

The Chair  
Cabinet Economic Growth and Infrastructure Committee

## Copyright (Infringing File Sharing) Regulations - Review of Notice fee

### Proposal

- 1 I propose that no change is made to the \$25 notice fee set out in the Copyright (Infringing File Sharing) Regulations 2011 (the Regulations).

### Executive Summary

- 2 Sections 122A to U of the Copyright Act 1994 (the Act) set out a three notice regime aimed at deterring peer-to-peer (P2P) file sharing that infringes copyright. The regime came into force on 1 September 2011, and requires internet protocol address providers (IPAPs) to send up to three infringement notices to internet account holders if they are alleged by copyright owners (rights owners) to have infringed copyright via a file sharing network. After a third notice has been issued, a rights owner can choose to pursue that account holder for a monetary penalty through the Copyright Tribunal.
- 3 The Regulations set out a number of technical matters relating to the implementation of the three notice regime, including the fee that IPAPs may charge rights owners for processing allegations of copyright infringement made against their customers. It is important that this fee is set at a level which appropriately balances cost recovery by IPAPs against the need for the regime to be effective. If the fee is set too high it will act as a barrier to rights owners sending infringement allegations to IPAPs. This is likely to limit the effectiveness of the regime. Conversely, if the fee is set too low the effectiveness of the regime may increase through higher notice volumes, but internet account holders are likely to subsidise the operation of the regime through IPAPs passing on their implementation costs.
- 4 I consider there is currently no case for either increasing or decreasing the fee. The current \$25 fee is set at an appropriate level because:
  - There has been a significant reduction in the volume of illegal file sharing in the first six months of the regime being in force. This suggests that the level of the fee has not initially prevented the regime from having the desired outcome; and
  - While the fee does not allow full cost recovery by IPAPs, it does allow recovery of an appropriate proportion of their costs, and at a level which appears to be consistent with similar regimes overseas. Lowering the fee at this time would impose an inappropriate level of costs on IPAPs.
- 5 A number of caveats were also noted in submissions to the review around the costs of the regime and its current impact, which further reinforce the fact that there is no case for change at this time. In particular, as the Copyright Tribunal has not yet been engaged to hear a claim, the full deterrent impact of the regime is not certain. I propose that MBIE officials continue to monitor the operation of the regime with a view to recommending whether future reviews of the fee are necessary.

## Background

- 6 In July 2011 Cabinet decided that \$25 was the appropriate level for the fee. Cabinet also decided that the fee should be reviewed six months after the regime came into force (EGI MIN (11) 118 refers). The review (undertaken by the Ministry of Business, Innovation and Employment (MBIE)) considered submissions on the actual costs of operating the regime for the period 1 September 2011 to 31 March 2012. Notices began to be processed by IPAPs in November 2011. The goal of the review was to consider whether the fee allows an appropriate proportion of cost recovery by IPAPs while still facilitating the effectiveness of the regime.

## Impact of the legislation in the first six months

### *Background*

- 7 The objectives of the three notice regime include the education of internet consumers through warning notices and the provision of a more cost effective enforcement mechanism against illegal file sharing for rights owners. The main objective of the regime, however, is deterring illegal file sharing. Accordingly, submitters were asked to comment on whether there had been any reduction in illegal file sharing in the first six months of the regime being in operation. This information has a bearing on whether the fee is set at an appropriate level. For example, if the fee was set so high that no notices are sent, the effect of the legislation in deterring illegal file sharing is likely to be nil.

### *Impact of the legislation – drop in file sharing*

- 8 There has been a significant initial reduction in the amount of illegal file sharing that has occurred in New Zealand. I therefore consider that the current \$25 fee has not substantially prevented the regime from having the desired effect in the first six months. Submissions noted the following about the reduction in file sharing:
- a. Several submitters noted a Waikato University study that assessed the impact of the legislation on P2P file sharing traffic. Researchers at Waikato gathered a snapshot of all the internet traffic that occurred across the network of one NZ IPAP. The study found that:
    - Traffic downloaded using P2P applications decreased to less than half the volume it had been prior to the legislation coming into force, and this decline persisted at least until January 2012;
    - The overall number of P2P users in January 2012 was around half that in January 2011; and
    - There was growth in the use of tunnelling, remote access and file transfer protocols. These are technical methods that savvy infringers use to hide file sharing downloads. This growth was nonetheless much smaller than the drop in file sharing, which suggests that only some of the infringers that have stopped using file sharing networks have moved to try other means.
  - b. The Recording Industry Association of New Zealand (RIANZ) stated that “since August 2011 overall P2P use in New Zealand is down 18% but still remains at a very high level with over 700,000 people still engaging in P2P on a monthly basis”. They went on to state that there was a noticeable decline in September 2011 when media coverage of the law was at its highest.
  - c. The New Zealand Federation Against Copyright Theft (NZFACT), in its submission, provided evidence showing there had been around 110,000 infringing downloads of major US movies in August 2011, but from that date downloads had plateaued at between 40,000 and 60,000 per month.

