

# **Classification in the digital age: a scoping study of future options**

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Irish Film Censor's Office

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# 1. Introduction

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The Irish Film Censor's Office (IFCO) is determined to meet the challenges to film and video/DVD classification posed by new technological developments and business models.

Rather than passively react to the fast-changing film and home entertainment landscape, IFCO commissioned this report to scope the future options for classification. This will help inform IFCO's contribution to debates both in Ireland and internationally.

Several factors have prompted this review:

- There is concern that digital distribution channels for film<sup>1</sup> are not covered by existing legislation and therefore fall outside the statutory classification system.
- These new means of distribution include internet-based video-on-demand (VoD) as well as non-linear transmission through digital terrestrial, satellite, cable and DSL networks (television-based VoD).
- Film distribution is currently in a transitional period as these services are pioneered and rolled out, and as new business models and consumer propositions are developed and tested in the market.
- There is uncertainty in the industry about the impact of these new means of distribution on existing theatrical and home entertainment markets, and this is further complicated by the introduction of two competing high definition DVD formats and the roll out of digital theatrical exhibition.
- These market developments are good news for consumers, as the growth in distribution channels has the potential to increase the range, availability and accessibility of filmed entertainment. However, local classification systems are in danger of being sidelined by new digital technologies unconstrained by national borders or jurisdiction, and where licensing and gate-keeping functions are harder to enforce.

These factors raise a number of questions, which form the core of this enquiry:

- a. What exactly are the threats to existing arrangements posed by technological and market changes?

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<sup>1</sup> For simplicity the terms 'film' and 'filmed entertainment' are used throughout this report to refer to all types of audiovisual work currently classified by IFCO, including feature films, trailers and television programmes/ non-theatrical works available on DVD.

- b. How can local classification systems regulate internet-based film distribution operated from other national jurisdictions?
- c. What changes, if any, are required to current legislation to ensure the classification system continues to inform and protect Irish consumers however they choose to access filmed entertainment?
- d. What other practical steps can be taken to maintain classification standards across all current and future forms of distribution?
- e. What impact will new distribution channels have on the size and vitality of the theatrical and video markets?
- f. Which arrangements are likely to find favour with film distributors, and therefore stand the greatest chance of success?
- g. What level of protection and information may be required by consumers accessing film through new digital platforms?
- h. What are other classification authorities and media regulators doing to meet these challenges?
- i. Is greater international co-operation required (and practical) to meet the challenges of globalisation in the supply of filmed entertainment?

This report addresses these questions and considers the main factors relevant to a decision about future classification options.

Section two examines the current size and dynamics of the home entertainment market in Ireland, both to assess its significance within the global marketplace (which may influence multinational studio opinion about the viability of local classification) and to consider the likely demand for digital distribution, and the longevity of the DVD market.

Section three looks in closer detail at current and planned digital distribution models as a way to assess the challenge posed to existing classification, and to identify the key players over the next five years.

Drawing together this information, section four provides a SWOT analysis to highlight the key elements at work both internally (strengths and weakness) and externally (opportunities and threats) that will determine IFCO's ability to respond to the digital challenges outlined above.

Section five reviews the evidence in light of the questions framing the enquiry, and sets out the main options open to IFCO to meet the digital challenge, taking account of their relative strengths and weaknesses.

Section six concludes with a brief summary and a list of recommendations for next steps.

## 2. Market data

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### 2.1 Introduction

The US has the world's largest home entertainment market, accounting for 45% of global VHS and DVD revenues (a total of \$24.9bn in 2005).<sup>1</sup> It is therefore likely to exert greater influence on major US studios' decision making about the roll out of digital distribution than any other single market.

But while the majors will probably have the domestic market in mind when making strategic decisions about digital distribution (like judging the trade-off between opening new revenue streams and cannibalising existing ones, e.g. theatrical and DVD income), the licensing of film content for digital distribution can be handled at the market 'territory' level, which means services are likely to emerge within specific, national contexts. Presently, Amazon Unbox and Apple iTunes have licensed film downloads for the US market, but in time these will be expanded to cover other territories (as these companies have global ambitions and reach), once the necessary licence agreements are in place.

Meanwhile, LoveFilm International (the largest online DVD rental<sup>2</sup> company in Europe since the merger between LoveFilm and Video Island in April 2006) has digital licence agreements with Universal, Warner Bros. and Sony (through its major shareholder, Arts Alliance Media), and currently offers 2,000 titles for download-to-own and download-to-rent in the UK. It looks likely that this model will persist, leading to localised digital distribution services tailoring content, marketing, logistics (e.g. local currency pricing and transactions) and support to specific territories.

This section begins by looking at the dynamics of the video<sup>3</sup> market in 2005 (the most recent year where data are available), to consider its vitality and, crucially, its longevity in the face of digital distribution. I also want to examine the likely demand for digital distribution in Ireland by looking at trends in broadband penetration and uptake as well as prevailing market developments.

