

*everything
everywhere™*

*Everything Everywhere's
response to Ofcom's
Online Infringement of
Copyright:
Implementation of the
Online Infringement of
Copyright (Initial
Obligations) (Sharing of
Costs) Order 2012*

Non-Confidential

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T-Mobile

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Summary

Everything Everywhere (EE) welcomes the opportunity to comment on Ofcom's latest consultation "Online Infringement of Copyright: Implementation of the Online Infringement of Copyright (Initial Obligations) (Sharing of Costs) Order 2012" ("the proposed Order") under the Digital Economy Act 2010.

EE supports some key aspects of the proposed Order, including proposing the same fixed cost for all Qualifying Internet Service Providers (ISPs) and proposing two fee levels. However, EE does not support some of the other key aspects of the proposed Order including the fixed and other cost estimates which appear to significantly understate the costs to Qualifying ISPs of implementing their obligations under the Code.

First, EE agrees with Ofcom that it should estimate a single, reasonable and efficient notional Qualifying ISP's fixed costs to meet the obligations under the Code which include:

- issuing notification letters to online copyright infringers on the request of Copyright Owners (COs), and
- the preparation of Copyright infringement Lists (CILs) for COs.

However EE considers that Ofcom's precise methodology (which relies on a single ISP's relatively low cost estimate for determining the notional Qualifying ISPs fixed costs) is inappropriate given the wide range of fixed cost estimates and therefore uncertainty inherent in the estimates. Ofcom's flawed methodology understates the likely reasonable and efficient fixed costs. EE proposes an alternative and more appropriate approach of using the simple average of the available fixed cost estimates in the proposed Order.

Second, EE supports Ofcom's approach of setting two fee levels to meet key requirements of the Code. Smaller ISPs who must necessarily recover the estimated efficient operator's fixed costs from relatively few notifications (in proportion to their low market share) will receive the higher proposed fee per notification.¹ Larger ISPs recovering the same efficient operator's fixed cost can expect to do so from a significantly greater number of notifications (in proportion to their high market shares) and therefore receive the lower proposed fee.²

This approach ensures the fee structure does not unduly discriminate against smaller ISPs who would otherwise significantly under recover the efficient operator costs under an otherwise lower average uniform fee (in contrast to larger ISPs who would over recover costs). This approach also ensures that in aggregate COs contribute toward 75% of the relevant cost for the industry represented by the six Qualifying ISPs. Both are key requirements under the Code.

EE considers the two tier structure to be an essential feature of the proposed Order if it is not to unduly discriminate against smaller ISPs as well as ensuring the regulatory burden is proportionate. EE, under the Orange Home brand, is a small ISP providing fixed broadband services with a customer base of around 0.7 million subscribers in the UK. Orange Home represents an important alternative competitive offering to the larger fixed ISPs in the fixed broadband market (with all six Qualifying ISPs accounting for a total of 20 million subscribers).

Third, Ofcom understates some variable costs and other potential variable costs are excluded. EE provides some additional evidence on these variable costs. Furthermore, EE believes Ofcom understates some operational ratios including the proportion of Copyright Infringement Reports (CIRS) or letters that generates subsequent variable costs (eg calls to call centres).

EE's response in these three key areas is set out in more detail in response to Ofcom's specific consultation questions below.

¹ Qualifying ISPs in the small ISP group include EE and O2.

² Qualifying ISPs in the large ISP group include BT, BskyB, TalkTalk and Virgin.

Question 3.1: Do you have any comments on the principles set out above; do you consider there are other economic principles to which we should have regard in setting fees.

Ofcom's primary statutory duties under section 3 of the Communications Act 2003 are to further the interests of citizens in relation to communications matters and to further the interests of consumers in relevant markets, where appropriate by promoting competition. In carrying out this duty, it is required to have regard to certain matters, including:

- regulatory principles of transparency, accountability, proportionality and consistency and any other principles which Ofcom considers represents best regulatory practice; and
- the desirability of encouraging investment and innovation in relevant markets.

Ofcom's duty to set fees under the Costs Order will also be subject to its duty under section 4 of the Communications Act 2003 to act in accordance with the six Community requirements. These include the requirement to carry out its functions in a manner which, so far as practicable, does not favour one form of electronic communications network or service.

