Ukie response to Ofcom consultation on Online Infringement of Copyright: Implementation of the Online Infringement of Copyright (Initial Obligations) (Sharing of Costs) Order 2012

Executive Summary

The Association for UK Interactive Entertainment (Ukie) is the trade association that represents a wide range of businesses and organisations involved in the games and interactive entertainment industry in the UK.

Ukie exists to make the UK the best place in the world to develop and publish games and interactive entertainment. Ukie's membership includes games publishers, developers and the academic institutions that support the industry. We represent the majority of the UK video games industry; in 2011 Ukie members were responsible for 97% of the games sold as physical products in the UK and Ukie is the only trade body in the UK to represent all the major console manufacturers (Nintendo, Microsoft and Sony).

As the trade association for the UK games and interactive entertainment industry, Ukie will respond to this consultation in terms of how the proposed processes and costs are perceived by our members.

We continue to support the policy intention behind the Initial Obligations Code introduced by the Digital Economy Act. Using notices to educate consumers about the realities of piracy and help them to find legal content, with court action as a final backstop only when necessary, is a practical and proportionate approach.

However, the costs order has revealed that the system, at least in its first year of operation, will be prohibitively expensive for our members, as copyright owners, to take part in. This is exacerbated by the long delays in the system, which will impact games more strongly than other content industries.

Piracy continues to be a major challenge for the games industry. However, innovations in technology and in business models constantly change the landscape and so the levels and impact of piracy. Our industry is in a period of evolution, with a new generation of consoles widely expected to appear over the next two years and the mobile market maturing rapidly. This makes it difficult to anticipate how the market will look even in six months' time.

As a result, asking our members to predict in February 2013 how much piracy they will face in February 2015, and to put down potentially millions of pounds to support this, is extremely difficult.

Each company will have a commercial decision to make as to whether to enter into this system, to which we cannot speak. However, it is clear from general discussions that the benefit of this system is uncertain and will not be seen for several years, and so is too likely to be outweighed by the high costs that have become apparent in this draft Order.

We recognise that Ofcom has worked to reduce these issues of cost and delay where possible, and construct a system in line with the requirements made of it that is fair for all parties. However, if this system is to work it will need a relatively large number of companies, from different creative sectors,

to take part, in order for legitimacy to be retained. Where possible we make suggestions below to attempt to aid this.

Ofcom Questions

Section 3 – Cost-Sharing Framework

Question 3.1: Do you have any comments on the principles set out above; if you consider there are other economic principles to which we should have regard in setting fees, please identify these?

The principles of proportionality, practicability and efficiency provide, in our opinion, the right guidance in how to implement this framework.

However, we have concerns that these principles have not been met in the implementation of the scheme. Although costs will come down in future years, the cost of taking part in the first notification period, and covering almost all of the expense of creating the framework, is likely to prove too high for many of our members to justify participation. We worry that this will reduce the legitimacy of the scheme in the eyes of the public, if it is the case in other industries as well. In short, we do not feel the costs set out represent proportionality in relation to the benefits provided.

This is exacerbated by the requirement for copyright owners to estimate their total number of CIRs for each of the six ISPs twelve months in advance of the first notification period. This means, for example, that they will have to estimate how many notices they will send to each ISP in February 2015, in February 2013. As we discuss in more detail below, this is likely to pose particular difficulties for games companies.

Section 4 – Process and Timetable

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?

The suggested iterative process is a sensible way to overcome the circularity problem in using estimated CIR numbers to set costs and vice versa. It also avoids the potential complexity of requiring copyright owners to reveal their full demand curve, allowing this to become apparent through discussion instead.

However, we again are concerned that requiring CIR numbers to be finalised by February 2013, a year in advance of the notification period itself beginning, will be a high barrier to our members taking part.

As in several other content industries, being able to predict the success of a game, and so the level of piracy it may attract, is very difficult a year in advance, never mind the nearly two years in advance this would require for a game to be released in November 2015, near the end of the first notification period.

However, games companies face additional challenges from this stretched timetable, which other industries will not encounter.

Firstly, console games will see significant shifts in piracy rates as consoles are 'hacked' and these hacks are overcome by system updates and other means. Piracy on an individual system can go from almost non-existent to the hundreds of thousands in the space of a month, and back again, and it is impossible to predict when this will occur, particularly over a year in advance. This will become a particular issue over the next two years, as it is expected that a new generation of consoles will be released.

Secondly, the development of new business models is changing the way companies interact with consumers, potentially altering flows of piracy. This has occurred mostly in the mobile games market so far, but many expect these innovative approaches to spread further over the next two years, just as the CIR process begins. The most notable example is the growth of free-to-play models, monetized by advertising or in-game purchases. In this context, where the game usually has to connect to the company's servers, piracy is almost irrelevant.

Any flexibility that can be afforded in this system, therefore, will be vital in maximising take-up, lowering the cost for all involved, and driving up the participation of games companies.

We are not convinced that ISPs require exact final numbers of CIR estimates in order to design their systems. As paragraph 6.17 of the consultation document states, the ISPs have made clear that, because the systems will be mostly automated, their capital expenditure and fixed operating expenditure would be the same whether they had to process 10,000 CIRs a month or 200,000. As such, it should be possible to allow the total number of CIRs to alter to some extent between February 2013 and March 2014.