What follows is necessarily speculative as the analysis is based on assumptions about commercial decision-making that cannot be verified by reference to published data alone (and which may, in any case, only become apparent with the benefit of hindsight). To counter this, wherever possible I have sourced comments by industry insiders and trusted commentators to inform the analysis.

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<sup>1</sup> Source: European Video Yearbook 2006, International Video Federation.

<sup>2</sup> 'Online DVD rental' is the term for describing the business model whereby subscribers can select DVDs to rent from an online database. The DVDs are then posted out to the subscriber, who returns them by post once they have finished with them. NetFlix pioneered the service in the US, and it now offers a range of 70,000 titles to around 5.7 million subscribers.

<sup>3</sup> 'Video' here is used as shorthand for VHS and DVD rental and retail.

## 2.2 The video market in 2005

The following data are sourced from the 'European Video Yearbook 2006' published by the International Video Federation:

### 2.2.1 Trends in Europe

- DVD sales grew across the EU but at a slower rate than in 2004, indicating the maturation of the DVD market.
- DVD hardware penetration reached 65% in Western Europe.
- The VHS format is 'almost extinct'. Spending on retail VHS in Western Europe fell by 70%.
- The overall rental market declined across Europe, driven by a large fall in VHS rentals (as against a small rise in DVD rentals, powered by online DVD rental services).

### 2.2.2 Video in Ireland

Table 1: Number of video transactions in Ireland, 2005

|          | VHS rental |       | VHS retail |       | DVD rental |       | DVD retail |       |
|----------|------------|-------|------------|-------|------------|-------|------------|-------|
|          | (m)        | %     | (m)        | %     | (m)        | %     | (m)        | %     |
| Ireland  | 2.0        | 6.7   | 0.9        | 2.6   | 14.0       | 1.9   | 8.0        | 1.2   |
| UK       | 7.4        | 24.7  | 10.4       | 29.8  | 130.1      | 18.0  | 211.2      | 32.9  |
| W Europe | 29.9       | 100.0 | 34.9       | 100.0 | 721.7      | 100.0 | 642.6      | 100.0 |

Source: International Video Federation

- Table 1 reveals that while Ireland accounted for 6.7% of all VHS rental transactions in Western Europe, it accounted for only 1.9% of the larger DVD rental market. In contrast, the UK (Europe's largest video market) accounted for 18.0%.
- Ireland had an even smaller share of DVD retail transactions (1.2%), while the UK accounted for nearly one third of the Western European total.
- But while the Irish market is relatively small, Ireland had the highest number of average annual DVD sales per DVD household (12), compared with 11 in the UK and 6 across Western Europe.
- Ireland also had the highest number of average annual DVD rentals per DVD household (20), compared with 7 in the UK and 7 across Western Europe as a whole.

### 2.2.3 Online DVD rental in Ireland

Given that online DVD rental companies have driven growth in the rental sector, and the fact that they are likely to bring internet-based VoD services to market alongside their core business, it is helpful to look at the sector in Ireland.

I found evidence of four main online DVD rental companies currently operating in Ireland:

**Screenclick** ([www.screenclick.com](http://www.screenclick.com)), formerly DVD Rentals Ireland, is now owned by LoveFilm International, and claims to have 50,000 subscribers. It does not currently offer a download service, but given the company's link to LoveFilm it is highly likely it will introduce a scheme similar to that operated by the parent company in the UK (see section 3.2.1).

**MovieStar.ie** ([www.moviestar.ie/](http://www.moviestar.ie/)) is a relative newcomer that claims to have 6,000 members in its first six months of operation. It offers films, TV shows and games for rental, but no download service at present.

**Busy Bee DVD** (<https://busybeedvd.rentshark.com/>), which also powers the CD Wow web site (<https://cdwow.rentshark.com/>), offers 10,000 titles to subscribers. The site does not offer a download service, and claims to be licensed by 'The Irish Film Censor's Office No. - 421/06' (it is the only online rental company to advertise this fact).

**Rentastic** (<http://sort.ucd.ie/www/contastic/htdocs/>) was established in January 2005 and appears to be run from the Computer Science Dept of University College Dublin (!). They do not yet offer a download service.

## **2.3 Information and Communications Technology in Ireland**

The data reported below have been sourced from 'Information Society and Telecommunications 2006', published by the Central Statistics Office.

### 2.3.1 Trends in ICT

- 59% of Irish households had a computer in February 2006.
- 83% of these had an Internet connection (a total of 722,200 households, 48.7% of all households).
- In February 2006, 26% of Irish households with Internet access had a broadband connection, compared to the EU-25 average of 62% (and 70% in the UK).
- The number of broadband subscribers rose to 310,000 by September 2006, equivalent to 21% of all households (source: Commission for Communications Regulation, Quarterly Report, December 2006).

So while the penetration of computers is quite widespread in Ireland, broadband uptake has been much slower than in other European countries, and is only available in a minority of households. This means the size of the potential market

for movie downloads is relatively small in Ireland (albeit growing) certainly in comparison with countries like the UK.

