SUBMISSION TO THE INQUIRY INTO IMPACTS ON LOCAL BUSINESSES IN AUSTRALIA FROM GLOBAL INTERNET-BASED COMPETITION

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Via On-Line Submission To:
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I INTRODUCTION

This submission has been prepared following the request, on 25 October 2017, for the Standing Committee on Industry, Innovation, Science and Resources 'to inquire into and report on the impacts on local businesses in Australia from global internet-based competition'.[1]

In brief, it proposes that businesses trading in physical goods and those trading in equivalent digital products should be subject to the same legal obligations. This is not currently the case under Australian law. Where businesses trade in physical goods, they are subject to legal obligations under the *Australian Consumer Law* and under State and Territory sale of goods Acts that do not apply to the supply of equivalent digital products. Australian businesses dealing in physical goods, competing with global internet-based businesses dealing in equivalent digital products, are subject to additional regulatory costs, and are therefore at a competitive disadvantage.

This submission has been prepared for the specific purpose of the Committee's present inquiry. However, its content and analysis is based on a detailed body of research underpinning the following recently-published paper:

- Benjamin Hayward, 'What's in a Name? Software, Digital Products, and the Sale of Goods' (2016) 38(4) *Sydney Law Review* 441 – 462.

Members of the Committee may access this paper (on an open-access basis) from the *Sydney Law Review* website (http://sydney.edu.au/law/slr/slr_38/slr38_4.shtml), as well as from SSRN (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2885523).

[1] Parliament of Australia, *Inquiry into Impacts on Local Businesses in Australia from Global Internet-Based Competition*, Standing Committee on Industry, Innovation, Science and Resources <https://www.aph.gov.au/internetcompetition>.

This submission is divided into four Parts. Following this initial introduction, in Part II, this submission:

- outlines the specific points of this inquiry's terms of reference that it responds to;
- identifies the scope of its analysis; and
- summarises its arguments and recommendations.

In Part III, this submission outlines its arguments and its recommendations in full. Part IV then concludes.

II IN SUMMARY – THE TERMS OF REFERENCE, THE SCOPE OF THIS SUBMISSION, AND ITS RECOMMENDATIONS

This Part provides an overall summary of this submission. It outlines the specific points of this inquiry's terms of reference that are responded to, identifies the scope of this submission's analysis, and summarises this submission's arguments and recommendations.

A *The Terms of Reference*

The terms of reference of the present inquiry ask the Committee to consider the following questions:[2]

- How has / will the existing retail industry cope with changes to the sector's landscape brought about by the existence of global online retail business?
- **What are the consequences for small businesses in terms of new competition and access to digital platforms?**
- How are small businesses responding to digital change and what is their uptake of new digital business services?
- What impacts do the above have on employment, including employment levels and conditions?
- **What roles can the Commonwealth Government and Parliament play in fostering innovation for Australian businesses to respond to these challenges?**

This submission addresses the second and fifth points raised by these terms of reference, bolded in the list above.

B *The Scope of This Submission*

This submission is concerned with an inequality in the law. At present, the law's treatment of physical goods and their equivalent digital products is unequal, with respect to the obligations that businesses owe to their customers.

[2] Parliament of Australia, *Terms of Reference*, Inquiry into Impacts on Local Businesses in Australia from Global Internet-Based Competition <https://www.aph.gov.au/Parliamentary_Business/Committees/House/Industry_Innovation_Science_and_Resources/InternetCompetition/Terms_of_Reference>.

This inequality relates to the second point of this inquiry's terms of reference. This submission addresses circumstances where Australian businesses (dealing in physical goods) compete against global internet-based businesses (dealing in equivalent digital products). Examples include Australian businesses selling print books and magazines, competing against international e-book sellers; and Australian music retailers (dealing in physical CD's, DVD's, vinyl records, and other physical music media) competing against international digital music suppliers. CD's, videos, software, and books are '[t]ypical examples' of 'physically tangible object[s]' that have digital product equivalents.[3]

On the current state of the law, businesses dealing in physical goods owe legal obligations to their customers (under the *Australian Consumer Law*, and under the State and Territory sale of goods Acts) that are not owed by businesses supplying digital products. Australian businesses competing against global internet-based businesses, in the manner described above, are therefore at a competitive disadvantage. They are subject to additional legal obligations, and therefore, incur additional regulatory costs.