Any method that can be found to allow additional copyright owners to buy into the system between February 2013 and, say, the end of that year, would benefit the process. If a way could be found to do this without destabilising the system it would hopefully lower the barriers to entry significantly.

Options for this could include allowing a small additional percentage of CIRs to be purchased in this interim period, beyond the total agreed in February 2013. This would of course have to see other rights owners compensated for their respective investment.

Less drastically, rights owners could sell on the CIR allocation they had taken on in February 2013 to new entrants in the interim. We understand this may already be possible under the Code, but clarifying this to rights owners, and helping advertise this fact during the interim period to attract new entrants, would be beneficial.

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

Ukie is not in a position to query the tender process or set-up process of an appeals body. However we comment to express concern for the possibility mentioned in paragraph 4.22 that a satisfactory external provider may not be found, and that Ofcom would itself have to set up a new appeals body.

As Ofcom accept, this would likely cause delays in the overall timetable. We urge Ofcom therefore to determine as early in the process as possible how likely this outcome is, and to make sure that advance preparations are undertaken to establish such a body as soon as it seems likely that it will be needed.

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?

Ukie is not in a position to query the ISPs' own evidence on how long it will take them to establish CIR-processing systems.

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 different dates are feasible and preferable?

As stated above, we have no evidence to challenge estimates of timetables for ISP systems or the appeals body. We also agree that a few months' leeway should be allowed in the timetable. Further, we recognise that ISPs cannot be expected to invest in systems until they are assured that copyright owners will take part in the process and pay their share of these costs. This can only happen after the Code comes into force, likely in January 2013.

As such, we agree that the first notification period should begin on March 1st 2014. However, we repeat our concern that requiring copyright owners to set out their CIR volume estimates for this notification period an entire year in advance will make it unappealing for our members to take part in the framework. Anything that can be done to reduce this requirement should be considered.

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

Requiring ISP notification fees and Ofcom initial costs to be paid at the start of the notification period will of course mean significant up-front payments for copyright owners taking part in the scheme. Allowing Ofcom's qualifying costs to be spread out into quarterly payments is, however, a welcome concession that will alleviate this somewhat.

Spreading notification fee payments to ISPs on a similar quarterly basis, if it is possible under the Code, would help make the system more accessible for copyright owners. This may be achievable through direct agreement between copyright owners and ISPs, rather than in the cost-sharing order itself.

We recommend that quarterly payments from copyright owners to ISPs during each notification period are facilitated if possible.

Section 5 – Qualifying Costs and Initial Costs

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?

No

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

No comment

Section 6 - Relevant Costs: Qualifying ISP Capital Expenditure and Fixed Operating 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 model of Relevant Costs for the purpose of setting a notification fee? If not, please provide your reasons for that view.

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?

We agree: all ISPs will logically have to put in place roughly the same automated system and call-handling teams, and so will have the same model of relevant costs.

This supports our earlier argument that ISPs will not have to know the exact CIR volumes before designing their systems and putting them in place. Again, we suggest that this should lead to some flexibility being allowed for copyright owners in their CIR estimates before the first notification period begins, to make the system more accessible.

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

As the consultation document recognises, there is a clear risk of gaming from the requirement for all ISP capital expenditure to be recovered in the first notification period. Even if it is not done consciously, it is likely that the system being cheaper in subsequent periods will make it more attractive for a wider range of copyright owners, whether they were aware of the reasons for this disparity in cost, meaning those taking part from the beginning will bear an unfair share of the burden.

However, as the consultation makes clear, there is no provision in the Costs Order for these costs to be reallocated in future rounds, and the DEA itself requires 75% of ISP capital costs to be recovered through the notification fee.

In sum, although it presents clear potential problems for the system, we agree that this approach should be taken as we cannot see an alternative.

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 have no evidence to challenge the assessment made of fixed costs that ISPs will reasonable incur.

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 recognise the logic behind the decision to make a separate fee for the two smaller ISPs, as otherwise they would face an unfair share of the overall burden.

However, if the system of two fees played out as illustrated, this would mean that BT recovered 101% of their relevant fixed costs. In other words, they would make a small profit on their participation in the scheme, despite the requirement that the industry as a whole pay 25% of these costs.

We recognise of course the risk of additional complexity that would result from assigning a third notification fee for BT alone. However, the potential for them to profit from participation in this scheme is a peculiar outcome.

One solution would be for the iterative process by which CIR volumes to be set to begin with such a three-tier system, and move to a two-tier system if this failed. However, we recognise that implementing this in time for February 2013 would be difficult.

We recommend that, if BT or any other ISP do indeed take more in notification fees than they spend on relevant costs in the first notification period, this three-tier system be reconsidered.

Section 7 - Relevant Costs: Qualifying ISP Variable Costs

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 have no objections to the proposed allowed and disallowed costs.

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 broadly agree with the assessment of relevant costs, and have no evidence to offer alternatives. However, there is concern that the estimated cost of handling a complaint and of monitoring the quality of processed CIRs have both been set after evidence from just one ISP. If further evidence

could be secured from other organisations with experience in handling customer complaints of a broadly similar nature, this should be used to verify these estimates.

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

We have no reason to challenge these estimates, as they have been developed through discussion with a satisfactory range of organisations.