### *Caveats on the drop in file sharing*

- 9 It is difficult to prove the cause of the reduction in the first six months. For example, RIANZ considers the majority of the reason for the drop in file sharing activity has been as a result of publicity around the new regime, rather than the notices themselves. Other factors, such as season and release times for popularly infringed works, may also have affected affect infringers' behaviour in this initial period.
- 10 An equally important aspect of deterrence under the new regime will be publicity around any claims taken to the Copyright Tribunal. As yet, no claims have been taken through the Tribunal. While several third notices were issued in the initial six months, RIANZ has decided not to pursue the recipients of those notices through the Tribunal. Until this occurs, intentional infringers may not consider there is a risk of monetary penalties being awarded against them, and may therefore ignore the notice process. However, when a precedent is set around the quantum of monetary penalties that may be awarded under the regime, it is likely infringing activity will be further deterred.

### *Impact of the legislation - digital market for copyright works*

- 11 Several submitters made reference to the efficient operation of a digital market for copyright works (especially the presence of online purchasing and subscription services for content) being an appropriate policy consideration. Some submitters suggested there was a lack of access to online content in the NZ market, and saw this lack of access to content as a key reason for piracy.
- 12 It should be noted that since the regime has come into force, there has been an increase in the number of online purchasing and subscription services for copyright content. In particular legal options for online music have grown, with the likes of "Spotify" and "Rdio" adding to a growing list. While film and television has seen Quickflix enter the market, there are fewer options for this type of content. The improvement in the online market for content may also contribute to a decline in illegal file sharing.

## **Distribution of costs**

### *Background*

- 13 In 2009, when policy decisions for the three notice regime were taken, Cabinet decided that IPAPs should "meet their own costs in collecting, maintaining and processing data to meet their obligations under this process", but that rights owners should pay a fee "to cover the ISP's administration cost for issuing notices" (EGI MIN (09) 249 refers). However when the fee was set, Cabinet also agreed that the fee could allow recovery of more than the simple administration costs of sending notices (EGI MIN (11) 118 refers).

### *Preferred outcome of submitters*

- 14 IPAPs have consistently maintained that they should be able to recover the full costs of operating the regime through the fee, including their set up costs. They consider that the current fee does not allow them to gradually recoup their setup costs over time. The Telecommunications Carriers Forum (TCF), which represents the majority of NZ IPAPs, would prefer the fee to be raised to \$40, but would reluctantly accept no change in the fee. Only Vodafone suggested there was no case for changing the current fee, due to some of the uncertainties around calculating costs which are noted below. A number of non-IPAP submitters also suggested keeping the fee at \$25.

- 15 On the other hand, rights owners have consistently maintained that the fee should be nominal or non-existent. RIANZ considers that the regime will decline in effectiveness if the fee remains at \$25, and would prefer to see it significantly reduced. RIANZ suggests that at \$2 per notice, they would send 5000 notices per month in total. Based on their monitoring of P2P usage in New Zealand, they estimate this would result in notices reaching 5% of P2P users per year.
- 16 I consider it remains appropriate that both IPAPs and rights owners bear some of the costs of the regime. Rights owners bear the majority of the responsibility for the enforcement of their rights through this process, and should therefore bear a good proportion of the cost.