Of course, Australian businesses may also supply digital products; and global internet-based businesses may trade in physical goods. This submission is therefore concerned with one manifestation of a larger, long-standing problem in the law – its treatment of digital products, with respect to all traders.

This inquiry is an opportunity for the Committee to consider an issue which has been problematic in Australian law for decades,[4] and to recommend law reform that will remove a legal distinction between physical goods and digital products that makes no logical sense in our modern economy.

C *Recommendations Summarised*

The fifth point of this inquiry's terms of reference queries how the Commonwealth Government and Parliament can foster innovation in order to facilitate responses to these challenges. As in the United Kingdom, where the *Consumer Rights Act 2015* (UK) has recently been enacted, the Commonwealth Government and Parliament can foster innovation in the law – to ensure that supplies of digital products are appropriately classified and regulated.

As will become evident in Part III, the problem addressed by this submission arises as a result of the law's definition of 'goods'. This problem can be solved by amending the law's definition of goods, to ensure that digital products are included. Though a more conservative step than that taken in the United Kingdom, where the *Consumer Rights Act 2015* (UK) recognises 'digital content' as its own *sui generis* category of supply carrying its own set of obligations,[5] this reform would nevertheless be effective in the immediate term.

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[3] Lee A. Bygrave and Dan Svantesson, 'Jurisdictional Issues and Consumer Protection in Cyberspace: The View From "Down Under"' (Paper presented at the Cyberspace Regulation: eCommerce and Content conference, Sydney, 24 May 2001) 8 <http://folk.uio.no/lee/oldpage/articles/CLE_paper.pdf>.

[4] See generally Benjamin Hayward, 'What's in a Name? Software, Digital Products, and the Sale of Goods' (2016) 38(4) *Sydney Law Review* 441, 447 – 454; Dan Jerker B. Svantesson, 'A Call for Judicial Activism – Rapid Technological Developments and Slow Legal Developments' (2011) 36(1) *Alternative Law Journal* 33, 33.

[5] *Consumer Rights Act 2015* (UK) s 1(1), s 1(3)(b) & ch 3.

Specific recommendation #1:
The Commonwealth Government and Parliament should amend the definition of goods contained in the *Australian Consumer Law* s 2(1), as follows:

> ***goods*** includes:
> (a) ships, aircraft and other vehicles; and
> (b) animals, including fish; and
> (c) minerals, trees and crops, whether on, under or attached to the land or not; and
> (d) gas and electricity; and
> (e) computer software and other types of digital products; and
> (f) second-hand goods; and
> (g) any component part of, or accessory to, goods.

Specific recommendation #2:
The Commonwealth Government, liaising with the Council of Attorneys-General, should co-ordinate complementary amendments to the definitions of goods contained in the State and Territory sale of goods Acts.[6] Though these definitions are subject to slight linguistic variations across the States and Territories, they are all substantially the same. The Victorian definition[7] is addressed here by way of example:

> ***goods*** includes all chattels personal other than things in action and money. The term includes emblements and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale. The term also includes digital products;

III DETAILED SUBMISSION – SECURING THE EQUIVALENT LEGAL TREATMENT OF PHYSICAL GOODS AND DIGITAL PRODUCTS

This submission addresses a problem that has remained unresolved in the law for decades – the law's classification of digital products. This problem arises, and persists to this day, because Australia's State and Territory sale of goods Acts are modelled on the *Sale of Goods Act 1893* (UK). Digital products could not possibly have been foreseen at the time that this legislation was devised.[8] As a result, they are not appropriately accounted for in Australia's sales law, nor in its consumer law.

