industry fears of ban on streaming soothed*, Sydney Morning Herald, 20 July 2000.
2 For example, see Tom Burton, *Damming the Internet stream*, Sydney Morning Herald, 21 June 2000.
3 Section 6(1) of the BSA.
4 The Determination is cited as *Determination under paragraph (c) of the definition of "broadcasting service" (No. 1 of 2000).*
5 http://webopedia.internet.com – Search "streaming".
6 http://whatis.techtarget.com – Search "streaming video".
7 Ibid.
8 http://home.t-online.de.
9 Section 4(1) of the BSA.

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The Ups and Downs of the Napster Revolution

Mia Garlick provides a thoughtful analysis of the Napster revolution.

Music has long been associated with revolutions but the revolution which we are currently experiencing is about music itself. It is a revolution about how we enjoy music and how people make money out of creating and selling music. At the heart of this latest revolution is the search and swap software called Napster, although the revolution has not been caused by Napster per se but the attitude which the Internet, and Napster, epitomise.

This article explores the Napster phenomenon to date. It briefly discusses the evolution of the Napster phenomenon and then reviews the Record Industry Association of America's recent preliminary injunction and the subsequent appeal which stayed the injunction.

STUDENTS AND ARTISTS REVOLT

As with many revolutions, university students have been heavily involved with the Napster revolution. In fact, university students have been so involved with Napster that many universities and colleges around the US blocked their students' access to Napster in February this year.[1]

Students and Napster fans have also been taking political action in defence of Napster. In response to the university bans, the Students Against University Censorship ("SAUC") group formed to collect signatures for a petition against the bans.[2] Several other protest sites have appeared more recently including anti-fan.com, which calls for boycotts against artists who have spoken out against Napster.

Also, when the US Senate recently began its hearings into music and copyright laws, hundreds of students bombarded the Senators who were participating in the hearings with emails in support of Napster.

Artists have also been lining up in support of and against Napster. Metallica announced in April this year it was bringing an action against Napster for copyright infringement (the band owns all of its masters and songs), unlawful use of a digital audio interface device and racketeering.[3]

Another band, the Tabloids, is critical of Napster because of the practical effect it says that Napster has on signed artists. The band claims that Napster only sends artists deeper into debt with their record labels by cutting into record sales. The Tabloids response has been to encourage people to create Trojan horse files and swap them through Napster, to frustrate the search and swap system.[4]

However, not all artists see Napster as the harbinger of doom. At the same time as Metallica was inflaming its fans, Limp Bizkit spoke out in support of Napster saying that Napster was an amazing way to market and promote music to a massive audience.[5] Rap artist Chuck D has also spoken out in support of Napster.[6]

NAPSTER'S BEGINNINGS

The Napster phenomenon is about a technology that has evolved gradually and continues to evolve to improve the ability of Internet users to locate and download music online.

Arguably, one of the first steps towards improving the ability of Internet users to search for and locate music online was taken by the search engine Lycos. Lycos developed an "MP3 Search" function as part of its website, which assisted music fans to locate MP3 files on the Internet.[7]

However, the MP3 searches which were available via search engines such as Lycos were unreliable and incredibly slow. The ability of "MP3 Search" to locate music files was limited to those files of which it became aware, either by registration or webcrawling.

As a direct result of the frustration experienced with Web-based search engines such as mp3.lycos.com, Shawn Fanning, who had recently dropped out of university and had never written a computer program before, bought a manual about programming and wrote his first Windows program. That program was called Napster.[8]

Napster enables a user to designate a folder in the harddrive of their own computer which is shared with the rest of the world. The user then stores their MP3 files in that folder and when they next log onto the Internet, the list of files stored in that folder is sent to Napster's central servers. Other Napster users can then search the directory at the Napster site to locate the MP3 files they want and go to the user's computer which has the desired file and download it.

Since Napster, several other programs have been written which further improve on the speed and reliability of locating and swapping MP3 files on the Internet.

One of these programs is Gnutella which was posted to the back pages of AOL's website while merger discussions were underway between AOL and Time Warner, one of the "Big 5" record companies. Gnutella was posted on an AOL subsidiary's pages for only 24 hours. It was quickly removed when AOL became aware of it amid mutterings that it was an "unauthorised freelance project". However, during Gnutella's limited online life, hundreds of free-software fans had downloaded the software and it is now circulating widely.[9] Due to its open source nature, programmers are able to continually improve Gnutella.

The AOL subsidiary which developed Gnutella, Nullsoft, was founded in 1997 by Justin Frankel who, shortly after he dropped out of the University of Utah, developed Winamp, a very popular program which allowed users to play music in the MP3 format. Nullsoft, was acquired by AOL 2 years later for approximately $80 million in stock.

As Napster was developed to improve on Lycos-style searches, Nullsoft developed Gnutella to resolve some of the bandwidth issues experienced in relation to Napster.[10] Unlike Napster, Gnutella does not require users to connect to each other through a central computer. Gnutella enables a peer-to-peer network to develop, basically linking users' computers and making the searching and swapping of music files quicker and easier.

Napster has to date been more popular than Gnutella precisely because it does have a central server. Gnutella servers change and migrate several times a day. This means that a person wanting to use Gnutella must know the numeric IP address of a Gnutella server in order to be able to use the application.

Already, new and varied software programs are being developed which aim to improve on both Napster and Gnutella, such as the services MojoNation, Scour.net (which is currently being sued by the Motion Picture Association of Amercia in an action similar to the action against Napster) and Free.net.

The most recent application which improves on Gnutella is Aimster. Aimster combines AOL's instant messaging ("**IM**") software with Gnutella. This new application is like a "skin" for an AOL IM user which reads the Internet addresses of "buddies" as they come online. Buddies can then share their music files amongst each other. AOL has not yet commented on Aimster.[11]

Amidst the variety of file swapping systems, Napster's centralised server is its main point of difference and also the reason for the current action against it.

BACKGROUND TO THE NAPSTER INJUNCTION

The major US record companies, including Universal, Sony, Warners, and BMC commenced an action against Napster in December 1999 alleging contributory and vicarious copyright infringement. US record companies' own the rights to many of the sound recordings which appear on CDs and which are being swapped and downloaded on Napster.