*IPAP submissions on the costs of processing infringement allegations*

- 17 The review asked IPAPs to submit their actual costs of processing a rights owner notice, for which they are able to charge a rights owner up to \$25. There was a wide variance in the IPAP submissions on processing costs, and IPAPs noted a number of caveats around calculating them:
- a. All IPAPs processed notices manually in the first six months, which means costs are largely staff costs. Due to low and varying volumes of rights owner notices, some IPAPs submit that it is unreasonable for them to invest in any level of automation of the process, which might lower costs. Inability to automate contributes significantly to the cost of processing a rights owner notice. For example, Vodafone currently considers notice processing costs to be \$30.50. However, at a volume of 5000 notices per month, Vodafone estimates that their notices processing costs would be \$19.11;
  - b. Some IPAPs were concerned that their costs could be higher if a larger number of second and third notices had been issued;
  - c. Some IPAPs were concerned that their participation in the Copyright Tribunal process, which could create further costs where Tribunal requests further information from an IPAP, had not yet been tested;
  - d. Smaller IPAPs that have not yet received notices pointed out that the costs could be higher for smaller operators; and
  - e. Some IPAPs considered costs could rise if more than one rights owner uses the system (which could make the processing of notices more complex).
- 18 Given the variance of estimates between the current five IPAPs operating the system, it is difficult to arrive at an average per notice cost, and thereby derive an average proportion of cost recovery. The variance is likely to be a result of the fact that IPAPs have different ways of operating and different market share (and therefore likelihood of having to process notices). The following table summarises the submissions made by IPAPs:

IPAP	Number of rights owner notices processed during the review period	Per notice operational costs	Proportion of costs recoverable through the \$25 fee, as estimated by MBIE
Vodafone	417	\$30.50	81%
TelstraClear	398	\$32.64	76%
Telecom	1238	\$104	24%
Orcon	115	Stated that it was too difficult to arrive at a per notice cost due to low volumes	n/a

- 19 In addition, IPAPs have incurred significant set up costs in gearing up to comply with the regime. These costs vary between IPAPs depending on the level of systems investment that has occurred. The TCF states that \$919,000 has been spent between Vodafone, Telecom, TelstraClear, Orcon and CallPlus in setting up for the regime. The highest of these has been Telecom which submits that it has incurred \$360,800 prior to the regime coming into force.
- 20 Nonetheless, I consider the current fee allows an appropriate proportion of cost recovery for the impact that the regime is currently having. For the most efficient IPAPs, the current notice fee represents around 76%-81% cost recovery of the on-going costs, based on per notice costs of \$32.64-\$30.50. Vodafone appears to be the current “most efficient operator” – i.e. the IPAP that has managed to process notices in the most cost effective manner. Telstra Clear’s system for processing notices is also similar, resulting in fairly consistent per notice costs.

*Are IPAP costs reasonable?*

- 21 A concern of rights owners is that IPAPs are overstating the costs of processing notices. It appears that the costs submitted by IPAPs, in particular, those submitted by Vodafone and TelstraClear, are reasonably consistent with costs under two foreign regimes MBIE considered during the review. I note that these examples are only an indication, as the process under these foreign regimes are not exactly the same as our regime.
- 22 In 2006, a study of the costs of a similar notice system was undertaken in Canada. The study found that a large IPAP would on average incur NZ\$16.28 per notice<sup>1</sup> based on average monthly volumes of 4,426 notices. This suggests that Vodafone’s lower estimate of \$19.11 (based on 5000 notices) is likely to be reasonable.
- 23 The United Kingdom Telecommunications regulator Ofcom is also currently consulting on the proposed per notice costs of the Digital Economy Act (DEA), which sets out a similar process to the NZ regime. Ofcom currently suggests that copyright owners should be required to pay £17.00 per notice for an internet service provider that receives 16,300 notices per month. This equates to \$32.94NZ<sup>2</sup>.

*Comment on relationship between costs and notice volumes*

- 24 The evidence examined during the review suggests that a higher notice volume will allow economies of scale to be achieved in the processing of notices (including by automating the process to an extent), thereby resulting in lower on-going costs for IPAPs. It appears that volumes around 5000 per month are the threshold at which IPAPs would invest in automating the process. In order to achieve this volume, however, a significant reduction in the fee would be necessary (as suggested by RIANZ, to around \$2). Such a reduction would result in IPAPs bearing nearly all of the costs of operating the regime.

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<sup>1</sup> In 2011 dollars using purchasing power parity rates.

<sup>2</sup> Based on a 5 June 2012 exchange rate.

