



**Online Infringement of Copyright:  
Implementation of the Online Infringement of  
Copyright (Initial Obligations) (Sharing of Costs)  
Order 2012**

**Ofcom Consultation published on 26 June 2012**

**BT response  
21<sup>st</sup> September 2012**

## **Executive Summary**

BT welcomes the opportunity to respond to the second of Ofcom's consultations – Sharing of Costs Order 2012 – on the Digital Economy Act 2010.

Our focus in responding to the Cost Code is to ensure that an appropriate cost recovery framework is clearly defined for ISPs. The framework needs to provide the opportunity for efficient cost recovery by ISPs. However, as we set out in this response, our recent, and more detailed internal modelling suggests that Ofcom's initial view of "efficient" costs – based on analysis conducted by BWCS reflecting data gathered from ISPs in 2010 – are materially lower than the efficient costs we expect to face in meeting our obligations. As such, if tariffs were set in line with the initial proposals put forward in this consultation, BT would face a significant risk of under-recovery.

Ofcom therefore needs to take full account of the evidence put forward in this response about our expected level of efficient costs and understand why these are higher than the levels set out in the consultation. We recognise that there will be uncertainty about the precise level of the costs of establishing and operating entirely new processes, particularly in relation to the level of operational activity required in processing CIRs and dealing with issues raised by customers. However, we believe that Ofcom's current view of the key "operational ratios" would significantly understate reality. Ofcom should establish the framework for setting year one fees to more plausible assumptions on these ratios and in a way that explicitly allows for the risk that incurred costs would be under-recovered in the first year of operation. In particular, Ofcom should allow for any under-recovered costs resulting from higher levels of operational activity to be recovered in the second year of operation.

As a point of principle, we agree that Ofcom has to have regard to economic efficiency when setting fees to ensure the correct pricing signals are sent to both Copyright Owners (COs) and ISPs. In this context, as well as our concerns about the assumed level of "efficient" costs, we are also concerned that Ofcom seems to consider that the Costs Order would – if approved in current form – place a fairly rigid constraint on how ISPs' costs would be recovered from COs. Ofcom's approach is based on allowing only 75% of "efficient" costs to be recovered.

In fact, the draft Costs Order simply requires that Ofcom "shall have regard to the desirability of..." setting fees to recover 75% of costs. We therefore believe that further consideration of the impact of only recovering 75% of costs is required by Ofcom before the framework is established. This issue certainly should not be presented as a point of economic principle.

### **Key points regarding the cost assumptions**

BT's latest costs remain materially apart from Ofcom's absolute levels of costs and assumptions used to derive these. Specifically, we have concerns regarding Ofcom's assumed:

#### **1. Costs of helpdesk per CIR received**

Ofcom's assumption that only 15% of notifications will generate helpdesk calls is far too low. Ofcom needs to take into account comparable market evidence such as the New Zealand experience (~66%) and other examples such as debt and fraud management that suggest a much higher propensity to call.

#### **2. Costs of complaints**

Again, Ofcom's assumption that 0.4% of notifications will lead to a complaint to ISPs is unreasonably low especially during the first year of the scheme. Given the nature of the DEA – subscribers being alleged of infringement – we also expect direct complaints / escalations to Senior Management and the need for a specialist second line support function. Ofcom needs to review this.

**3. Ongoing fixed (and semi fixed) costs of processing CIRs**

Ofcom does not explicitly acknowledge that ongoing fixed and semi-fixed costs will be incurred after the first year of operation. While this can be reflected in setting charges in subsequent years, Ofcom should clearly indicate that it will allow such ongoing costs to be recovered.

**4. One-off capital investment costs**

BT's upfront capital costs largely reflect the need to include a number of products across the Group – BT Consumer, BT Business, BT Global Services and Plusnet. This cost of product inclusion and integration of the various products needs to be properly accounted for and is the most efficient approach for BT.