The rights in the underlying songs are owned, generally, by music publisher and songwriter representative organisations. These organisations, such as Frank Music Corporation, have also brought an action against Napster for contributory and vicarious copyright infringement. Their action has been joined with the record companies' action because the same issues arise in both cases.

Essentially, the basis for these actions against Napster is that Napster is authorising copyright infringements. As the owners of the rights in the sound recordings, the record companies' members control whether and how much a person can, for example, copy or broadcast or transmit their recordings over the Internet. Publisher and songwriter organisations can do the same in relation to the songs which make up such recordings. This means that if, for example, someone copies or transmit a sound recording over the Internet without the permission of the rightsholder, that person is infringing copyright.

However, it is also an infringement of copyright to "authorise" someone else to infringe copyright. In other words, if you direct someone to infringe copyright or if you let them do it or provide them with the facilities on which to infringe, and do not take reasonable steps to prevent them from infringing copyright, you will also be guilty of infringement. Essentially, this is record companies' complaint against Napster.

In July this year, Napster sought to dismiss the case against them on the grounds that they were similar to an ISP and therefore came within the special exception provisions, also known as "safe harbours", of the *Digital Millennium Copyright Act 1999* ("**DMCA**")[12]. The DMCA was enacted in the US to provide specifically for copyright laws as they apply to the Internet. Part of the DMCA provides that 'mere conduits' such as ISPs, are not liable if copyright infringing material is on their networks or passes through their networks. To come within this exception, an organisation must satisfy the definition of a 'service provider' under the DMCA as well as other conditions, such as removing any material if and when the service provider becomes aware that such material infringes copyright.

Judge Patel of the US District Court, Northern District, dismissed Napster's motion on the grounds that Napster did not satisfy the elements of the definition of 'service provider' and also, because she considered that the record companies raised genuine issues that Napster did not comply with the other requirements for a service provider to be exempt from infringements, namely that Napster did not have a policy of terminating repeat copyright infringers.

It is against this background that the record companies sought a preliminary injunction to shut Napster down on the grounds that, before a full trial of the issues was concluded, Napster would have 75 million users, "*a user base which would irreparably harm the industry and drive down CD sales*".[13]

"THE DOWN" – THE NAPSTER INJUNCTION

On 26 July 2000, the same Judge Patel who had heard Napster's motion for summary judgement, heard oral arguments in relation to the record companies' application for a preliminary injunction. In practical terms, the record companies were seeking an order against Napster to stop music files being swapped via the Napster service, until its action against Napster had been fully heard.[14]

Somewhat dramatically, the attorney for the record companies, Russell Frackman, opened his arguments with the claim that within the few minutes it took people to find their seats in the courtroom that morning, 30,000 songs, the majority of which were protected by copyright, were downloaded using the Napster service.[15] Frackman emphasised the historical importance of the injunction, saying:

> "*this is just the beginning and your honour has the ability to nip this in the bud.*"[16]

Essentially, the record companies' case was that its members would suffer irreparable harm if Napster was allowed to continue until the conclusion of the trial. The record companies claimed that 87% of all files swapped via Napster were unauthorised copies. In conjunction with this statistic, the record companies estimated that Napster would have 75 million users by the end of the year.

To be successful in the injunction, the record companies needed to show that they would suffer irreparable harm, which could not be remedied by monetary compensation, if Napster was not stopped. The record companies also had to show that it was reasonably likely to win at trial.

Judge Patel found that the record companies were not only reasonably likely to be successful at trial but had a strong chance of success. She granted the injunction and gave Napster until midnight two days later to remove all copyright material from its service.

In response to Napster's protests that the effect of such a ruling was to cause Napster to shut down its service, Patel commented that "*You have other substantial, non-infringing uses that you tried to convince me of*" and further, that "*That's the system you created.....Napster wrote the original software. It's up to Napster to write software which will*

remove the copyright material. They've created the monster."[17]

As well as making the ruling against Napster, Patel ordered that the record companies pay $5 million dollars to protect Napster against any damage it may suffer in the event that the record companies were not successful at trial.

Napster's arguments seem to have held little sway for Judge Patel. In particular, early internal documents of the company supported Patel's view that Napster not only knew about the infringements which were occurring via their service but actually encouraged and participated in them.

A key piece of evidence for Patel in reaching her decision was an internal memo written by Fanning which stated that Napster users had to remain anonymous because they were engaged in copying files illegally. Also, the fact that some Napster executives were former music industry executives, who, the judge found, were aware of copyright laws and knew what their users were doing but nevertheless downloaded copyright songs from the Napster service themselves and did not act to prevent Napster users doing the same.

Patel dismissed each of Napster's defences and found that Napster employees and executives knew that direct infringement was occurring on their service. This made Napster liable for authorising the infringements because the company failed to take reasonable steps, or indeed any steps, to stop the infringements its users were committing. Patel also found that Napster was likely to be guilty of vicarious infringement to the extent that it had the ability to supervise the actions of its users.

Napster raised a number of arguments in defence. The first was the decision in what is popularly known as the Betamex case. In *Sony Corporation of America v Universal City Studios, Inc*[18], which was decided on US legal principles, the US Supreme Court held that Sony's Betamex VCRs were not illegal for two reasons despite the fact that users were able to use VCRs to make copies of copyright protected films. The reasons for the decision were that VCRs were capable of substantially non-infringing uses and because part of the purpose of using VCRs to copy films was 'time shifting', that is, making copies to enjoy the programs at a later date. Time shifting was considered by the court to be a "fair use" which did not do substantial harm to Universal's interests.

David Boies, Napster's attorney, argued that Napster was similar to the VCR because it could be used for non-infringing purposes. Boies cited as examples the ability of users to "space shift" their collections from CDs to their computers, to sample a CD before buying it or to find out about and search for new artists on Napster's New Artist Program.

Patel rejected this argument. She found that Napster differed from to a VCR because it connected to a vast number of people over the Internet. It did not facilitate better personal use of copyrighted material but promoted a use which went beyond any concepts of noncommercial or personal use.