This issue manifested itself as early as the 1980's, when questions were raised as to the law's treatment of software as an emerging unit of economic exchange.[9] At that time, the question posed was – does software constitute goods? Over time, after a number of cases were handed down[10] and also following legislative intervention,[11] an answer became evident. For the purposes of the State and Territory sale of goods Acts, software is only goods if it is

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[6] *Goods Act 1958* (Vic) s 3(1); *Sale of Goods Act 1954* (ACT) s 2 & [dictionary]; *Sale of Goods Act 1923* (NSW) s 5(1); *Sale of Goods Act 1972* (NT) s 5(1); *Sale of Goods Act 1896* (Qld) s 3(1); *Sale of Goods Act 1895* (SA) s A2(1); *Sale of Goods Act 1896* (Tas) s 3(1); *Sale of Goods Act 1895* (WA) s 60(1).
[7] *Goods Act 1958* (Vic) s 3(1).
[8] Svantesson, above n 4, 35.
[9] Hayward, above n 4, 452.
[10] *Toby Constructions Products Pty Ltd v Computa Bar (Sales) Pty Ltd* [1983] 2 NSWLR 48; *St Albans City and District Council v International Computers Ltd* [1996] 4 All ER 481; *Watford Electronics Ltd v Sanderson CFL Ltd* [2000] 2 All ER (Comm) 984; *Re Amlink Technologies Pty Ltd and Australian Trade Commission* (2005) 86 ALD 370; *Gammasonics Institute for Medical Research Pty Ltd v Comrad Medical Systems Pty Ltd* (2010) 77 NSWLR 479.
[11] *Australian Consumer Law* s 2(1).

embodied in a tangible object; and not if it is (for example) directly downloaded from the internet.[12] For the purposes of the *Australian Consumer Law*, software is legislatively clarified to be goods regardless of its form.[13]

So far as the sale of goods Acts are concerned, this answer is not satisfactory, as a matter of principle. This is because software sold through digital distribution channels fulfils a role functionally equivalent to software sold by way of traditional physical media. As posited by Bygrave and Svantesson:

> [I]f a consumer buys a paper version of the Encyclopaedia Britannica in an ordinary bookstore, this is clearly a supply of goods. If the consumer orders a paper version of the encyclopaedia via the Internet, this is also clearly a supply of goods. If the consumer buys the encyclopaedia via the Internet and takes delivery of a digitised version, *this is still a supply of goods*.[14]

However, this answer is also not satisfactory, even in relation to the *Australian Consumer Law*. This is because a focus on software alone is inappropriate in modern economic conditions, where a variety of different types of digital products are commonly traded.[15] In making the case for greater judicial activism in this area, Svantesson has noted that 'it cannot be expected that the legislature will be able to address all legal questions stemming from the development of new technologies'[16] – and that has been the case here. There is a risk that focusing attention only on whether or not software constitutes goods risks excluding, by implication, other digital products – such as electronic books, and digital music.[17]

This risk appears to have been borne out in a recent decision of the Federal Court of Australia, being *ACCC v Valve Corp [No 3]*.[18] In that case, Edelman J was required to decide whether or not the distribution of computer games through the Steam gaming platform[19] involved a supply of goods, for the purposes of the *Australian Consumer Law*. His Honour held that goods were supplied, on the basis that the *Australian Consumer Law's* definition of goods includes computer software.[20] In so holding, his Honour made the following observations:

> Mr Dunkle's evidence, which I accept, was that computer software is instructions or programs that make hardware work. The video games provided by Steam required computer software to make them work. The material downloaded by consumers included non-executable data such as music and html images. Mr Dunkle's uncontested evidence on this point was that this non-executable data was not computer software. But he accepted that the computer software made that non-executable data work … As Mr Dunkle said, the games consist of software and a number of other assets (eg[.] music, images).[21]