EE agrees that practicality and proportionality are key principles for setting fees and are reflective of Ofcom's duties. If the fee setting process is too complex it may undermine participation in the scheme and generate scope for disputes or legal challenge.

Economic efficiency is also relevant as it represents best regulatory practice and fees should therefore reflect efficient costs. EE notes that where there are fixed costs, it would not be allocatively efficient to set notification fees based on variable or marginal costs alone as suggested by Ofcom. It is more accurate to say that in the presence of fixed costs, distortions from pricing above marginal costs are minimised by recovering fixed costs through mark ups on top of incremental cost according to a reasonable method of allocation (ie a cost orientation approach). The proposal for recovering fixed costs by spreading these costs across the volume of notification letters across each Qualifying ISPs groups appears reasonable given some of the variable costs are also related to the volume of notification letters.

Question 4.1: Do you have any comments on the proposed process for establishing CIR estimates and costs; do you have evidence which would suggest that a different process should be adopted?

EE supports the iterative process proposed for (a) publishing illustrative fees, (b) seeking forecast volumes of CIRs (to be provided by COs), (c) Ofcom translating those volumes into the consequent fees and (d) allowing a period where COs will accept or reject the costs, whereby steps (b)-(d) are repeated if COs reject the costs in (d).

For the avoidance of doubt, EE notes the legal obligation to commence investing in relevant costs should only arise once the iterative process is complete and not from the initial provision of forecasts (ie once final volume forecasts are agreed).

Question 4.2: Do you have any comments on the proposed process or timetable for establishing the appeals body

EE disagrees with Ofcom that 9 months would provide adequate time in which to develop the systems required for EE to meet its obligations under the Code from the point at which final and agreed forecast volumes of CIRs are provided by COs. EE suggests 12 months to be more appropriate. For example, testing of the systems may highlight unforeseen problems given the obligation is novel with limited national or international experience of implementation. Another example includes the uncertain lead times for the development and agreement to the Publicly Available Specification (PAS) standards for ISPs and COs.

Question 4.3: Do you agree that Qualifying ISPs should have 9 months from the point at which estimates are finalised to prepare for the operation of the DEA scheme?

EE considers that 9 months should provide adequate time in which to develop the systems required for EE to meet its obligations under the Code from the point at which final and agreed forecast volumes of CIRs are provided by COs. However 12 months might be more prudent in the event testing of the systems

highlight unforeseen problems given the obligation is novel with limited national or international experience of implementation.

Question 4.4: In light of the evidence above, do you agree that the first notification period should start on March 1st 2014 and end on March 31 2015; do you have evidence which would suggest that a different date is feasible and preferable?

EE considers that the proposed start and end dates for the first notification are likely to be reasonable. However, we note that in response to question 4.3 there remains a risk of slippage in the event testing of systems highlights unforeseen problems. This may suggest building in an additional 3 months into the start and finish dates, and we would propose that the dates for the end of the first notification period, as defined in the Interpretation section (section 2) of the draft Order be amended accordingly.

Question 4.5: Do you agree with the proposed industry payment schedules for fees in respect of Initial and Qualifying Costs

EE supports the proposal for the notification fees in the first period to be paid on or before the first notification period from COs to Qualifying ISPs due to the large up-front costs that will be incurred by Qualifying ISPs. Such a proposal is essential to minimise the impact on cash flow within the business (which under Ofcom's proposed Order will initially generate a negative cash flow impact for the Orange Home profit and loss account of just over £1 million).

Question 5.1: Do you have any comments on the activities which we anticipate carrying out under the DEA amendments which will give rise to Qualifying Costs in the first notification period?

EE agrees the activities outlined by Ofcom giving rise to Qualifying costs appear reasonable.

Question 5.2: Do you agree with our proposed approach to the costs incurred by the appeals body during a notification period?

EE has no comment on the proposed costs.

Question 6.1: Do you agree that all initially Qualifying ISPs will face the same model of efficient costs in carrying out the Initial Obligations and hence should be treated as having the same Relevant Costs for the purpose of setting a Notification Fee? If not, please provide your reasons for that view.

EE strongly supports the approach that treats all Qualifying ISPs as having the same model of efficient costs. The evidence clearly shows that the fixed set up costs will not vary across a very broad range of possible volume of CIRs (ranging from 2,500 to 200,000 a month). EE also notes that the Code requires costs to be based on a notional efficient qualifying ISP, and hence the intention is clearly for there to be a single cost model applied for all Qualifying ISPs.

