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The Value of Copyright: Determining Shadow Prices

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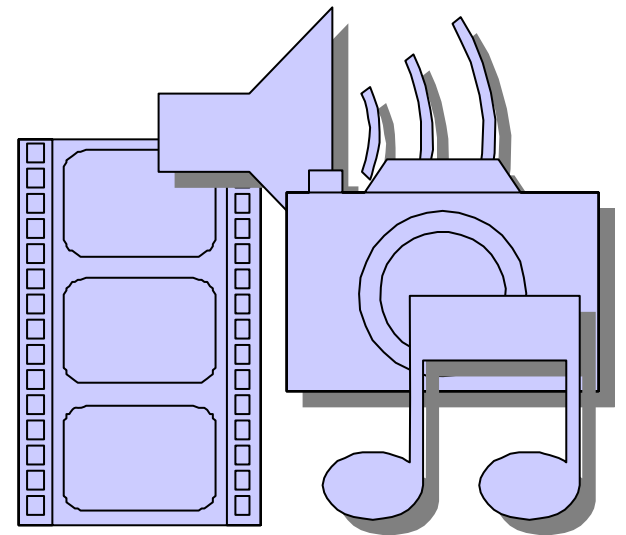
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Paying the piper: but how much? Valuing copyright licences for music

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IPRs solve a problem

- The grant of statutory IPRs addresses the disincentive to innovate/create that results from the ability to copy/imitate/reproduce such creations very cheaply.
- This property right gives the right to:
 - i. exclude others from use; and
 - ii. transfer the right to use, requires a pricing decision.

But, there is still a problem

- While the grant of IPRs enables creators to extract payment, it does not determine the amount that should be paid – that is left to the parties.
- So the issue is: how is the ‘right’ price for copyright licences to be determined?

Determining prices

- Let's consider how prices are determined for non IP products eg a restaurant meal.
- What is the cost of supply?
 - i. the marginal cost of supplying an additional unit;
 - ii. a return to capital.
- A price that just covers these costs is the minimum price that will justify supply.
- However, different suppliers will have different costs (eg different types of restaurants) and WTS increases as the price of the product increases.

Determining prices

- On the buyer side of the market, what determines what a buyer is willing to pay for a product such as restaurant meals?
- WTP depends on the value of the product to the buyer and this depends on **functionality**, buyer attitudes (desire for fashion, exclusiveness etc), particular attributes of the product like taste (eg wine) and smell (eg perfume) [Consumer tastes/preferences]

Determining prices

- WTP is also affected by the availability and price of substitutes.
- Actual purchase is constrained by income (or for businesses, by earning power).
- WTP determines the maximum amount that consumers will pay for the product. For some a product may have very high value and so their WTP is high; others only value it enough to buy when prices are low. WTP may change as circumstances change.

Under competitive conditions

- Buyers want to achieve a price close to suppliers' cost and sellers want to achieve a price close to buyers' maximum WTP.
- Interaction of demand and supply result in a market price.
 - i. If the price is too high, demand exceed supply, prices rise &/or supply increases;
 - ii. If price is too low supply exceeds demand, prices decrease &/or supply decreases.
- Prices adjust to equate WTP and WTS – under competitive conditions, this corresponds to the cost of supply of the relevant quantity of supply.

How does this work?

- For many products, the buyer appears to face take-it-or-leave-it prices – eg in the supermarket, at a restaurant. Nevertheless, this price is constrained by buyer WTP but may be greater than WTP if markets are not competitive.
- For products that are expensive &/or purchased irregularly, price may be negotiated. While still constrained by WTP & cost of production, the outcome depends on the bargaining power of the parties eg under uncompetitive supply conditions supplier has more bargaining power.

How does this apply to IP?

- On the buyer side, much the same conditions apply as for non IP products.
- The difference is on the supply side – creating the first ‘product’ incurs very high costs but re-creating thereafter costs very little (mc approximately zero). Technology has exacerbated this.
- The *Pont Data* case.

Assistance from other areas?

- Requirements under Part IIIA of the Trade Practices Act in relation to access pricing.
- ACCC has role as arbitrator when price negotiations fail – ACCC access pricing principles. These rely on a cost structure that differs significantly from that for IP products.

So what has happened?

- For end users of IP products, such as CDs, like supermarket products, generally the products are retailed at a set price.
- Generally at the intermediate level (publishers/record companies) prices for IP licences are negotiated
 - i. sellers are frequently represented jointly to reduce transactions costs – for individual composers/songwriters or even record companies negotiating individual transactions is too costly to be commercially realistic.
 - ii. this also increases the bargaining power of sellers – buyers of licences face fewer close alternative.

So what has happened?

- The price is negotiated based on what the seller *believes* is the WTP of buyers.
- Valuation is subjective and the buyer possesses the information (not the seller) – asymmetric information.
- Further, the buyer has no incentive to reveal his/her valuation.

How to assess buyer WTP?

- Guess/trial and error;
- Revealed consumer preference;
- Contingent valuation;
- Choice modelling – used in PPCA & Night Clubs & Dance Parties (July 2007);
- Other/combination.

David is going to discuss
these options - and more!

Some other issues

- When IP is an input into further production (as in the use of recorded music on radio or at night clubs) its value is often enhanced by other factors eg the skill of the DJ, and this needs to be taken into account where end product value is used as a basis for determining the licence price.
- IP products tend to be high risk – some succeed (but for how long?), many fail. The price of the successes must pay for the failures eg pharmaceuticals.
- In relation to copyright, failure to agree price may result in a determination by the Copyright Tribunal – this possibility (and the costs involved) may influence the outcome of negotiations.