In commenting on the New Artist Program, Patel said that the program was not part of Napster's main strategy but something which was developed "late in the game" after the litigation had commenced.

Also, Patel posed the question that if Napster is capable of substantial non-infringing use, Napster should not be arguing that the injunction would put it out of business. She considered that these two arguments were inconsistent.

Napster's other defence, that it was entitled to a fair use defence was similarly given short shrift. Under US copyright law, a person is not liable for infringing copyright where it can show that its use was fair. Fair use of copyright work is use which is for a "fair use" purpose, such as criticism, comment, reporting the news, study and research. As well as being for a fair use purpose, the extent of the use must also be fair. This is determined according to a non-exhaustive list of factors having regard to the circumstances. Section 107 of the *US Copyright Act* sets out these factors. They are:

- the purpose and character of the use, including whether the use is of a commercial nature;
- the nature of the copyrighted work;
- the amount and substantiality of the portion of work used in proportion to the whole of the work; and

- the effect of the use on the potential market for or the value of the copyrighted work.

It is clear from the wording of section 107, even without considering the cases in which these fair use factors have been applied, that it would be difficult for Napster to show that the file swapping which users engaged in via its service satisfied all the conditions.

Patel said that Napster was not entitled to a fair use defence because the free music which was available through Napster would lead to reduced CD sales. Users downloaded songs from Napster rather than going out and purchasing it.[19]

Finally, Napster claimed that it was excused from copyright infringement under the US *Audio Home Recording Act 1992*.[20] The Audio Home Recording Act was enacted to prevent unauthorised serial copying of recordings. However, under the legislation, an infringement action cannot be brought for noncommercial digital or analog copying of sound recordings. However, Patel quickly rejected this claim on the basis of the definitions of "audio recording devices" in section 1001 of the US Copyright Act. Patel said that the Audio Home Recording Act did not apply to computers and harddrives, such as Napster. It applied to audio recording devices, which Napster was not.

"THE UP" – INJUNCTION STAYED

Although the news of the Napster shutdown spread like wildfire across the globe and, particularly, among online music fans everywhere, the shutdown never took place.

The day following the grant of the injunction, on 27 July 2000, Napster's attorneys were in the US Circuit Court of Appeals asking that the order be stayed (in other words, postponed) until a formal challenge to the ruling could take place.

In seeking the stay of the injunction, Napster claimed that it would be forced to close its services within 48 hours and lay off 40 employees within days in order to comply with the injunction. In addition, Napster claimed that it would suffer irreparable harm to its business reputation and customer goodwill.[21]

The Court of Appeals granted the stay giving a short decision without reasons. The decision states that Napster

> *"raised substantial questions of first impression going to both the merits and the form of the injunction."*[22]

Rather than allow a formal challenge to the injunction, the Court of Appeals expedited the hearing. Napster has filed its opening brief with the court on 18 August, the US record companies on 8 September.

It is peculiar if the Court of Appeals granted the stay on the basis of Napster's evidence that it would have to close its business. In a recent decision, *eBay, Inc v Bidder's Edge, Inc.*[23], the court refused to allow Bidder's Edge to crawl and take information from eBay's site on the grounds of trespass saying that

> *"In the copyright infringement context, once a plaintiff has established a strong likelihood of success of the merits, any harm to the defendants that results from being preliminarily enjoined from continuing to infringe is legally irrelevant..... ....a defendant who builds a business model based on a clear violation of the property rights of the plaintiff cannot defeat a preliminary injunction by claiming the business will be harmed if the defendant is forced to respect those property rights".*[24]

More likely is the fact that the Court of Appeals considered that the Napster case raises serious and novel questions of law, in particular in relation to copyright, which need to be given a full hearing. Indeed, several trade groups such as the Consumer Electronics Association and the Digital Media Association have taken the opportunity to file submissions with the Court on points of the law being considered in this case.[25]

WHAT DOES IT ALL MEAN?

The most telling comment about the case against Napster was made by the Record Industry Association of America ("RIAA") Senior Executive Vice President, Cary Sherman when he said that:

> *"This once again establishes that the rules of the road are the same online as they are offline and sends a strong message to other that they cannot build a business based on others' copyright works without permission".* (emphasis added)[26]

The Napster case is about establishing the principles to guide businesses about what they can and can't do with copyright protected material. The record companies are seeking to assert that it is illegal to conduct a business based on an interference with property rights. It is not and can not be about Napster users or the way in which people enjoy MP3 or music in the future.

The Napster case will not be effective to change the nature of the use of music online. This is evidenced by the fact that, within hours of the injunction being granted, the number of unique users of Napster increased by 71%. It is also evidenced by the fact that the main webpage for Gnutella was forced to shut down temporarily within hours of the injunction because of increased file trading, although it was back online later with increased capacity. New and improved file sharing applications are being developed each week.

Indeed, the US record industry admitted that its high profile attempts to stop online music piracy were only exacerbating the problem. Reports have commented on users engaging in a "downloading binge" in the wake of the injunction. Hilary Rosen, the head of the RIAA noted that, since the injunction"

> *"the illegal downloading of copyright music openly encouraged by Napster has probably exceeded all records."*[27]

There is certainly a real danger that if and when Napster is shut down, digital music pirates will be forced to the "underner".

Upon hearing of the injunction, Napster users posted messages to the service lamenting the expected loss of Napster but also encouraging Napster users to move to other file-sharing applications. For example[28], "Estecaz" wrote "*This is a sad day for our community*" but then "*I encourage all of you who love this program as I, don't buy label music, and go to Gnutella!*". "Teilo" wrote:

> *"Everyone is focusing on Napster. Why bother? Napster can be shut down because it is a company and requires dedicated servers. Gnutella is open source and does not require any servers, it cannot be stopped without placing individual writs on the entire Internet community around the world."*[29]

These statements and the proliferation of file-sharing applications, indicates that

the heart of this revolution is not Napster itself but rather the attitude of music's biggest consumers, the under 18 year olds, who are highly technologically literate and have little respect for proprietary rights.