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[12] *Gammasonics Institute for Medical Research Pty Ltd v Comrad Medical Systems Pty Ltd* (2010) 77 NSWLR 479, 480 [5] – [6] & 489 [47].
[13] *Australian Consumer Law* s 2(1); *Goldiwood Pty Ltd v ADL (Aust) Pty Ltd* [2014] QCAT 238 (27 May 2014) [37].
[14] Bygrave and Svantesson, above n 3, 8 (emphasis added).
[15] See generally Hayward, above n 4, 452 – 459.
[16] Svantesson, above n 4, 34.
[17] Hayward, above n 4, 459.
[18] *ACCC v Valve Corp [No 3]* (2016) 337 ALR 647.
[19] See generally Valve Corporation, *Welcome to Steam* (2017) <http://store.steampowered.com/>.
[20] *ACCC v Valve Corp [No 3]* (2016) 337 ALR 647, 680 [157].
[21] Ibid 676 – 677 [138] – [139].

> I do not accept the ACCC's primary submission that *everything* that was supplied by Valve … was a supply of a good. As I have explained, some matters provided were not goods. For instance, the non-executable data which accompanied, and was incidental to, the computer software was not a good although it is hard to see how it could be decoupled from the computer software.[22]

As is clear from this passage, the definition of computer software was not a contested issue in this case. His Honour adopted the definition put by a witness in uncontested evidence. However, should Edelman J's view be accepted in future cases, only computer 'programs'[23] – the traditional conception of consumer software – would be captured by the inclusion of computer software in the *Australian Consumer Law* s 2(1)'s definition of goods. Other digital products, such as electronic books and digital music, would not be included where they are not in themselves executable files – that is, where they rely on other executable files (such as e-book readers, or digital music players) for their use. These kinds of digital products are akin to the music and image files referred to by Edelman J. They are associated with software, and require software to work, but – according to this definition – e-book files and digital music files are not software in and of themselves.

This analysis may sound technical, but it is far from academic. Whether or not the law's definition of goods includes digital products affects legal rights and obligations. What is ultimately at stake are the rights of customers, and the obligations of businesses, where physical goods and digital products are the subject of exchange.

Under the State and Territory sale of goods Acts, businesses owe their customers obligations as a result of terms implied into contracts of sale. Though these implied terms may be excluded by agreement,[24] they will otherwise apply automatically to contracts for the sale of goods. The most relevant of these implied terms, with respect to this submission, include:

- the implied condition of merchantable quality;[25]
- the implied condition of fitness for purpose;[26] and
- the implied condition that goods will correspond with their description.[27]

Under the *Australian Consumer Law*, businesses also owe obligations to their customers in the form of consumer guarantees. A breach of the consumer guarantees gives rise to statutory rights of recourse. These consumer guarantees are non-excludable.[28] Relevant consumer guarantees, with respect to this submission, include:

- the consumer guarantee that goods will be of acceptable quality;[29]
- the consumer guarantee that goods will be fit for disclosed purposes;[30] and
- the consumer guarantee requiring goods to correspond with their description.[31]

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[22] Ibid 679 [156] (emphasis in original).
[23] Ibid 676 [138].
[24] See, eg, *Goods Act 1958* (Vic) s 61.
[25] See, eg, ibid s 19(b).
[26] See, eg, ibid s 19(a).
[27] See, eg, ibid s 18.
[28] *Australian Consumer Law* s 64.
[29] Ibid s 54.
[30] Ibid s 55.
[31] Ibid s 56.

If digital products (such as e-books and digital music) are not considered goods for the purposes of these regimes, these protections do not apply. Customers of businesses supplying digital products enjoy a lower level of legal protection; while those businesses are in turn subject to lower regulatory costs.

The second point of this inquiry's terms of reference asks:

- What are the consequences for small businesses in terms of new competition and access to digital platforms?