**Key points on process and definition**

BT remains concerned that a number of important process definition and enforcement issues remain outstanding. Some of these points were made in our response to the Initial Obligations Code (IOC) and are reiterated here for completeness. In addition, a number of general points not covered by Ofcom's specific questions are also made in section 2.

Some of these concerns are outlined below. BT would like Ofcom to consider these and the other points made in section 2 in a more detailed and objective way to ensure the DEA works both commercially and technically as intended for ISPs, COs and Subscribers – we expand on these points in the main body of this response:

**1. Enforcement of CIR estimates and non-payment of notification fees**

Ofcom is asked to ensure that CIR estimates provided by COs become a commitment by way of regulation and code powers. We also ask Ofcom to clarify that non-payment of notification fees by COs constitutes a breach of the code.

**2. Identification of CPs and ISPs**

BT made the point in its response to Ofcom's IOC consultation that determining who is and who is not an ISP is not straightforward, particularly for smaller business customers. Ofcom must define which legal entities and types of evidence would define non-qualifying ISPs to prevent BT and other qualifying ISPs breaching the code by sending notifications incorrectly.

**3. Appeals and associated costs for ISPs**

BT would like Ofcom to clarify exactly what would be required of ISPs regarding the provision of data and timescales, and how any consequential incremental costs would be recovered.

This response is structured in three sections:

1. Responses to Ofcom's questions
2. Key points not covered by Ofcom's questions
3. **Confidential Annex A** – BT's costs compared with Ofcom's proposed costs

## 1.0 Responses to Ofcom's specific questions

### Introductory comments

In Section 2 of the consultation paper, Ofcom summarises the legislative framework within which it is conducting this consultation. This highlights the fact that there are three key areas where implementation of the framework is still to be finalised:

- Ofcom needs to issue a code detailing how the Initial Obligations under the Digital Economy Act (DEA) will be implemented (the **Initial Obligations Code or IOC**). Ofcom has consulted on proposals for the Code and is considering responses to that consultation, including comments made BT.
- The Secretary of State needs to issue a **Costs Order** specifying how costs incurred by Ofcom, industry and the appeals body in implementing the requirements of the Code should be shared among industry participants. A draft of the Costs Order has been laid before Parliament and, if approved, will provide Ofcom with the duty of setting fees. The draft Order is included as Annex 5 to the Cost Sharing Order consultation.
- Following on from the above, Ofcom needs to issue a **Cost Sharing Order** in which it will decide how to set fees. This is the subject of the consultation to which this submission responds.

As noted by Ofcom, it is in many ways unusual to be conducting a consultation on the setting of fees ahead of the finalisation of legislation which would provide Ofcom with the duty to set such fees. However, the complexity of the exercise and the need to consult fully with all affected stakeholders makes it sensible to avoid delay by conducting the consultation now in anticipation of the legislative duty being established. It will be vital, however, to take full account of how changes to either the proposed version of the IOC or to the current Costs Order before finalising the Costs Sharing Order.

Overall, a number of practical issues of implementation will only be confirmed following further industry dialogue and Ofcom engagement and this should ultimately shape the costs that Ofcom assesses when issuing any Cost Sharing Order.

**Question 3.1: Do you have any comments on the principles set out above [i.e. paragraphs 3.7 to 3.12]; do you consider there are other economic principles to which we should have regard in setting fees?**

In paragraphs 3.7 to 3.12 of the consultation, Ofcom sets out the economic principles it believes it needs to adhere to in setting fees. Ofcom positions these in the context of the legal framework setting out its duties within the draft Costs Order. It is helpful to establish such principles up front in a consultation of this nature before delving into the specific details of costs and alternative approaches for recovering such costs via fees.