The growth of the Internet has seen the rise of a hacker mentality and an entitlement philosophy. The majority of Internet users expect information, and particularly music, to be free. They also feel entitled to access such information or music, regardless of any technological protection measures. This is partly reflected in the share and swap practices made possible by Napster and the popularity of MP3. This attitudinal change makes the outcome of the Napster decision fairly irrelevant on a practical level, even though Napster epitomises this change.

Napster also epitomises the Internet business model. It has been very successful in attracting a huge user base, 22 million users, and is widely known. However, the company has not yet earned any revenue from its service.

There is some positive fallout from the Napster case. Through cases such as the Napster case, copyright laws and their effect on the Internet and new forms of technology are clarified. This promotes greater stability for business. There are several lawsuits in the US, in addition to the Napster case, which are currently being brought in relation to the DMCA which will give guidance to lawyers and businesses about the permitted uses of copyright protected material in the brave new world of the Internet.

John Potter, director of the Digital Media Association when commenting on the current dispute between the record companies and webcasters, noted that:

> "*With copyright legislation, there are very strong political interests and the only way to get things through Congress is to leave the statutes grey. At the time the DMCA was going through Congress, the National Association of Broadcasters and the Recording Industry Association of America agreed to support the legislation with the understanding that there would be some kind of legal confrontation between the two sides once the law went into effect.*"[30]

With cases like the record industry v Napster, the laws in the US are clarified, which may offer guidance in other jurisdictions such as Australia.

Another benefit of Napster is that it has brought "old economy" companies kicking and screaming into the "new economy". Some record companies have been slow to embrace digital technologies and incorporate them into their products and businesses.

In 1998, before Napster had been developed, the RIAA's members were only talking about the security of their product. With the advent of Napster in mid-1999, the RIAA's members could not postpone making their catalogues available in a digital format any longer. Since Napster's meteoric rise in fame, three of the majors have made albums and singles available for download and numerous other online music initiatives have been developed, such as Garageband.com.

On a more humorous note, perhaps the real cause for concern in the Napster revolution is the fact that the prime movers of the revolution have had sufficient time to create such a commotion. It is university drop outs or, in the case of Aimster, college trained friends, who have given birth to the applications which have realised file search and swap services. It is university students on campus, with the benefit of state of the art connections and high bandwidth, who have been prime consumers of search and swap services. Maybe the real issue here is to make tertiary studies more interesting with the aim of minimising the time which students have to participate in the revolution.

Note: This article is current to 9 September 2000.

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2 Kelsey, D, *Universities ban Napster Downloads*, Bizreport.com, 25 February 2000.

3 *Metallica Takes on Napster*, The Standard Media Grok, 14 April 2000.

4 King, B, *Napster Fight Goes to the People* Wired News 29 July 2000.

5 Reuters, *Bizkit Bonds with Napster*, Wired News, 25 April 2000.

6 *Showbiz reacts to Napster Ruling*, Salon.com Technology 28 July 2000.

7 Similar to the Recording Industry Association of America's action against Napster, the Norwegian company which provides the technology which enables the search, is being sued by the International Federation of Phonographic Industry of Norway for infringement of copyright in the music which is made available on the Lycos site.

8 Brown, J *MP3 Free-for-all*, Salon.com Technology, 3 February 2000.

9 Brown, J *Did AOL eat Gnutella for lunch?*, 15 March 2000.

10 Ibid.

11 Breitling, J *Start-Up Debuts File Swap, AOL Instant Messaging Hybrid*, Webnoize, 10 August 2000.

12 5 May 2000, US District Court, N.D. Cal No. C 99-05183.

13 Cave & Quistgaard, *Court to Napster: You're Going Down*, 27 July 2000.

14 The actual decision of Judge Patel in granting the preliminary injunction against Napster has not yet been published. The following discussion is based on a variety of news reports of Judge Patel's statements during the hearing and when giving her decision, such as *Judge Rules Against Monster, Napster to Appeal*, Webnoize 27 July 2000; King, B *Napster's File-Trading No More*, Wired News 27 July 2000; *Federal Appeals Court Grants Stay of Napster Injunction, Service Will Continue*, Webnoize 28 July 2000; Cave & Quistgaard, *Court to Napster: You're Going Down*, Salon.com Technology 27 July 2000.

15 Cave & Quistgaard, *Court to Napster: You're going down*, Salon.com Technology 27 July 2000.

16 Ibid.

17 Ibid.

18 US Supreme Court, 1983/1984, 2IPPR225.

19 Although there are studies which contradict this finding, see for example Bailey, M *Digital Delivery: An Eight Fold Path to Digital Enlightenment*, Webnoize Research Report, 15 August 2000; King, B *Despite Piracy, CD Sales Up* Wired News, 24 April 2000.

20 It should be noted that the *Audio Home Recording Act* does not have an Australian counterpart.

21 Barnes, C, *Napster Seeks Injunction Appeal* CNet News.com 27 July 2000.

22 28 July 2000, US State Court of Appeals, 9th Circuit, No, 00-16401, No, 00-16403.

23 US District Court, N.D. Cal. No C99 21200RMW).

24 at p15.

25 King, B *Napster's New Friends*, Wired News 25 August 2000.

26 Opsit, at 14.

27 Foremski, T *Napster Dispute Increases Piracy*, FT.com 30 July 2000.

28 Philipkoski, K *Napster Still an Open Issue*, Wired News 27 July 2000.

29 Ibid.

30 King, B *Tuning Up Digital Copyright Laws* Wired News 16 May 2000.

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Where to Now?
The On-line Gambling Moratorium

Lisa Vanderwal and Rebekah Cheney examine this controversial issue in light of the recent Senate debate.

In 1996 State and Territory Gaming Ministers agreed to develop a model code for interactive gambling that called for a strict licensing regime. In the following few years, the Northern Territory, Queensland and the ACT passed legislation[1] that addressed, to a certain extent, such a regime. However, in January this year the Prime Minister indicated that he would prefer the banning of on-line gaming altogether, rather than regulating it as was the preference of the States and Territories and peak industry bodies such as the Internet Industry Association ("**IIA**").