But a broadband subscription is only part of the equation. The speed of a broadband connection is a crucial element in the uptake of downloading services. Quite simply, the quicker and easier it is to download a film in a high quality format, the greater the appeal it will have to mass-market consumers (as opposed to early adopters).

As a rough guide, it can take around 1 hour 20 minutes to download a feature film in 'High Quality' format using a broadband speed of 1 Mb (or 2 hours 40 minutes in 'Super High Quality'). At a speed of 8 Mb the former will take only 10 minutes to download, and the latter 20 minutes.

I have not been able to source figures for the breakdown of broadband connections in Ireland by connection speed, but it is likely the majority of existing connections are at the lower connection speeds. Thus, not only are a minority of households connected to the Internet using broadband, but most of these will be slower connections.

## **2.4 Summary**

In summary, the prospects for DVD in Ireland look quite healthy in the foreseeable future. DVD hardware penetration is continuing to grow in Europe, albeit at a slower rate. Coupled with this, a number of Irish companies have been attracted into the growing online DVD rental market.

While the volume of rental and retail VHS and DVD transactions in Ireland is low in comparison with other European markets, it is not insignificant (amounting to a total of 24.9 million in 2005), and Ireland had the highest average number of transactions per DVD household in Europe.

The potential for commercial film downloading services in Ireland is harder to fathom on the available evidence. There is a good chance that ScreenClick will launch its own download service in Ireland, although the timescale is not clear. Perhaps most significantly, AOL Ireland will go live in 2007, and they already offer VoD services in the UK using Arts Alliance Media technology and licensing agreements with studios.

Given the relative weakness of broadband connectivity in Irish households it looks as if the smart money will continue to back DVD until such time as the market for digital distribution reaches a sufficient size to justify the investment.

## 3. Digital distribution models

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### 3.1 Overview

The long predicted development of digital video-on-demand (VoD) services is now finally taking off after several years waiting in the wings and a few false starts. According to the International Video Federation, 'Internet video on demand (VoD) services have been arising gradually in Europe since 2000, and 2005 witnessed the launch of the first platform in the UK...2006 is becoming a watershed year for movie downloading' ('European Video Yearbook 2006').

The basic principle of VoD is that users have access to a large (and potentially limitless) catalogue of film and TV titles from which to select content to view at a time of their choice.

This simple idea has been translated into a bewildering array of services underpinned by just as many business models.

For the purposes of this scoping report it is helpful to distinguish two types of VoD service, although the trend towards media convergence blurs such a distinction in reality<sup>1</sup>:

- Television-based VoD  
Television companies offer these services in addition to their regular broadcast services (whether digital terrestrial, cable, satellite or DSL).<sup>2</sup>
- Internet-based VoD  
These are video content download services operated via the Internet by new media companies (including start-ups, ISPs, online DVD rental companies and electronic sell through businesses).

The former are likely to be subject to broadcasting regulations and licensing regimes, although under proposals from the European Commission<sup>3</sup> it is not yet clear whether, and to what extent, these 'non-linear' transmissions will be covered by the Television Without Frontiers Directive.<sup>4</sup>

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<sup>1</sup> As I write, Virgin Media has been launched in the UK, bringing together Virgin Mobile, Virgin Broadband ISP and digital cable operators ntl:Telewest to form a single, converged new media company offering TV, phone, mobile and broadband services (including VoD).

<sup>2</sup> Near Video-on-Demand (NVOD) falls into this category, which is the term given to the use of multiple broadcast channels to transmit content (e.g. a film) at staggered start times, giving users a number of options for viewing content at a time that suits.

<sup>3</sup> See details of the Audiovisual Media Services Directive:

[http://ec.europa.eu/comm/avpolicy/reg/tvwf/modernisation/proposal\\_2005/index\\_en.htm](http://ec.europa.eu/comm/avpolicy/reg/tvwf/modernisation/proposal_2005/index_en.htm)

<sup>4</sup> I understand there is some debate within the industry and among broadcasting regulators about the distinction between TV-based VoD and internet-based VoD services. The prevailing view is that the latter is sufficiently different to fall outside broadcasting regulations (and currently there are no Internet-based VoD members of ATVoD, the trade body for UK based VoD operators).



Internet-based VoD may not be covered by the Commission's proposals (although this is a moot point), and as a form of electronic sell through they are closer to the traditional model of film distribution than broadcasting. These services are therefore of most interest for our present purposes.

### **3.2 Internet-based VoD**

This typically involves private users accessing films for downloading via a broadband connection to their PC, for personal viewing at a time that suits them.

The service may be restricted to subscribers, who pay a regular fee for a certain number of downloads (including 'unlimited' downloading), or it may be available on a unit charge basis to registered users. In all cases payment is made through credit or debit cards, the details of which must be supplied when registering with a VoD service provider.

Pricing structures vary from provider to provider, as do the terms and conditions of supply (which are manifested in the Digital Rights Management [DRM] software that determines how often and where a download can be played).

There are three broad types of Internet-based VoD consumer propositions available currently: Download-to-Own & Download-to-Rent, Download-to-burn, and streaming video.