Ofcom is right to have regard to considerations of **practicability and proportionality** when setting fees. It is no-one's interests to have an unduly complex fee structure in place. However, such aims should not be at the cost of leaving an inappropriate level of risk with ISPs facing the task of investing in new systems and processes before COs have actually paid any fees. As such, practicability and proportionality should be assessed in the context of overall **economic efficiency**: we should seek to set the simplest fee structure that delivers maximum economic efficiency and this requires that COs deriving benefit from the processes contribute fairly to the costs ISPs will

face in introducing and operating these processes. Ofcom appears to accept the need to strike this balance by highlighting the significance of productive and allocative efficiency considerations alongside the need for practicability and proportionality.

Economic efficiency requires that prices send the right signals to both COs and ISPs in terms of (i) minimising the costs of processing CIRs (productive efficiency); and (ii) ensuring that CIRs are only processed where COs consider that the benefits exceed the costs (allocative efficiency).

However, in this context, we are concerned that that Ofcom seems to consider that the Costs Order would – if approved in current form – place a fairly rigid constraint on how ISPs' costs would be recovered from COs by establishing that only 75% of total efficient ISP costs can be recovered. The draft Costs Order simply requires that Ofcom “shall have regard to the desirability of...” setting fees to recover 75% of costs. We therefore believe that further consideration of the impact of only recovering 75% of costs is required before fees are implemented in this way. This issue certainly should not be presented as a point of economic principle.

In fact, allocative efficiency considerations will be undermined if fees are set to recover anything less than 100% of the costs an efficient ISP is expected to incur. In this case, a CO would be incentivised to submit CIRs even where the expected benefits to the CO are beneath the expected (efficient) costs the ISP would incur in processing the CIRs. It is not clear that productive efficiency considerations – or even dynamic efficiency considerations which are not explicitly assessed in the condoc - justify recovery of less than 100% of efficient costs as some balance to the impact on allocative efficiency.

We are then also concerned by the approach which Ofcom proposes to take in establishing “efficient costs” for ISPs. In theory, setting a standard set of fees for processing CIRs based on expected costs to be incurred by an “efficient ISP” could meet the static efficiency considerations. As such, any individual ISP could receive fees that either under or over-recover incurred costs reflecting whether they are relatively more or less efficient than the implicit “efficient ISP”.

Ofcom may believe that such risks/opportunities would drive ISPs to maximise their efficiency beyond the levels forecast when setting fees in order to gain the “reward” of potential over-recovery – i.e. by being more efficient than the “efficient ISP”. However, the key issue here is to ensure that any standardised view of “efficient costs” does not either significantly understate the level of costs that efficient ISPs will face and/or miss any structural/operational differences between ISPs that may impact on their specific costs of processing CIRs. If the fees are set by reference to a view of “efficient costs” that an efficiently operated individual ISP cannot reasonably be expected to achieve, then allocative efficiency will not be achieved in respect of sending CIRs to that ISP.

We note that the draft Costs Order refers to Relevant Costs being those costs “which would be reasonably and efficiently incurred by a notional qualifying ISP”. Ofcom's general approach therefore seeks to take a view on the “efficient” costs of implementing and operating the necessary systems and processes taking account of costs that each of the Qualifying ISPs expects to incur. These estimates of costs were gathered in 2010. As well as the risk that such estimates are out of date given the further clarification on what is required that is now available (see our comment on the need to process CIRs for all business divisions), economic efficiency

considerations require Ofcom to have a deeper understanding of why costs may objectively differ between ISPs. The overall approach taken seems to effectively rely on an implicit assumption that each ISP could be as efficient as the assumed level of costs in meeting its requirements. At the very least that requires Ofcom to understand why some ISPs are suggesting their costs will be higher than the apparently “efficient” levels proposed by Ofcom.