True to his word, on 17 August 2000 the Government introduced the *Interactive Gambling (Moratorium) Bill 2000* ("**Bill**"), which immediately became the subject of much controversy. The Bill proposed imposing a 12 month moratorium on the development of the interactive gambling industry in Australia, beginning retrospectively on 19 May 2000 and ceasing at midnight on 18 May 2001. The Bill was to create a criminal offence of providing an Interactive Gambling Service ("**IGS**") during that period, unless the service was already being provided when the moratorium began.

The Government was, in effect, using the Bill as an interim measure to halt the further expansion of the interactive gambling industry in Australia while it made decisions as to the feasibility and consequences of a ban on on-line gaming services in Australia. The Bill was also to assist in the development of a uniform approach to harm-minimisation measures, as State and Territory Governments had significantly different approaches to this issue.

However, whether the Government would have achieved these objectives through the Bill is now almost academic, as on 9 October 2000 the Bill was defeated in the Senate when the Government failed to obtain a majority by a tied vote of 33:33. The main reasons the Bill was defeated appear to be that the Government failed to address the issue of problem gambling itself, or recognise that a ban on on-line gambling may not technically be possible?.

This article examines some of the key elements of the defeated Bill. It also outlines some of the issues that were debated in the Senate, with a view to determining whether the Government will, as promised, reintroduce moratorium legislation at a later date. It also considers whether the Government will take a more extreme measure and attempt to completely ban on-line gambling indefinitely, or, as the States and other bodies have suggested, adopt a regulatory approach.

WHAT THE BILL HAD PROPOSED

The definition of IGS in the defeated Bill had four essential elements. An IGS must be:

(a) a gambling service;

(b) provided in the course of carrying on a business;

(c) provided to customers using any of the following communication services;

(i) an Internet carriage service (a listed carriage service that enables end users to access the Internet);

(ii) any other listed carriage service (as defined in the *Telecommunications Act 1997*);

(iii)a broadcasting service (as defined by the *Broadcasting Services Act* 1992);

(iv)any other content service (defined by the *Telecommunications Act 1997,* and provided using a listed carriage service or a service specified by the Minister); or

(v) a datacasting service (delivery of content in any form to persons having equipment appropriate for receiving that content or delivery of the services using the broadcasting service bands and the services provided in Australia under a datacasting license); and

(d) linked in a specified way to Australia.

Some of the issues raised by this definition are examined below.

Exclusions to an Interactive Gambling Service

There were a number of exclusions to the definition of an IGS:

- Telephone betting, being a gambling service provided to customers wholly by way of voice calls made using a standard telephone service. Customers who have a disability, such as a hearing impairment, were permitted to access communications that were equivalent to a voice call.
- Services relating to options contracts, futures contracts, relevant agreements and Chapter 8 agreements as specified in the Corporations Law.
- Online share tradifig as it involved the acquisition of contractual rights.
- Exempted services determined by the Minister.

Relevant Communication Services

An Internet service provider ("**ISP**") would generally fall outside the ambit of the definition unless it intentionally provided the content of an IGS. Where the ISP was merely carrying the gambling service, it would not be guilty of an offence. Similarly, entities providing ancillary services such as bill payment and credit provision would not be guilty of an offence under the Bill, unless the provider of such services was the content provider.

Service linked in a Specified way to Australia

The service had to be linked in a specified way to Australia. There were three links specified in the Bill.

- Services provided in the course of carrying on a business in Australia.
- Services provided where the central management and control of the service was in Australia. The

Explanatory Memorandum[2] provided the example of a company that provided an on-line gambling service, such as a casino, that had its website maintained in an off-shore jurisdiction but the principal company executives were based in Australia.

- Services provided through an agent in Australia. The Bill provided a special rule for the service of summons or process on body corporates incorporated outside of Australia that did not have a registered office in Australia, but did have an agent in Australia.

Residency or citizenship issues were not relevant to determining whether a link to Australia had been established.

Extra-Territorial Application

The Bill had extra-territorial application. Any Australian Interactive Gaming Service Provider ("**IGSP**") who provided a service overseas would have committed an offence. The intention, according to the Explanatory Memorandum, was to " *pause the development of the Australian-based interactive gambling industry, which includes the provision of services to persons outside of Australia*".[3]

THE DEBATE

When the Bill was initiated in the Senate, it was immediately referred to the Senate Environment, Communications, Information Technology and the Arts Legislation Committee ("**Committee**") who handed down a report on 4 September 2000. The Committee Report ("**Report**") consisted of a majority report endorsing the Bill, accompanied by two dissenting reports by the Australian Labor Party and the Australian Democrats. Some of the issues raised in the Report and debated in the Senate prior to the defeating vote are discussed below.