Both Australian businesses and their global internet-based competitors may trade in physical goods, digital products, or both. However, where local Australian businesses trade in physical goods, and where global internet-based competitors trade in digital equivalents, Australian businesses are subject to legal obligations that do not bind their competitors. Where an Australian bookstore trades in hard copy books and magazines, its sales are subject to the sale of goods Acts' implied terms, and also to the *Australian Consumer Law's* consumer guarantees – internet-based supplies of e-books are not. Where an Australian music retailer trades in physical CD's, DVD's, and vinyl records, its transactions attract the sale of goods Acts' implied terms and the *Australian Consumer Law's* consumer guarantees – while the internet-based distribution of digital music does not. In these cases, local Australian businesses are subject to additional regulatory costs. This places them at a competitive disadvantage, as compared to their global internet-based competitors.

It might be thought that these additional costs may be relatively small. Without the benefit of empirical evidence or economic modelling, it might be supposed (for the sake of argument) that this is the case. However, even minor additional costs cannot be justified when their imposition is based on a distinction without a difference. Where businesses operate in the same market, supplying functionally equivalent products, it is both principled and fair that they be treated – by the law – in the same way.

To summarise, in relation to the second point raised by this inquiry's terms of reference, it is submitted that the *Australian Consumer Law* and the State and Territory sale of goods Acts treat some Australian businesses differently to their global internet-based competitors.

The fifth point of this inquiry's terms of reference asks:

- What roles can the Commonwealth Government and Parliament play in fostering innovation for Australian businesses to respond to these challenges?

The Commonwealth Government and Parliament can assist Australian businesses to meet the challenges identified in this submission through fostering innovation in the law. Specifically, the law should be amended to ensure that the supply of digital products attracts the same legal obligations (and therefore the same regulatory costs) as supplies of equivalent physical goods. Amending the law to this effect would necessarily require liaison with, and the co-operation of, the State and Territory Governments and Parliaments.

The United Kingdom has recently addressed the legal obligations that apply to the supply of 'digital content' (to consumers) through an innovative *Consumer Rights Act 2015* (UK). This legislation recognises the supply of digital content as a *sui generis* category of case, sitting alongside (not subsumed within) the traditional categories of goods and services.[32] Nevertheless, this legislation only applies to consumer transactions, as defined by the *Act*.[33] In relation to non-consumer sales, the *Sale of Goods Act 1979* (UK) contains a similar definition of goods as found in the State and Territory sale of goods Acts in Australia.[34]

The United Kingdom's legislative intervention is an innovative model for the reform of Australian law,[35] though even in the UK context, its application to consumer supplies only means that its reach is incomplete. This submission proposes more modest law reform in the Australian context, that would nevertheless correct the classification anomaly identified here. It is submitted that amendments should be made to the law's definition of goods, to ensure that digital products are included.

With respect to consumer transactions, it is submitted that an amendment should be made to the definition of goods contained in the *Australian Consumer Law* s 2(1), as follows:

> ***goods*** includes:
> (a) ships, aircraft and other vehicles; and
> (b) animals, including fish; and
> (c) minerals, trees and crops, whether on, under or attached to the land or not; and
> (d) gas and electricity; and
> (e) computer software and other types of digital products; and
> (f) second-hand goods; and
> (g) any component part of, or accessory to, goods.

In accordance with the Intergovernmental Agreement for the Australian Consumer Law, any amendment to the *Australian Consumer Law* requires consultation with the State and Territory Governments, given that the *Australian Consumer Law* is also part of the law of the States and Territories.[36] Though the consultation required by this agreement is only binding as a matter of political – rather than legal – imperative, it would be prudent to co-operate with State and Territory Governments in securing this reform, given that corresponding reforms to Australia's sale of goods Acts would be the responsibility of the State and Territory Parliaments.

With respect to ordinary sales transactions, the reform recommended by this submission would be achieved by amending the definitions of goods contained in the State and Territory sale of goods Acts. Though this is a matter for the State and Territory Parliaments, given the Commonwealth's interest in this issue (in relation to the *Australian Consumer Law*), it would be feasible for the Commonwealth Government to facilitate discussions around this proposed reform through the Council of Attorneys-General.