This simply confirms the need to ensure that Ofcom has a detailed understanding of the costs that will be incurred by ISPs when processing CIRs so that any objective differences (e.g. the fact that some Qualifying ISPs may have to process CIRs across different subsidiary companies with different systems) can be recognised. Elsewhere in this response and in Annex A, we set out our detail of the costs we believe we will efficiently incur in processing CIRs and highlight the significant risk that we will under-recover our incurred costs. The costs we set out at Annex A should therefore be assessed in detail by Ofcom in reaching its final decision. To adopt lower costs without clear objective justification for believing them to be inefficient presents obvious risks to BT in terms of cost recovery and would significantly more fees away from the economic efficient level.

We of course recognise that there will be uncertainty about the precise level of the costs of establishing and operating entirely new processes, particularly in relation to the level of operational activity required in processing CIRs and dealing with issues raised by customers. However, we believe that Ofcom’s current view of the key “operational ratios” would significantly understate reality. This is highlighted in Annex A where we set out our views.

Our overall view is that Ofcom should:

- (i) set year one fees by reference to more plausible assumptions around operational ratios and efficient costs that ISPs are expected to incur;
- (ii) establish the framework in way that explicitly allows for the risk that incurred costs could be under-recovered in the first year of operation due to higher levels of operational activity than anticipated, by allowing for such unrecovered costs to be recovered in the second year of operation; and
- (iii) ensure initial assumptions about operational activity are updated at the earliest opportunity to reflect experience.

As well as the above issues which could be seen as driving the level of costs, we are also concerned that the Costs Order will be seen as placing rigid constraints of how the structure of fees is set – e.g. the Costs Order establishes that fees are to be set on a per-CIR basis driven by CO estimates. But such a structure could, again, undermine achievement of economically efficient charges. The potential lag in time between the volume estimates being made (which triggers the need for ISPs to begin investments) and COs paying in advance means that ISPs may face risk exposure in that costs are incurred but not actually recovered. We agree that set-up costs need to be recovered quickly from COs committing the sending CIRs. However, further practical safeguards – e.g. clear contractual requirements linked to estimates – need to be in place to minimise such risk.

Linked to this, we are also concerned about incentives to ‘game’ processes here and ‘free-ride’ on established processes either by leaving costs for ISPs to recover or placing burden on smaller group of COs committing to the scheme in the first notification period. The introduction of these processes must be expected to have a ‘dynamic’ impact on the volume of infringements – and therefore CIRs that will be generated – over time. That is, the ultimate aim of the processes being put in place

must be to ensure that infringements are avoided moving forward rather than to simply enforce copyright breaches. The benefit of establishing processes may therefore be felt more broadly than those COs actually using the processes. So long as ISPs recover set-up fees early, they may be viewed as broadly indifferent to certain COs seeking to avoid contribution to set-up fees by, for instance, delaying commitment until year 2. However, we are concerned about the potential impact on incentives to game any perceived gaps in the process. COs could, for instance, seek to ensure ISPs commit to establishing systems and incur set-up fees by submitting high levels of initial volume estimates without then subsequently contractually committing to any year 1 spend. Processes should be resilient to such incentives.

**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?**

We set out in answer to question 3 our concerns that ISPs could face risk exposure by incurring costs of establishing systems capable of processing CIRs before contractually binding commitments to process such CIRs have been made. The processes for establishing CIR volumes estimates – which will derive ISP cost estimates - must therefore guard against incentives to game the system or otherwise overstate volumes in the short run. Our reading of the proposals is that Ofcom is alive to the need to prevent an outcome where volumes do not materialise. Reference is made to the fact that COs will be required to submit estimates under the IOC which will then bring financially binding commitments with regards to payments. The proposals are therefore – in our view – absolutely contingent on the IOC clearly establishing a process whereby such failure to pay can result in refusal to process CIRs.

It is also unclear how the initial “iterative” round of estimates/fees fits within the timeframes envisaged by Ofcom. The iterative estimates would not, we presume, be financially binding until the “final round” but under Ofcom’s timeframe, this final round would need to be reached by February 2013 in order that ISP investments can be made such that systems are operational by the 1 March 2014. We comment on other aspects of the timetable below, but the iterative stage of setting fees and agreeing volume commitments seems particularly ambitious. We therefore require clarity that no investment will be required until the iterative stage has been completed. Delays could then have knock on impacts on the timelines overall.