On-line gambling pushed off shore

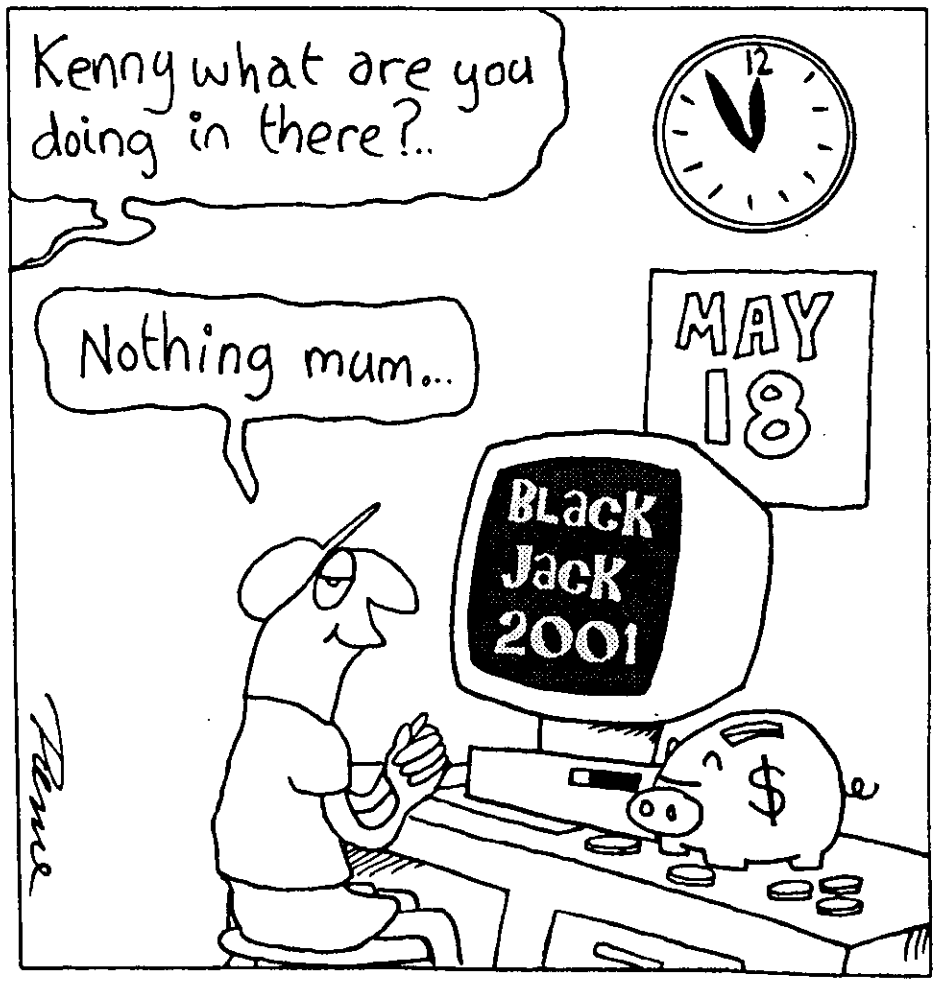
The ALP and the Democrats argued that a moratorium would not address problem gambling and would encourage Australians to use international IGSPs, which often operate in a less regulated environment with few harm-minimisation measures. In a submission by Lasseters Online, statistics were introduced stating that the number of international IGSPs is growing by around 20 per week in line with increased consumer demand, providing Australians with more options for on-line gambling every day.

The majority report of the Senate Committee conceded that the moratorium would not restrict Australian gamblers' current ability to access offshore sites, but argued that "*widely-held privacy and security concerns*" about the Internet would hinder Australians from betting on "*dubious overseas casino sites*".[4] However, the majority report argued that interactive gambling in reputable jurisdictions (such as the US and the UK) would probably be limited over the next 12 months resulting in a reduced expansion of the offshore industry in reputable jurisdictions. As a result, the majority report concluded the absence of reputable IGSPs would also discourage most Australians from gambling on-line with overseas-based IGSPs hence "*interim controls on the expansion of Australian-based IGSPs . . . will limit the most likely source for increased gambling activity and therefore problem gambling*".[5]

The dissenting Democrat report stated that maintaining a multifaceted harm minimisation regulatory strategy is the most effective strategy against problem gambling in Australia and claimed the introduction of an interim moratorium on interactive gambling would not adequately address this highly complex social phenomenon. The Democrats instead proposed a three month non-retrospective moratorium that would be immediately followed by the implementation of a national regulatory scheme.[6] This proposal was rejected by the Senate and was not fully supported by the Democrats – senators Lyn Allison and John Woodley crossed the floor to vote with Government in favour of the Bill.

Problem Gambling

Australia experiences a particularly good reputation for consumer protection legislation and therefore engenders trust with online gamblers both in Australia and internationally. However, the ALP criticised the Bill for not providing regulation of interactive gambling and therefore not addressing the issue of problem gambling. While the Government stated it was not the aim of the Bill to regulate, merely to reduce expansion, the Bill did not impose a



requirement to explore the feasibility of the regulation of IGS (as distinct to exploring the feasibility of a ban) or to implement a framework at the end of the moratorium. The absence of this regulation "*damages Australia's international reputation for effective consumer protection laws and strong, workable gambling regulations.*".[7]

Overseas IGSPs banned from Australia

The definition of a specified link to Australia in the Bill (as discussed above) in conjunction with its extra-territorial application meant that the Bill applied to interactive gambling operations not wholly based in Australia, and to Australian companies providing services in other jurisdictions. The majority report argued that this was to ensure organisations would not be in a position to shift their Internet service to an offshore server whilst continuing to offer services in Australia, as has been the case in some instances with the Government's scheme for Internet content regulation.[8] The Committee also argued that for the sake of "consistency", Australian companies should not be allowed to provide to persons in other jurisdictions services that are classified as illegal in Australia. In contrast Publishing and Broadcasting Limited Gaming Management Pty Ltd argued in its submission that "it is for foreign governments, rather than Australia's, to determine foreigners' access to the Internet".[9]

Impact of the Bill on e-commerce

Regulation is in line with Australia's strategy for developing and encouraging e-commerce in Australia. The Senate Committee report notes that Australia's reputation provides Australian IGSPs with a significant market advantage over their international competitors. However, the IIA advised that imposing a ban, would result in a number of Australian-based organisations moving overseas.

In spite of the impact on society of problem gambling, the export income from gamblers overseas that do use Australian on-line gambling sites will benefit Australia. While the Government has argued any "*potential negative economic impact*" would be "*offset by the need to ensure Australians are not subject to the potentially adverse effect of increased gambling opportunities.*",[10] it would appear that a moratorium would not have stopped an increase in gambling opportunities but would certainly have adversely affected e-commerce, thereby resulting in a double loss for Australia.

CONCLUSION

The defeat of the Bill raises a number of questions. It is apparent that following the defeat, there may be a spate of new on-line gambling sites. Does this reiterate the argument that the proposed moratorium was not assisting problem gamblers, only adversely affecting e-commerce? Will the Government realise its threat of reintroducing moratorium legislation, or will it move more directly towards legislating for an absolute ban? If so, how will the States and Territories respond? Despite the governmental split, given that national attention has now been focussed on the short falls of any banning legislation, the Government has probably missed its only opportunity, unless it significantly refocuses the impact of any future bills.