#### 3.2.1 Download-to-Own (DTO) and Download-to-Rent (DTR)

This model, favoured by online DVD rental companies like LoveFilm in the UK<sup>1</sup>, allows users to select a title to download either to own or to rent. DRM software determines the terms under which the user can view the downloaded material.

In the case of the service offered by **LoveFilm** (www.lovefilm.com), the period available to view a rented title varies according to the licence agreement with the distributor but typically varies from five to seven days. Registered users can either pay a unit charge (of around £3.99) or a subscription of £9.99 per month for unlimited download rentals.

DTO titles are sold as a bundle, with users paying a unit charge (typically £19.99) for a digital copy for a PC, a digital copy for a Portable Device (e.g. any Windows Plays4Sure Portable Video Player) and a copy of the film on DVD (which is mailed to the user).

**Arts Alliance Media** (AAM) is LoveFilm's largest shareholder and the most significant player in the European digital distribution market. AAM holds the licences for digital distribution services offered by LoveFilm, plus AOL UK and other partners through its Vizumi VoD service. The following is taken from their website:

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<sup>1</sup> Online DVD rental services are looking to digital distribution to reduce delivery times and cut their overheads (by dispensing with the need for physically postage).

'For Download-to-Rent (DTR) and Download-To-Own (DTO), AAM provides ISPs, media companies and e-tailers with turn key solutions for acquiring rights and securely distributing digital video content over the internet to their audiences.'

It is worth noting that LoveFilm now carries BBFC certificates onscreen alongside filmographic details for each download title.

**Movielink** ([www.movielink.com](http://www.movielink.com). NB this site can only be accessed from within the US) offers downloads to rent and own in the US. Rented titles can be stored for up to 30 days after downloading and can be viewed within any 24-hour period (the clock starts once viewing has begun, and it means the film can be viewed as many times as the user wants within 24 hours). Rentals cost from 99c per film and membership is free.

Purchased titles can be stored on a PC and watched unlimited times. Some titles will be available to view on up to three different PCs (depending on the licensing agreement in place). These films can be copied onto a CD or DVD for playback on a PC but not on a conventional DVD payer. Download-to-own prices start at \$1.99 a film. Users must be registered with the site, which is currently restricted to US postal addresses.

Other examples of companies offering DTO and DTR include:

**Filmnight** ([www.filmnight.com](http://www.filmnight.com)) offers a download service in the UK alongside its electronic sell through business, as well as 'Films to View', which uses streaming technology (see section 3.2.3).

**Jaman** ([www.jaman.com/](http://www.jaman.com/)) is a new download service that deals exclusively in independent films and world cinema releases. Registered users can download a film to own for \$4.99 or to rent for \$1.99, and the service is open to anyone in the world (although specific titles may be restricted to users in countries where a licensing agreement with a distributor or sales agent exists).

**Apple iTunes** ([www.apple.com/itunes/store/movies.html](http://www.apple.com/itunes/store/movies.html)) offers US based customers the opportunity to download to own video content from Disney and Paramount, including feature films. Disney movies are released simultaneously on iTunes and DVD, and can be bought for \$12.99. Library titles from Disney and Paramount are available for DTO from \$9.99 to \$14.99.

**Unbox** ([www.amazon.com/unbox/](http://www.amazon.com/unbox/)) is the download service operated by Amazon, the electronic sell through giant. Titles are available for DTO and DTR, and the service is currently restricted to US users only. Rentals are stored on the PC for up to 30 days, and users have a 24-hour window to watch the film once play has

started. Owned titles can be stored on up to two different PCs and are normally supplied along with a copy that can be used on portable video players.

**Wippit** ([www.wippit.com](http://www.wippit.com)) is a music download service that also offers video content downloads, including movies. The service is available to subscribers, who get unlimited downloads and access to premium content. Non-subscribers can pay a unit charge for downloads. Movies are offered for download in the UK, and while users can select to see content tailored for Ireland (with prices displayed in Euros) no video content is currently available to Irish users (although I have not been able to test this from an Irish PC!).

### 3.2.2 Download-to-burn

This is a variation of DTO with the added facility that users can burn (i.e. permanently copy) a downloaded film onto a writable DVD. Many industry insiders believe this is the 'killer application' that will drive mainstream consumer demand for Internet based VoD, as it provides users with a relatively straightforward means to transfer video content from the PC to the television set.

Development of download-to-burn has been slow because of the particular DRM issues it raises (and, presumably, fears about cannibalising existing DVD revenues). However, **CinemaNow** ([www.cinemanow.com/](http://www.cinemanow.com/)) announced their download-to-burn service in September 2006<sup>1</sup> having developed new technology to allow burnt DVDs to play on conventional players and- importantly- remain copyright protected (where previously this was not always possible).

Perhaps more significantly, the service offered the first simultaneous download and DVD retail release (the first title available, priced at \$9.99, was *The Fast and the Furious: Tokyo Drift*). As BusinessWeek Online commented at the time, the 'deal marks the first time a major studio is releasing a DVD in retail stores and on a download site at the same time. Studios typically release their movies as DVDs in retail stores first, then hold off six weeks or more before making them available for download.' (25.09.06).