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

BT remains concerned about the lack of detail from Ofcom regarding the operation of the appeals process and any specific requirements for ISPs. We would like to understand what will be expected from ISPs above and beyond the generic DEA process and how any consequential costs, if any, will be recovered. BT feels strongly that it would be inappropriate to require ISPs to develop a database system to a higher standard than for e.g. criminal proceedings, to support the appeals process. We would ask Ofcom to commence engagement with the ISPs to agree/develop best practice at the earliest opportunity.

**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?**

For BT's Consumer broadband product, BT believes that developing a system through the stages of requirements analysis, specification, design and build, and testing will take at least 9 months to achieve. This would then be followed by a period of extensive trialling, estimated to take between 3 months and 6 months (in the event that fixes and retesting is required from the first 3 months of trialling). This approach is required to provide a high level of confidence in the end to end delivery to ensure BT successfully launches the DEA scheme.

BT's system developments operate on quarterly release cycles and means that requirements need to be specified by certain milestone dates throughout the year in order to meet defined delivery dates. As a result BT's development cycle may not follow '9 calendar' months from the point at which CIR estimates are finalised to operation of the scheme. As an example, if the DEA is proposed to commence on 1<sup>st</sup> March 2014, BT must have all the key data such as committed CIRs from COs and clear process definition for all transactions by 1<sup>st</sup> March 2013. Any delay in obtaining these critical dependencies will require BT to reassess the timings outlined above.

It should be noted, that the above timescales apply to launching DEA for BT's Consumer broadband product. The most economic and technically efficient method of including BT Business, Global Services and Plusnet products is to integrate these with the BT Consumer solution. Our current estimate is that this will require at least a further 3 months to the timescales outlined above.

**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?**

Our position here follows from our response to question 4.1. The contingencies in the proposed timeframe flow from (i) the timely conclusion of the iterative volume/fee setting stage and (ii) the implementation timeframe for making systems operational following initial investments. As noted, delays in concluding the iterative process will inevitably need to be reflected in delays to implementing a new system.

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

The gap between ISPs incurring investment costs and COs paying year 1 fees could be as long as one year if investment begins following conclusion of the "final round" of the iterative process for submitting estimates in February 2013. It is therefore important that ISPs have the contractual/ legal security that financial commitments will be met before the start of the initial period.

**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?**

We do not have any detailed comments on these activities beyond broadly noting that they seem appropriate and that it is important that – given general administrative fees already paid by ISPs such as BT to Ofcom – COs make an appropriate contribution to additional costs Ofcom will face in implementing the DEA.

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

We have no detailed comments on this issue.

**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.**

We set out in **Annex A** our view on the costs we expect to incur in meeting our obligations under the DEA. These show a significant gap between Ofcom's view of "efficient costs" and our view of the efficient costs we will face. Commentary is provided to explain why the gap is so significant.

We are not in a position to comment in detail on the costs of other ISPs, but would note that there may be a number of objective reasons why costs could differ significantly across ISPs. In particular, we would highlight the extent to which our costs of implementing systems and processes are driven not just by the overall volume of CIRs we expect to process but by the need to ensure we can process CIRs in relation to all customers across distinct parts of BT's corporate business, including BT Retail customers, Plusnet customers and Global Services customers. In Annex A we specifically note that our submission on costs to Ofcom in 2010 only related to BT Retail customers and that additional costs were needed to cover Plusnet and GS customers. Separate systems need to be developed to ensure we have the capability to interrogate the records for customers of the different parts of the BT group of companies. Any assumptions about 'fixed' costs for single systems spread across all CIRs (regardless of part of business) will understate the costs faced. This may suggest, more broadly, that Qualifying ISPs may face different model of their costs. It certainly suggests that Ofcom's "efficient operator" costs are significantly misaligned with the costs we will incur.