- 25 Volumes have been significantly lower than initially expected as NZFACT, the major representative for NZ and US film and television rights owners, has so far chosen not to use the system. Given that a large volume of illegal file sharing is done in respect of new release film and television, NZFACT's participation in the regime might warrant investment by IPAPs in further automation, which in turn might warrant a further review of the fee. NZFACT submits that the level of the fee is the reason for their non-participation. NZFACT is of the view that the fee would have to be a matter of cents for it to start using the system. However, it is clear from RIANZ's participation in the regime that the current fee does not prevent rights owners from using the system. Reducing the fee to the level preferred by NZFACT is not appropriate because of the costs this would impose on IPAPs.

## Conclusion

- 26 I consider that the fee currently strikes an appropriate balance between ensuring the regime is effective and allowing appropriate cost recovery by IPAPs. There has been a significant reduction in file sharing in the initial six months that the regime has been in force, and there has been an improvement in the online market for copyright protected content. While it is difficult to prove whether these positive impacts are a direct cause of the regime, nonetheless there have been positive impacts. The Copyright Tribunal process is also likely to add to the deterrent effect of the regime in future.
- 27 Lowering the fee would result in a higher volume of notices being processed under the regime. In turn this is likely to result in the regime being more effective than it currently is. However, the extra cost that this would impose on IPAPs (which they are likely to pass on to their customers) is not justified because of the presence of the positive impacts noted above. If these impacts are to erode over time, there may be stronger arguments for lowering the fee.
- 28 Conversely, raising the fee at this time would result in a very low volume of rights owner notices being sent to IPAPs. I consider that such volumes would result in the regime being largely ineffective. IPAPs cannot take advantage of the economies of scale that could be achieved if a higher volume of notices was received (in particular, by being able to automate aspects of the process), therefore raising the fee is also likely to result in the somewhat perverse outcome that IPAPs waste resources in being required to comply with the regime but not processing many notices. This would not be beneficial for IPAPs or rights owners.
- 29 Accordingly I propose that no change to the \$25 fee set out in the Copyright (Infringing File Sharing) Regulations 2011 is made at this time.

## Further reviews

- 30 I propose that MBIE officials should continue to monitor the operation of the regime. If notice volumes are to rise significantly (due to other rights owners beginning to use the process), IPAPs may be able to implement more efficient systems and therefore there may be scope to review the fee again. Furthermore, if the current positive impact of the legislation fades over time, as is expected by rights owners, there may also be scope for a further review. A key factor in whether the initial effect fades will be the outcome of initial cases at the Copyright Tribunal and the deterrent precedent this sets. As the time frame for these circumstances to occur cannot be predicted, I do not consider it appropriate to set a time frame for a further review at this stage.

**Consultation**

- 31 The Ministry of Economic Development undertook a six week consultation in which 32 submissions were received. The consultation was targeted at those who are currently implementing the regime. Submissions were also received from interested parties such as the Telecommunications Carriers' Forum (the major IPAP industry body), several major rights owner organisations, Internet NZ and the Telecommunications Users Association (TUANZ). A number of members of the public also submitted.
- 32 In addition, the Treasury and the Ministry of Justice have been consulted on this paper. The Department of the Prime Minister and Cabinet has been informed.

**Financial Implications**

- 33 There are no financial implications resulting from this paper.

**Human Rights**

- 34 The proposal in this paper appears consistent with the Human Rights Act 1993.

**Legislative Implications**

- 35 There are no legislative implications resulting from this paper.

**Regulatory Impact Analysis**

- 36 An exemption from the RIA requirements is claimed due to the fact that this paper proposes no change to regulation.

**Publicity**

- 37 I propose to make a press release outlining the result of the review in my capacity as the Minister of Commerce.

## Recommendations

It is recommended that the Committee:

- 1 **Note** that a review of the \$25 fee set out in the Copyright (Infringing File Sharing) Regulations 2011 was undertaken by the Ministry of Business, Innovation and Employment;
- 2 **Agree** that there is no case for changing the \$25 fee set out in the Copyright (Infringing File Sharing) Regulations 2011 at this time;
- 3 **Note** that officials will continue to monitor the operation of the legislation with a view to recommending whether further reviews of the fee may be necessary.

Hon Craig Foss  
**Minister of Commerce**

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