### 3.2.3 Streaming video

The download service recently announced by **Netflix**<sup>2</sup>, the world's largest online DVD rental company ([www.netflix.com](http://www.netflix.com)), is based on streaming media technology and is only available to registered users in the US. Subscribers will be able to download video content to watch immediately on their PC (or pause as required). Significantly, no downloaded content is retained in the computer memory. This method has the advantage of speed, as content can be viewed as it is being downloaded, and it avoids complicated DRM issues because users retain none of the content once viewing is complete.

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<sup>1</sup> 'CinemaNow's Internet Cliff-Hanger', BusinessWeek Online, 25.09.06.

<sup>2</sup> 'Netflix to Deliver Movies to the PC', The New York Times, 16.01.07.

The business model is also different to other services, as 'live movie viewing' (as Netflix terms it) will be offered free to subscribers of the existing online rental service. The amount of downloading available will vary by subscribers' monthly plans. For example, subscribers on the entry-level \$5.99 plan will have six hours of online movie watching per month, while those paying \$17.99 for unlimited DVD rental and three discs out at a time, will have 18 hours of online movie watching per month.

In the press release announcing the service, Reed Hastings (Netflix CEO) stated: 'While mainstream consumer adoption of online movie watching will take a number of years due to content and technology hurdles, the time is right for Netflix to take the first step. Over the coming years we'll expand our selection of films, and we'll work to get to every Internet-connected screen, from cell phones to PCs to plasma screens. The PC screen is the best Internet-connected screen today, so we are starting there.'

The longer-established 'broadband movie' service offered by **MovieFlix.com** ([www.movieflix.com](http://www.movieflix.com)) offers registered users access to a large catalogue of free streamed downloads (although these tend to be obscure library pictures). For 'premium' content users must pay \$7.95 a month subscription (and this is restricted to users with a US billing address), and this gives them unlimited downloading from the MovieFlix database of 3,000 full-length movies, short films, independent films and television shows.

### **3.3 Digital exhibition**

Ireland is likely to be one of the first countries to be completely converted to digital cinema, under the plans of Digital Cinema Ltd (Ireland), a subsidiary of Avica Europe (see [www.digitalcinema.ie](http://www.digitalcinema.ie) for details).

Under the scheme, Irish exhibitors pay an annual maintenance fee per projector to Avica, in addition to fees for digital 'prints'. These digital prints are distributed to cinemas by physical hard drive media at present, but the service will eventually use satellite technology to deliver them.

I understand the Censorship of Films Act applies to digital film exhibition in the same way as for traditional analogue (i.e. celluloid) projection.

I am not aware of any plans for the public exhibition of video content downloaded via VoD services. The same restrictions to public exhibition apply to downloaded films as for DVDs under the terms of standard licensing agreements.

### **3.4 Likely impact on DVD market**

In section 2.4 we looked at the prospects for DVD in the Irish market. This section draws together other evidence to build a picture of the likely impact of digital distribution on DVD in the wider context of international market developments.

A recent report in The Economist ('What's on next', 08.02.07) cites VoD revenue data over the next four years. The figures, from iSuppli, reveal that VoD revenues (from internet- and TV-based services) stood at just under \$2bn in 2006, rising to over \$12bn by 2010 (it is assumed these are US-only revenues). According to iSuppli, this striking growth rate will be driven by internet-based services. Putting these figures in perspective, predicted VoD revenues for 2010 are dwarfed by current DVD sales in the US, which had a value of \$24.9bn in 2005.

As distributors wish to maximise returns across all distribution channels it is unlikely DVD will be retired in the near future. One prominent industry leader, Reed Hastings, Netflix CEO, does not think internet-based VoD will have a serious impact on DVD distribution for some years to come: 'DVD is going to be a very big market for a very long time' (The New York Times, 16.01.07). This view is shared by other industry players and commentators: as The New York Times concludes 'some analysts believe the hurdles to mass digital distribution will not disappear any time soon'. The two biggest barriers, one technological the other commercial, are cited as the difficulty in delivering Internet video content to TV sets and worries about piracy and cannibalisation of DVD revenues.

And despite CinemaNow's optimism for download-to-burn, some analysts are less certain. Charles Wolf, of Needham & Co., is quoted as saying, 'This is an emerging technology that probably will not become material for several years' ('CinemaNow's Internet Cliff-Hanger', BusinessWeek Online, 25.09.06). He predicts online DVD rental models will continue to gain market share in the next few years.

It is too early to say how the launch of rival high definition DVD formats (Blu-Ray and HD-DVD) will affect the DVD market. In principle, high definition has the potential to revitalise growth in physical media distribution, but this is dependent on the way the format war plays out and affects consumer hardware uptake. It may be that consumers will decide to take the path of least resistance and back VoD services (which will also be able to provide high definition content in future) to avoid choosing between Blu-Ray and HD-DVD. Only time will tell.