On-line gambling can not easily be banned, despite Minister Alston's statement "*I have seen at least three experts who explained to me in very cogent detail precisely how [banning on-line gambling] could be done, and it sounds very simple to me*". Minister Alston was in fact referring to enacting legislation to require ISPs to block all access to every on-line gambling site. Senator Lundy of the ALP argued that not only would a complete ban not address Australia's gambling addiction, but because of constant developments in technology, it is not technically feasible in the long term.

In the meantime, the industry is arguing that the e-commerce opportunity cost is significant as investment is slow during this time of uncertainty, and community groups are reiterating the urgent need for harm minimisation measures for problem gamblers.

Currently, the online gambling industry is subject to a degree of regulation that varies between State and Territory governments. However, it is clear that the industry favours strict regulation coupled with "*a federal legislative framework worked out cooperatively with the States including codes of practice for sporting organisations to ensure that match fixing, point sharing and insider information are addressed*".[11] Indeed, at the time of writing State and Territory regulators have come full circle from 1996 and met in Darwin on 27 October 2000 to discuss the implementation, yet again, of player protection standards by adopting a uniform national code. In principle, such a code is supported by the IIA and the Australian Casino Association, but whether the bickering States and Territories can unite to create a workable system before the Government makes its next move to ban on-line gambling is questionable.

1 Northern Territory – The Gaming Control Amendment Act 1998; Queensland – The Interactive Gambling (Player Protection) Act 1998; Australian Capital Territory – The Interactive Gambling Act 1998; Victoria – The Interactive Gaming (Player Protection) Bill 1999.

2 Explanatory Memorandum, Interactive Gambling (Moratorium) Bill 2000, p17.

3 Explanatory Memorandum, Interactive Gambling (Moratorium) Bill 2000, p19.

4 Senator Alston, Senate Debate. Monday 9 October 2000, p17994.

5 Senate Committee Report, p6.

6 Interactive Gambling (Moratorium) Bill 2000, Report of the Senate Environment, Communications, Information Technology and the Arts Legislation Committee, Australian Democrats, Dissenting Report, Senator Stott Despoja.

7 Senator Lundy, 12.57pm Thursday 5 October 2000, p17864.

8 Broadcasting Services Amendment (On-line Services) Act 1999.

9 Publishing and Broadcasting Limited Gaming Management Pty Limited Submission 9, p2.

10 Senate Report, p10.

11 Senator Sherry, 12.31pm, 9 October 2000, p17935.

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Racial Hatred Provisions Applied to the Internet

Michelle Hannan examines a landmark case before the Human Rights and Equal Opportunity Commission and its implications on the on-line industry.

In a significant decision for on-line racist hate material, the Human Rights and Equal Opportunity Commission ("**Commission**") recently ordered that materials on the website of a South Australian organisation be removed on the basis that they were an unlawful breach of the racial hatred provisions of the *Racial Discrimination Act* 1975 (Commonwealth) ("**RDA**"). The Commission also ordered the organisation to post a detailed apology on its homepage. The case is the first finding of unlawful racial hatred in relation to materials published on a website in Australia.

Jeremy Jones, the Executive Vice President of the Executive Council of Australian Jewry, lodged a complaint of racial hatred under the RDA against Frederick Toben on behalf of the Adelaide Institute in relation to material published by the Adelaide Institute on its website. The complaint alleged the material published constituted "malicious anti-Jewish propaganda".

Under the RDA, material published in public will breach the racial hatred provisions where it is reasonably likely to offend, insult, humiliate or intimidate another person or group of people and is published because of the race, colour, national or ethnic origin of the other person or some of or all of the people in the group.

In this case, the Commission found it was apparent from the content of the materials that they were published to offend, insult, humiliate and intimidate members of the Jewish community.

However such material will only offend the racial hatred provisions of the RDA if it is made available in a public place or communicated to the public. The Commission's fundamental finding in this case that placing material on a website which is not password protected and is "generally available to anyone who can access an Internet connection" is an act "done in public" demonstrates that the RDA provisions are broadly applicable to websites and those who post material on them. Commissioner McEvoy found that publishing material on such a site is "equivalent to publishing material in a newspaper".

Password protected websites could also fall within the scope of the RDA provisions given that allowing access by invitation only or through paying a fee does not prevent an act from being a public one. Factors such as the number of subscribers to the site, the purpose of the site and the connection between the subscribers to the site would all be relevant to determining whether or not a password protected site would also fall within the realm of a "public place".

The position of Intranet sites is unclear. It might be that these sites are sufficiently private to avoid the racial hatred provisions of the RDA. However, whether or not this is so would depend on the purpose of the Intranet, the number of subscribers and whether or not there is a sufficiently close tie between the subscribers to argue that the material was published privately.

A question which is likely to cause significant argument in some similar cases, but was not an issue in this case, is that of liability. In this case the question was not debated as the Respondent, Dr Toben, acknowledged that he was responsible for the offending material being posted on the website. However, this question may be an issue in matters where members are able to directly post material on a website of their own accord. The question of whether or not the host of a site could be liable for publishing material which amounts to racial hatred also remains unanswered.

BROADCAST-TYPE SCRUTINY

In some ways, the Commission's findings bring website materials under the kind of scrutiny previously reserved for broadcasting services.

For example, under the industry codes of practice for commercial radio broadcasters (the **FARB Codes**), a commercial radio licensee must not broadcast a program which is likely to incite or perpetuate hatred against or vilify any person or group on the basis of age, ethnicity, nationality, race, gender, sexual preference, religion or physical or mental disability. It is also a condition of commercial radio broadcasting licences that a broadcast service not be used in the commission of an offence against another Act. Similar provisions apply to commercial television broadcasting licensees.

The reason that commercial television and commercial radio are highly regulated forms of media is that traditionally, they have been regarded as "influential". The regulatory policy stated in the *Broadcasting Services Act* 1992 (the BSA) is that *"different levels of regulatory control be applied across a range of broadcasting services according to the degree of influence that different types of broadcasting services are able to exert in shaping community views in Australia"*. Content on Internet services is only regulated in relatively extreme cases under the BSA (under Schedule 5). The Commission's finding may be an early sign that certain website content may be more scrutinised by the regulators, whether broadcasting or otherwise, in the future.