It is clear that efficient costs are not subject to economies of scale across the range of possible CIR volumes. To propose different cost models applying to different ISPs would therefore have the effect of distorting competition between small and large ISPs.

Question 6.2: Do you agree that we should apply the full automated cost model to all Qualifying ISPs for the full range of monthly activity from 2,500 to 200,000 CIRs per month? Do you have evidence that an alternative approach to costs should be adopted for any levels of CIR activity; and any evidence about what costs should be for those levels?

EE supports this approach for the full range on CIRs from 2,500 to 200,000 because the evidence indicates that the same costs of automation for compiling CIRs and sending notification letters is incurred across the range. It is also that case that CILs also need to be prepared which also requires a fully automated process. See also EEs response to Question 6.1.

Question 6.3: Do you agree that the Relevant Costs for the first notification period should include 100% of ISP relevant capital expenditure?

EE agrees these costs be fully recovered in the first year, to ensure impacts on all ISPs' and EE's cash flow are minimised. For instance, ISPs will need to build new systems and processes in order to automate the

processing of infringement reports, matching IP addresses to individuals and sending notifications. ISPs should be able to fully recover these capital costs in the first notification period.

EE considers the risks of COs not joining the scheme in the first notification period if such an arrangement is imposed is low given the value attached to copyright infringement by COs.

Question 6.4: Do you agree with our assessment of the fixed costs which will be reasonably and efficiently incurred by a Qualifying ISP in carrying out the Initial Obligations? Do you have evidence to suggest amounts attributed to these costs may be incorrect?

EE agrees with the in-principle approach to estimate relevant fixed costs based on a single reasonable and efficient costs, noting the Code clearly states that the notification fee be set with reference to costs which: "would reasonably and efficiently be incurred by a notional qualifying internet service provider".³

However, EE does not agree with Ofcom's methodology for applying this principle. Ofcom argues that a reasonable and efficient cost is best reflected in the lowest cost estimate provided by ISPs. ISP1 had the lowest fixed cost estimate (£1.09 million, pre inflation) but this estimate was deemed not to include all reasonable costs by Ofcom (as there was no provision for quality assurance checks) and hence was rejected. Ofcom therefore chose the second lowest cost estimate provided by ISP2 (ie £1.32m uplifted to £1.4 million for inflation). This estimate which was deemed to have factored in all relevant cost categories, along with all remaining higher ISP estimates.

EE's concern with this approach is that there is a wide range and dispersion of fixed costs between ISP2 and ISP5 (ie from £1.32 million up to £2.02 million, on a pre inflation basis). EE argues that given this wide range and the distribution of estimates within this range, a better approach is to take the simple average (ie mean) of the estimated fixed costs from ISP2, ISP3, ISP4 and ISP5. EE argues this approach better reflects the requirements of the Code in light of this uncertainty and wide range of possible cost. Relying solely on the cost estimate of ISP2 risks underestimating efficient and reasonable costs.

For these reasons EE considers that the proposed fixed capital expenditure and fixed operating expenditure costs to be recovered through the notification fee under the Initial Obligations should be £1.68 million with an additional adjustment (ie indexation) for inflation, based on the currently available evidence.

Other potential fixed operating costs

There may also be annual costs of auditing of ISP compliance with the PAS standards. It is unclear whether these costs have been factored into the fixed operating costs (see EE's response to Question 4.3).

There may be further costs of providing information to Ofcom, e.g., the Technical Measures report. It is not clear whether this is a separate cost that can be recovered under the Order or whether ISPs have to absorb this as though part of normal Communications Act and/or Ofcom compliance.

Question 6.5: Do you agree the proposal that we set two notification fees, one for O2 and Everything Everywhere and the other for the larger Qualifying ISPs?

EE strongly supports this proposal for setting two notification fees. This approach ensures the fee structure does not unduly discriminate against smaller ISPs who would otherwise significant under-recover the efficient operator costs under a lower uniform fee (in contrast to larger ISPs who would over recover costs). This approach also ensures that in aggregate COs contribute toward 75% of the relevant cost for the industry represented by the six Qualifying ISPs.

Ofcom considers that there is broad correlation between the number of subscribers an ISP has and the level of alleged copyright infringement activity on their service. On this basis the largest ISP may receive around 10 times more reports per month than the smallest ISPs who Ofcom intends to include in the scope of the regulations for the first period.