In closing, a word of caution is required. The film distribution market is changing rapidly, and it would be unwise to make any firm predictions about the longevity of DVD. This was recently demonstrated when BusinessWeek Online reported that Wal-Mart, the largest DVD retailer in the US (accounting for 40% of total sales), was likely to bring pressure to bear on the major studios to limit download deals and preserve the DVD retail window, in order to protect its business ('More Movies than iTunes', 02.02.07). However, a week later Wal-Mart announced its own download-to-own service in the US, with the backing of six major studios ('Wal-Mart to offer movie downloads in the US', The Times Online, 09.02.07). This is a clear signal that the download market is set to takeoff in 2007, as other bricks and mortar retailers are likely to follow this example and join electronic sell

through companies (like Amazon) in offering download services. For example, Blockbuster is expected to announce its own digital distribution service later in 2007.

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The evidence, and prevailing industry opinion, suggests there is still some mileage in the DVD market, but things can change quickly with the pace of technological development coupled with consumer appetite for innovative content delivery that responds flexibly to their needs (as witnessed in the music industry).

## 4. SWOT analysis

A conventional SWOT analysis addresses the entire range of an organisation's activities within the broadest possible context, but that would be inappropriate in this scoping exercise. Instead, the analysis presented in Table 2 is tightly focussed on those elements most relevant to IFCO's response to the challenges posed by digital distribution:

Table 2: SWOT summary

| <b>STRENGTHS</b>  | <b>WEAKNESSES</b>   |
|---|---|
| <ul style="list-style-type: none"> <li>▪ There is high consumer awareness of, and support for, the existing classification system</li> <li>▪ Distributors are used to working with IFCO</li> <li>▪ The logistics of classifying digital video content are much the same as for theatrical and DVD releases, so IFCO is well placed to expand into this field</li> <li>▪ IFCO has the backing of the Department of Justice, Equality and Law Reform</li> </ul>   | <ul style="list-style-type: none"> <li>▪ Ireland is a relatively small market for film, therefore IFCO has less leverage with major distributors</li> <li>▪ Ireland and the UK are treated as one commercial 'territory' by the major studios</li> <li>▪ IFCO cannot act independently of the Department of Justice, Equality and Law Reform on major strategic matters</li> <li>▪ There is no tradition of self-regulatory approaches to classification in Ireland</li> </ul>  |
| <b>OPPORTUNITIES</b>  | <b>THREATS</b>  |
| <ul style="list-style-type: none"> <li>▪ VoD is still in its infancy and so there is scope to develop new arrangements before the market matures or an alternative classification system emerges</li> <li>▪ Distributors are waiting to see what the established classification bodies, like IFCO, can offer</li> <li>▪ BBFC is already developing proposals for a voluntary system with major distributors, and there may be scope for collaboration</li> <li>▪ TVWF: favours co-regulatory approach for non-linear services, so there may be scope for IFCO involvement in classifying for TV-based VoD services</li> </ul> | <ul style="list-style-type: none"> <li>▪ Existing legislation does not apply to internet-based VoD</li> <li>▪ Consumer confidence in the existing classification system may diminish if unclassified video content becomes widely available in Ireland</li> <li>▪ Distributors stop releasing content on DVD</li> <li>▪ Distributors or VoD providers develop their own standards for classifying online video content, or impose existing standards from their country of establishment (e.g. BBFC, CARA etc.)</li> <li>▪ Media convergence continues to blur the distinction between TV-based and internet-based VoD, bringing the latter into the purview of broadcasting legislation</li> </ul> |

## 5. Classification options

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### 5.1 Key factors for decision-making

There are a number of elements to consider when deciding the best way to approach the classification of film for digital distribution. Before outlining the main options it is worth revisiting each of the questions that have framed this enquiry:

#### a. What exactly are the threats to existing arrangements posed by technological and market changes?

The most obvious threat is that the current statutory classification system does not apply to internet-based VoD services and therefore unclassified video content may become widely available to Irish consumers. This has two important implications for IFCO: firstly, the rise of online distribution will jeopardise IFCO's ability to inform and protect consumers unless classification is extended to cover downloads.

Secondly, consumer confidence in the existing classification system may diminish if unclassified video content becomes widely available in Ireland.

These threats may be further exacerbated if VoD service providers offer alternative classification and consumer advice in their attempts at self-regulation, either by developing their own standards or adopting those operated in their country of establishment (e.g. the UK or US).

A further threat is that media convergence will continue to blur the distinction between internet-based and TV-based VoD services, which will throw into question the division of responsibility between broadcasting regulation and film classification. This issue is already exercising minds in Brussels as the European Commission seeks to distinguish between linear and non-linear transmission in proposals to extend broadcasting regulations to VoD services. With trade bodies like ATVOD pursuing self- and co-regulatory arrangements (a position that seems to be favoured by national regulators like Ofcom) it may be appropriate for IFCO to explore co-regulatory options for TV-based VoD classification in discussion with Irish providers and broadcasting authorities (e.g. the Broadcasting Commission of Ireland).