DEFENCES

This determination also indicates that ensuring material posted on a website is not defamatory will not necessarily ensure that the material does not fall foul of the racial hatred provisions of the RDA. The Respondent in this matter did not attend the hearing, however, prior to the hearing he indicated that he relied on the truth of the documents as a defence to the publication. The Commission, without accepting that the contents of the materials were true, made it clear that truth alone is an insufficient defence to the provisions. The standard New South Wales defence to defamation of truth and public interest might not be sufficient to provide a defence to a publication which is alleged to amount to racial hatred.

The RDA sets out the only bases for materials which would otherwise amount to racial hatred being exempted. Broadly, the materials must fall into one of the following categories:

- A performance, exhibition or artistic work;
- A statement, publication, or debate for genuine academic, artistic, scientific or public interest; or
- A fair and accurate report or comment on a matter of public interest as long as the comment is a genuine belief held by the person making the comment.

However in each case the Commission recognises that there is an "overarching" requirement that the publication, work or comment has been made "reasonably and in good faith". As it did in this case, the Commission can draw a conclusion as to whether an act is done reasonably and in good faith based on the nature of the comments made in the publication. The Commission found that in this case the highly inflammatory and offensive comments, as well as the links to hate sites, undercut any arguments that the publication was made reasonably and in good faith.

ORDERS

The Commission has very broad powers to deal with material amounting to racial hatred. They include ordering that the material be removed from a website and not republished, that compensation be paid to a complainant for any damage resulting from the offensive publication and/or that an apology be given.

In this case the Commission ordered that all the offensive material be removed and that a detailed apology, as worded by the Commission, be published on the homepage of the Adelaide Institute. Although the orders of the Commission are not enforceable, complaints under the same provisions are now heard by the Federal Court, which can make orders binding on the parties.

The views expressed in this article are the author's views and not necessarily those of the firm or its clients.

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Legislation Note: Bradman Deserves More Than Corporations Law

Ann Slater analyses recent Corporations Law amendments to protect the Don.

Recently, the Corporations Law was amended by the Federal Parliament to prohibit incorporation of companies using the surname "Bradman". Bradman, however, deserves more than an amendment to the Corporations Law.

It is a common mistake, even in the corridors of power it seems, that the protection and prohibition of names begins and ends with the Corporations Law and State Business Names Act.

What our Don needs is formal protection under the *Trade Marks Act*, and through domain name registry practice, to prohibit the third party registration of SIR DONALD BRADMAN, BRADMAN, THE DON, 99.94 and DON BRADMAN across all goods and lines of service.

It shouldn't stop there. Why not protect other Australian icons such as Sir Gustav Nossal, Dawn Fraser, Cathy Freeman, Nova Peris Kneebone, Ian Thorpe, Keiren Perkins, Chips Rafferty, Kylie Minogue, Errol Flynn, Bananas in Pyjamas, Play School, Barry Humphries, Weary Dunlop, Fred Hollows, Sir Robert Helpman and Albert Namatjira to name only a few.

The more appropriate, but under-appreciated, legislation for such protection is the *Trade Marks Act 1995*. There are at least four other potentially better ways to protect these names and they all fall within the scope of the *Trade Marks Act*. The *Trade Marks Act* and Regulations provide regulation regarding:

- prohibited trade marks;
- the registration of domain names as trade marks
- defensive registration; and
- well-known trade marks

Firstly, legislators can secure the names of our deceased icons such as Weary Dunlop and Albert Namatjira by amending the Trade Marks Regulations to include appropriate names as prohibited trade marks.

The current list of prohibited marks under Schedule 2 of the Trade Mark Regulations is:

AUSTRADE

C.E.S.

OLYMPIC CHAMPION

REPATRIATION

RETURNED AIRMAN

RETURNED SAILOR

RETURNED SOLDIER

OMS list now needs to be revisited by Government.

It is possible for living icons to protect themselves under the little used defensive trade mark regulation provisions of the *Trade Marks Act*. A defensive registration allows an individual or company to register its famous trade mark for all matters of goods and lines of service. It is not like normal trade mark registration: it is a recognition that the mark is of icon status.

International celebrities and companies are using the Australian defensive registration route but Australians are proving slow to use the system.

Some of the international icon defensive registrations are:

RONALD McDONALD

ESTEE LAUDER

JACK DANIELS

HUGO BOSS

HARLEY-DAVIDSON

However, Australian icons such as those in the recent Olympic closing parade (Elle McPherson, Paul Hogan, and Greg Norman) have not registered their names or alter egos "The Body", "Crocodile Dundee" and "The Shark" as defensive trade marks.

Our corporate legislators and regulators should take time to understand the value of intellectual property and celebrity, and either legislate or research the most effective ways to protect our national icons from exploitation. Amending the Corporations law is not the most effective solution.

This note was prepared by Ann Slater, a Partner in the intellectual property group at the Sydney Office of PricewaterhouseCoopers Legal.

The Communications Law Bulletin is the journal of the Communications and Media Law Association (CAMLA) which is an independent organisation which acts as a forum for debate and discussion and welcomes the widest range of views. The views expressed in the Communications Law Bulletin and at CAMLA functions are personal views of the respective authors or speakers. They are not intended to be relied upon as, or to take the place of, legal advice.

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are sought from the members and non-members of CAMLA, including features, articles, and case notes. Suggestions and comments on the content and format of the Communications Law Bulletin are also welcomed.

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The Communications and Media Law Association (**CAMLA**) brings together a wide range of people interested in law and policy relating to communications and the media. CAMLA includes lawyers, journalists, broadcasters, members of the telecommunications industry, politicians, publishers, academics and public servants.

Issues of interest to CAMLA members include:

- defamation
- privacy
- advertising
- telecommunications
- contempt
- copyright
- film law
- freedom of information
- broadcasting
- censorship
- information technology
- the Internet & on-line services

In order to debate and discuss these issues CAMLA organises a range of seminars and lunches featuring speakers prominent in communications and media law policy.

Speakers have included Ministers, Attorneys-General, members and staff of communications regulatory authorities, senior public servants, executives in the communications industry, lawyers in media and communications law, and overseas experts.

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