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[32] *Consumer Rights Act 2015* (UK) s 1(1), s 1(3)(b) & ch 3. See also chs 2 & 4.
[33] See ibid s 2(3).
[34] *Sale of Goods Act 1979* (UK) s 61(1).
[35] Hayward, above n 4, 459 – 461.
[36] Intergovernmental Agreement for the Australian Consumer Law (2 July 2009) [5] & [11] <http://consumerlaw.gov.au/files/2015/06/acl_iga.pdf>. See, eg, *Australian Consumer Law and Fair Trading Act 2012* (Vic) ss 7 & 8(1).

The various State and Territory sale of goods Acts define goods in substantially the same terms, though subject to slight variations in expression.[37] For the purposes of this submission, proposed amendments to the definition contained in the *Goods Act 1958* (Vic) s 3(1) are given for illustrative purposes:

> ***goods*** includes all chattels personal other than things in action and money. The term includes emblements and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale. The term also includes digital products;

These amendments would level the playing field between suppliers of physical goods, and their digital equivalents, so far as the legal obligations of businesses to their customers are concerned. Where Australian businesses dealing in physical goods compete with global internet-based businesses dealing in equivalent digital products, those competitor businesses would become subject to the same regulatory costs as Australian businesses currently are. Where those businesses operate in the same market, and supply functionally equivalent products, this outcome is both principled and fair. To adapt the words of Fullerton J in *Gammasonics Institute for Medical Research Pty Ltd v Comrad Medical Systems Pty Ltd*, 'it seems to me that the approach of the commentators and their analysis generally has merit, especially insofar as it serves to afford protection to the consumer irrespective of the means by which the [products] are delivered'.[38]

IV CONCLUSION

Australian businesses no longer operate in an environment where their only competition is local; or where their competitors necessarily deal in physical goods. The present inquiry is an opportunity for the Committee to consider aspects of this trading environment – including the laws that regulate it – that may operate unfairly. This inquiry presents an opportunity to remedy an inequality in Australian law, concerning the obligations imposed on traders dealing in physical goods, and in equivalent digital products.

This remedy rightly comes from the Government and Parliament. As explained in *Gammasonics Institute for Medical Research Pty Ltd v Comrad Medical Systems Pty Ltd*, in holding that software distributed electronically is not goods for the purposes of the *Sale of Goods Act 1923* (NSW):

> In this case, the plaintiff submitted that it is productive of injustice if consumers purchasing software in the form of CDs or DVDs, either sold in retail shops or via the internet, are protected by the statutory warranties in the *Sale of Goods Act*, whereas consumers who download the same software directly from the internet or from a supplier (as was the case here), would not. Accepting that to be the case, rectifying that injustice or perceived injustice in this case, is a matter deserving of a legislative review of the operation of the *Sale of Goods Act* rather than judicial intervention.[39]

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[37] *Goods Act 1958* (Vic) s 3(1); *Sale of Goods Act 1954* (ACT) s 2 & [dictionary]; *Sale of Goods Act 1923* (NSW) s 5(1); *Sale of Goods Act 1972* (NT) s 5(1); *Sale of Goods Act 1896* (Qld) s 3(1); *Sale of Goods Act 1895* (SA) s A2(1); *Sale of Goods Act 1896* (Tas) s 3(1); *Sale of Goods Act 1895* (WA) s 60(1).

[38] *Gammasonics Institute for Medical Research Pty Ltd v Comrad Medical Systems Pty Ltd* (2010) 77 NSWLR 479, 487 [38].

[39] Ibid 488 [45].

Despite these comments being made some seven years ago, the 'slow speed of the legislature'[40] in responding to difficulties in classifying software, and digital products more broadly, has persisted.

Where Australian businesses deal in physical goods, they are subject to legal obligations (and regulatory costs) that global internet-based competitors, dealing in digital products, are not. It is submitted that law reform should be pursued in order to ensure that the law's current distinction between physical goods and their equivalent digital products is eliminated for all traders.

[40] Svantesson, above n 4, 33.