Ofcom must understand the detail of these differences and base fees on ensuring that ISPs such as BT can recover the efficiently incurred costs they are reasonably expected to face. To do otherwise, implies that Ofcom believes any costs above those driven from "industry averages" are inherently 'inefficiently incurred'. We do not believe the evidence supports such an implication.

**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?**

Based on BT's experience of managing abuse enquiries which involves the receipt of an IP address, port and timestamp and requires look up of a customer account, we believe an automated solution would be required to manage CIRs greater than a few hundred per month. In excess of this number of CIRs, the costs associated with a manual solution would soon outweigh the cost of developing and implementing an automated solution. Therefore we agree that it would be necessary to apply the full automated cost model for the full range of monthly activity from 2,500 to 200,000 CIRs per month.

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

Yes. As outlined above, ISPs must not be left with risk exposure by incurring significant investment costs upfront which then fail to be recovered from CIR volumes

over time. This requires financially binding commitments upfront and the recovery of all costs from that initial commitment.

**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?**

We set out our views on the fixed costs which we expect to incur in meeting our obligations in Annex A.

**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?**

We have no objection to having higher notification fees for ISPs with lower volumes, but Ofcom needs to consider further whether other objective differences exist between ISPs which will drive different levels of “per-CIR” costs. We can only comment in detail on our own view of costs and this is set out at Annex A.

**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?**

We set out the detail of the costs we expect to incur in **Annex A** and compare these to the cost items specified by Ofcom. With a couple of key exceptions, our concerns are not with the identification of particular Relevant Costs but with the assessment of the value of costs to be incurred. We explain the key differences between Ofcom and BT’s views in Annex A.

However, we do challenge Ofcom’s view that costs of “save” activity and “churn” should be excluded from the definition of “Relevant Costs”. We accept that the Schedule to the draft Costs Order, at Section 1(5), refers to the requirement that Relevant Costs exclude “costs of economic opportunities lost as a result of compliance” with the DEA requirements. However, we would draw a clear distinction between (1) the economic opportunity costs that could arise if resource used to comply with the DEA requirements was diverted away from potentially revenue generating capital and operational expenditure and (2) the loss of future revenue streams that is expected to result from customers deciding to leave BT as a result of BT’s activities in complying with the DEA statement. Ofcom should only seek to exclude the former.

To be clear, we would only seek to include the costs of save activity and the cost of customer churn to the extent that these were the result of BT operating the requirements of the DEA (processing CIRs and communicating with customers as required by the IOC) in an efficient and effective way. The risk that BT customers perceive a “bad” customer experience as a result of BT taking the required action should not result in additional costs for BT unless that customer experience can be linked to failures on BT’s part in processing CIRs. As things stand, Ofcom is seeking to exclude any costs associated with save or churn activity.

**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?**

We set out the detail of the costs we expect to incur at Annex A. We explain the key differences between Ofcom's assumptions (based on the BWCS report) and our view of costs. Again, Ofcom must give weight to the evidence put forward by BT and not simply rely on evidence based on information gathered back in 2010.

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

We set out the detail of our view of the operational ratios we would expect to face at Annex A. In each case, we have attempted to take as objective a view on the ratios we would expect to see based on our experiences in the UK when engaging with customers on issues such as fraud and on relevant experiences outside the UK. In reach case, we believe that Ofcom risks understating the level of operational activity that BT will undertake and therefore the costs it will incur. By basing the fees on such assumptions there is a significant risk that BT will fail to recover its efficiently incurred costs. Ofcom should therefore revisit its assumptions before generating Tariff Tables.