#### b. How can local classification systems regulate internet-based film distribution operated from other national jurisdictions?

The first point to consider is to what extent downloading services will be available to Irish consumers from companies established elsewhere, as opposed to Irish companies. This is not entirely clear from the available evidence.

In the UK, online DVD rental companies, like LoveFilm, and electronic sell through businesses, like Filmnight, offer downloading alongside their existing services. Both of these companies are based in the UK and restrict their



services to UK consumers. There is a good chance that Screenlick, Ireland's largest online DVD rental company and part of LoveFilm International, will follow its parent company's lead and begin offering DOT and DTR services to its Irish subscribers. As Screenlick is based in Ireland any extension of the criminal law to encompass digital downloads will apply to it, at least in theory.

But offshore services (i.e. those companies based outside Ireland but offering downloading to Irish consumers) may emerge as the market matures and competition leads to consolidation in the hands of large multinational corporations based overseas. At the micro level it may be that such a move is prompted, or at least encouraged, by the imposition of a local classification system that increases costs and reduces market efficiency (through, for example, slow turnaround of classification decisions). This makes it even more important that any new classification proposals are developed in partnership with distributors, to ensure they are fully signed up and, therefore, less likely to seek ways of circumventing legal or voluntary solutions.

For the moment let us consider the implications of extending statutory classification to digital distribution. One undesirable scenario would see a two-tier system developing, whereby Irish companies are subject to statutory control while offshore services operate outside the law. In addition to undermining the classification system with the possible loss of consumer confidence, such a situation could unfairly burden Irish companies in what will undoubtedly prove to be a highly competitive and dynamic market.

The only way to avoid this situation is to provide a legal 'level playing field', which means finding a way to apply sanctions to companies operating in Ireland irrespective of their country of origin. This is a notoriously difficult proposition to achieve. Creative thinking is required, and it is instructive to consider solutions that have developed in other spheres. I include two such models here, not as firm proposals but as food for thought because they help to clarify some of the main challenges facing attempts to regulate the Internet.

The first model is based on Notice & Takedown Orders (NTOs) that currently operate for illegal content on the Internet (like child pornography and copyright infringement). The locus of control is the Internet Service Provider (ISP), who is required to remove illegal content brought to their attention through a complaints mechanism. As I understand it, the ISP hosting the illegal content is responsible for its removal, and national authorities can call upon international partners to help enforce these regulations. In Ireland, the Internet Service Providers Association of Ireland (ISPAI) supports and funds a hotline service ([www.hotline.ie](http://www.hotline.ie)) that is a member of Inhope, the international organisation of Internet Hotlines.

NTOs have developed in areas where there is a very high level of public concern (e.g. child pornography) coupled with a genuine will for cross-border

co-operation (and backed by EU regulations). It is unlikely these sentiments will develop for film classification and so the problem of how to deal with offshore download services will remain if this model were followed. However, it may be possible for Irish based ISPs to block access by broadband accounts with an Irish IP address to sites offering unclassified film downloads. Such a move would no doubt prove extremely unpopular with ISPs (making them *de facto* enforcement agencies, as well as adding an additional administrative burden) and would run the risk of blocking access to legitimate services (particularly for sites that offer DVD retail as well as downloads). As this is a highly specialised area that goes beyond my expertise, further investigation of this option's feasibility is required.

The second model examined here shifts the locus of control from ISPs to operators of online payment systems. Rather than pursue enforcement through gatekeepers controlling Internet access, the law could be applied to block transactions between consumers and internet-based VoD services providing unclassified downloads.

This is the route taken by the US federal government in its recent clampdown on Internet gambling. Congress passed the Unlawful Internet Gambling Enforcement Act in October 2006 and federal officials have until July 2007 to devise enforcement mechanisms to prevent American consumers from taking part in electronic gambling transactions. The Act requires all parties connected with a 'designated payment system' to block certain restricted transactions.

For credit card companies, like Visa, this is a relatively straightforward matter of blocking payments with a specific merchant code. However, for other payment providers there is some question about how this might be achieved as they currently have no way of identifying gambling transactions. For example, the Automated Clearing House network (ACH) cannot distinguish between transactions on the basis of the product or service purchased.<sup>1</sup>

Furthermore, financial institutions based outside the US, like Neteller, are outside US jurisdiction and may decide not to honour the regulations. As overseas payments cannot be regulated directly, the Act empowers US and state attorneys to bring civil actions in a federal court. Another enforcement approach is for US authorities to force US based banks to cease trading with overseas payment operators involved in illegal transactions.

These complications have led some commentators to doubt whether an effective enforcement mechanism will ever be developed. Nonetheless, the immediate impact of the Act was to force publicly listed Internet gambling companies to abandon the US market, even before enforcement had come into effect. But given the lure of high revenues other operators are expected to

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<sup>1</sup> 'Ban unlikely to end Web gambling', MSNBC.com, 17.10.06.

fill the void left by these companies, and the long-term impact of the Act on its desired goal is far from certain.