³ Article 2 of the Costs Order.

It would be perverse if the system penalised those ISPs which have low volumes of reported copyright infringement over their networks and rewards those ISPs with higher volumes - the opposite effect of what this legislation is intended to achieve.

Question 7.1: Do you agree with the proposals for the ISP cost items to be counted as part of the Relevant Costs; do you have evidence to support alternative approaches?

EE notes there may also be variable costs arising from the confusion and difficulties in the definitions of "subscriber" and "communications provider". For example, the Code may encourage customers to act as communications providers, by providing broadband or wifi to many users. The customer could, for example, present themselves as offering a wifi café service (eg where an internet access code is given out) and therefore argue they are not responsible for the viewing of content that infringes online copyright law through its own IP address.

At the most recent DEA Implementation meeting Ofcom made it clear that ISPs would need to implement a process for investigating claims by customers that they are communications providers and not subscribers and therefore should not receive notifications. However it was recognised that this is a grey area as many of these establishments such as libraries, bed and breakfast establishments and hotels may be both subscriber and communications provider.

The way in which such issues are dealt with in practice is likely to lead to greater costs and inbound calls than Ofcom appears to be assuming.

There may also be appeals related call centre costs with potentially allegations of incorrect IP address matching by those claiming not to be "subscribers". Even where we have matched records accurately, we may face costs from additional calls to call centres where customers refuse to accept the CIR findings or have queries about the appeals process.

Question 7.2: Do you agree our proposals in relation to the activities which give rise to variable Relevant Costs and the proposed values of those relevant cost items? Please provide reasons and evidence to support any different assessment of the variable cost element of Relevant Costs and/or alternative values?

EE disagrees with the proposed average costs of sending a first class letter. For Orange Home, the cost is [confidential] per letter.

Question 7.3: Do you with agree the proposed values for the operational ratios? Can you provide evidence to support alternative values?

EE does not agree with the operational ratios for:

- the proportion of CIRS producing a letter and
- the proportion of letters resulting in contact with call centres (both call enquires and complaints).

First, COs have indicated that they intend to request notification letters be sent in all cases where a CIR is generated (see paragraphs 7.57). This would suggest a higher operational ratio than 45% (possibly closer to 60%).

Second, given the nature of the notification letters, i.e., to warn consumers they are potentially in breach of copyright infringement laws, the likelihood of call centre contacts per letter is likely to be much higher than suggested in the proposed operational ratio of 15% for call enquires and 0.4% for call complaints.

EE notes that initially calls of an enquiry nature are likely to be significantly above 15% per letter notification given:

- many subscribers will have privacy concerns and believe that their internet usage has been monitored
- in some cases they will be unaware their internet account is being used to infringe copyright law (or at least unaware that there may be serious consequences of doing so)
- we expect there to be a significant lobby who are opposed to this enforcement action and believe this enforcement action is censoring the internet. This reaction can be seen in the media coverage surrounding any proposals on blocking or moderation of websites. When the 6 largest ISPs recently

blocked the PirateBay website in response to the BPI Court Order most were subject to denial of service attacks.

- many customers will wish to verify their reported infringement, including for example, what they were viewing, when and for how long, as well as to understand how their usage is monitored by the ISP generally.

This will generate significantly more calls than estimated by Ofcom.

EE notes that complaint levels to call centres have previously increased materially in response to communication of modest RPI increases to mobile subscription prices to the customer by text. Notification letters which warn of serious legal consequences in the event that their internet usage does not change are very different in nature to texts informing customers of RPI increases and are likely to result in significant increases in complaints. This is especially likely where individuals were not aware that their actions constituted online copyright infringement or even simply where they have an in principle objection to the law which may be viewed as censoring content on the internet. Moreover, call centre costs are driven not simply by the incidence of call complaints but also by the longer duration of such calls. Complaints tend to result in longer calls to customer support representatives and in some cases escalation to supervisors. These factors do not appear adequately reflected in Ofcom's proposed operational ratio.

EE notes that the distinction between a call enquiry and a call complaint has not been clarified by Ofcom. Whilst there is an artificial separation proposed by Ofcom, in practice there is a considerable grey area. EE seeks further clarification on how these two groups are distinguished going forward as this may have implications for operational ratios and call centre costs.