## 2.0 Additional key points not covered by Ofcom's specific questions

### 1. Enforcement of CIR estimates and non-payment of notification fees

We seek clarity that:

- Qualifying COs are legally bound to pay ISPs for agreed CIR estimates
- Ofcom will develop appropriate regulation and code powers to take enforcement action against COs as a matter of priority in any case of non-payment / withholding of payment to ISPs
- ISPs are not obliged to take any action in respect of any CIRs submitted to them prior to receiving full payment from qualifying copyright owners.

Both of Ofcom's latest consultation documents do not provide the degree of clarity and certainty required on these issues for the reasons outlined below. Given that the initial obligations on ISPs are statutory obligations, we are concerned that there is no clear protection enabling ISPs to obtain payment from COs for such activities:

- a. The Schedule to the Costs Order would oblige qualifying COs to pay the total amount of notification fees for the estimates of CIRs which it has given to the ISP for that notification period. ISPs would therefore have the right to receive the notification fees before they were under any obligation to process CIRs, including matching IP addresses, sending notifications to subscribers and providing CILs.

However, Ofcom's changes to the Initial Obligations Code (IOC) are inconsistent with this requirement in the Costs Order. In the IOC, Ofcom has provided that qualifying COs can send CIRs to ISPs even if notification fees have only been partially paid, or not paid at all. This is reflected in the IOC itself – the only conditions which have to be met before CIRs can be sent to ISPs are that qualifying COs have provided estimates of CIRs to that ISP and that their evidence gathering gives reasonable grounds that an infringement of copyright has taken place. Three issues arise here which need to be addressed:

- i. The Code should provide that the estimated number of CIRs that the ISP relies on when building a system to process them would be legally binding on the qualifying CO meaning that they would have to pay the notification fees for their estimate in full;
- ii. If an ISP receives CIRs without the corresponding notification fees and therefore without any obligation to process them, they should equally be entitled to the fees; and
- iii. There is a clear route to enable ISPs to obtain payment from the qualifying copyright owner on receipt of an estimate of CIRs as systems will be built to process the volume of CIRs agreed with the ISP.

We therefore repeat the request made in our response to the IOC that the ability to send CIRs, in the event that notification fees have not been paid, serves no useful purpose and creates uncertainty about ISPs' rights and obligations in this respect.

- b. The Costs Order provides that Ofcom and the appeals body can recover any sums owing to them by qualifying copyright owners as a civil debt. No specific provision is made in the Costs Order (or the IOC) for ISPs to recover notification fees due to them irrespective of whether any CIRs are sent or not.

Our understanding is that the agreed estimate of CIRs given by a qualifying CO to an ISP should be a legally binding commitment to pay those notification fees in full, but we cannot see a legal mechanism in the Costs Order or the IOC which would provide for this. We ask Ofcom to clarify if there is such a mechanism and how it would operate and if there is not to introduce such a mechanism. We also request Ofcom to confirm that ISPs are not to be precluded from applying commercial terms to the invoicing process on receipt of estimates from COs.

- c. The only provision dealing with enforcement of the IOC is contained in section 40. This is a general provision granting Ofcom the power to take enforcement action in the event of breach of the Code. There is, however, no *specific* requirement on Ofcom to take enforcement action against copyright owners in the event of non-payment of notification fees. At a minimum, we need the Costs Order and / or the IOC to provide that Ofcom can do this promptly. Since it is not clear that ISPs could take direct enforcement action against a non-paying copyright owner, they would be reliant on Ofcom to do so without Ofcom's confirmation that ISPs can treat the provision of systems which can match subscriber details to CIRs provided by COs as a commercial matter.

## **2. Identification of CPs and ISPs**

In its response to Ofcom's IOC consultation (June 2012), BT made the point that determining who is and who is not an ISP is fraught with difficulty, especially for SMEs and other business customers where their use is not obvious to BT. The procedure of identifying non-qualifying subscribers remains a concern for BT who would be in breach of the code if a notification was sent in error to these subscribers. A consistent and definitive approach should be developed by Ofcom to prevent ISPs sending notifications incorrectly, i.e. defining which legal entities and types of evidence would define non-qualifying subscribers. Ofcom has a clear role to play here as well as ensuring that this legitimate head of cost is fully recovered by ISPs. Failure to achieve a consistent approach / standard by all the qualifying ISPs can only lead to these ISPs potentially breaching the code where notifications have not been sent as the conditions in clause 18 have not been satisfied to a standard which we are currently not aware of, and having appeals raised against them by COs. It must be clear in the Code that a qualifying ISP will not be liable in the event of an appeal by a fixed subscriber who has received a notification when that subscriber claims to be an ISP or communications provider, when that ISP has acted in good faith in sending a notification. The obligation in the Code is to send notifications as the word 'must' is used, and this is the starting point for a qualifying ISP. A recipient may be able to appeal the notification, but the ISP should not have any financial liability if the appeals body determines in favour of the recipient of the notification.

## **3. Aggregation of COs**

It is likely that some COs will chose to use collective rights agencies to act on their behalf in sending CIRs to ISPs. Currently the Codes are silent on the role of these agencies and in particular in relation to requesting and receiving CILs. The IOC itself provides that 'a copyright owner can request an ISP to provide them with relevant parts of those records on request, but in an anonymised form to comply with data protection legislation'.

As Ofcom has called out data protection legislation in this context, ISPs need to know if CILs can be returned to collective rights agencies on behalf of COs under the normal laws of agency.

#### **4. Shortfall of CIRs**

The Costs Order provides for COs to carry forward unused CIR volumes into the next notification period. As the variable (and semi-fixed costs) for the new notification period could be different to the previous period, ISPs could face a risk of not recovering their entitled costs in one or both notification periods for CIRs carried forward. Ofcom must explain and clarify their approach here to ensure ISPs are not disadvantaged.

#### **5. Proportion of CIRs failing to result in a match**

Para 7.20 states that Ofcom expects circa 10% of CIRs will fail to result in a match, and the cost of CIRs will be set to reflect this. BT would like to understand Ofcom's derivation of the 10% level. BT is concerned that ISPs could be unduly penalised for breaching the code especially in the event that failure to match CIRs is due to legitimate network conditions and / or quality of CIRs from COs. BT would welcome greater clarity regarding Ofcom's workings and that ISPs will not be penalised for legitimate failure on its or the COs part.

#### **6. ISPs compliance costs**

Ofcom's revision of CIRs to be checked by ISPs has been reduced from their 2010 estimate of 2% of CIRs received to 0.02% in the Cost Order. It is unclear what compliance activities Ofcom expects ISPs to undertake, and why they have reduced the volumes and hence cost allocation by such a material level.

#### **7. Appeals**

Para 3.41 of the Costs Order states that all ongoing appeals body costs should be recovered through the case fee and subscriber appeal fee, and none through the Qualifying Costs charges applied to Copyright Owners. The specific role for ISPs to support the appeals procedure and any consequential direct costs arising are very unclear at this stage. BT would like to understand upfront to assist with its solution development and budget planning exactly what, if any, incremental process and database requirements are to support the appeals procedure.

#### **8. Gaming**

BT remains concerned that Ofcom has made no provision in the IOC or otherwise to prevent COs specifically targeting certain ISPs. This would lead to disproportionately higher CIRs being sent to targeted ISPs who would therefore incur higher non-recoverable costs and also face the potential risk of higher churn. There is also no provision to cover the scenario when COs decline to participate in the first notification period to avoid higher notification fees to recover ISPs fixed costs, but then join in the second notification period.

#### **9. Sunsetting of systems**

The Costs Order makes no provision for technology refresh. As systems require updating due to new and more efficient technology and / or accounting practices adopted, consideration must be made by Ofcom through regulation and the costs code to enable ISPs to obtain cost recovery when they update their systems, and when this might be expected of ISPs.

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