In summary, neither of these alternative models provides a wholly satisfactory solution to the problem of enforcement against companies based outside Ireland, and ISPs and online payment service operators are certain to resist any attempt to corral them into enforcement roles. I cannot escape the conclusion that each of these alternatives would be like employing a sledgehammer to crack a nut!

**c. What changes, if any, are required to current legislation to ensure the classification system continues to inform and protect Irish consumers however they choose to access filmed entertainment?**

The answer to this question very much depends on whether a legal remedy is sought, or if some form of voluntary arrangement involving IFCO is adopted.

If the former avenue is taken, changes to the law will necessarily follow the preferred approach to enforcement. But as the preceding discussion illustrates, the matter of enforcement is far from straightforward.

An approach not yet touched on, one that takes a less stringent view of enforcement, would be to use the mere threat of criminalising an activity to ensure compliance (which may be a particularly effective influence on publicly listed companies, as the gambling clampdown has shown in the US). I am not a legal expert and cannot say, for example, whether simply extending the licensing requirements under the Video Recordings Act, 1989 to cover electronic sell through (either of physical DVDs or downloads) would be sufficient to keep the major distributors in line (as they are unlikely to want to confront a sovereign state that wishes to protect children from unclassified content). Distributors could be directed to encourage VoD providers with whom they have content agreements to seek a retail/rental licence. Of course there are a number of untested assumptions about the degree to which distributors and VoD providers will co-operate in this regard, but it may be worth further investigation.

The alternative to statutory classification is a voluntary system, which is the route currently being explored by the BBFC. In this context, no changes are required to current legislation. Instead, a voluntary scheme administered by IFCO could be established in collaboration with distributors, who would pay a fee to have their works classified for digital distribution and then licence the classified film to internet-based VoD providers serving the Irish market (making it a condition of the licence agreement that classification information is supplied at the point of sale). The biggest risk to this scheme (aside from a total absence of industry co-operation) is that smaller distributors, lacking the same incentives as large multinational companies, simply opt out, resulting in a two-tier system.

**d. What other practical steps can be taken to maintain classification standards across all current and future forms of distribution?**

Outside the immediate concern with classifying Internet-based VoD, it is clear that in the next few years mobile VoD services will gather momentum. Downloaded video content is already available for portable players, and 3G mobile phones can offer video content (e.g. TV clips). The content industry is clearly aiming to make VoD content available to consumers whenever and wherever they are, at home or on the move, and this poses further opportunities- and challenges- for classification bodies.

Although this is outside my area of expertise, the factor likely to complicate the extension of film classification to new platforms appears to be the extent to which European legislation, covering telecommunications and broadcasting, applies to these services. It is the same issue discussed earlier: media convergence is blurring the traditional division of responsibility between communications regulators and film classification bodies.

Opportunities for extending film classification to mobile VoD (and other platforms) will become clear only through a process of negotiation with stakeholders such as national telecommunications and broadcasting regulators, content providers and VoD service operators (or their representative trade bodies). The most obvious practical step would therefore be to open just such a dialogue while the market is still in its infancy.

**e. What impact will new distribution channels have on the size and vitality of the theatrical and video markets?**

This report has considered the likely timescale for digital distribution roll out in Ireland. All the available evidence suggests that worldwide growth in the DVD market will continue to slow but physical media distribution will remain a force to be reckoned with for the foreseeable future. The large, installed DVD hardware base in Europe coupled with the medium's ease of use and- crucially- its link to the TV set will ensure mainstream consumer demand for DVDs continues until cost-effective alternatives offering the same ease of use are brought to market.

It is too early to predict the impact of high definition formats, but they certainly offer at least the potential for new growth in the DVD market. Undoubtedly the main driver for DVD will continue to be retail (including electronic sell through) and online DVD rental, and it is these companies that are most likely to succeed in the short-term with internet-based VoD services that leverage their established subscriber bases (as LoveFilm and Filmnight have demonstrated in the UK).

Internet-based VoD services are likely to have an impact on DVD once several elements are in place:

- **High-speed broadband connections are installed in a significant proportion of households.** At present Ireland has one of the lowest broadband penetration figures in Europe (21% of households), which makes the potential customer base for VoD much smaller than in other countries.
- **Downloaded video content can be transferred easily from PCs to TV sets.** It is possible to physically connect a PC to a TV but this is not considered a user-friendly option. Apple has launched the AppleTV player, which can wirelessly connect a computer to a TV, but the technology (and uptake) is unproven. Another approach is download-to-burn, but until recently DRM software only allowed burnt DVDs to play on other PCs. However, CinemaNow's new DTB service allows burnt DVDs to play on conventional DVD players. None of these solutions are presently available in Ireland.
- **Digital Rights Management solutions offer robust safeguards against piracy.** Distributors are wary of the ever-present threat of piracy and they have tended to apply strict DRM restrictions on VoD content. As distributor confidence grows and DRM develops in more consumer-friendly directions we will see more simultaneous VoD and DVD retail releases, making the consumer proposition for VoD more attractive.
- **First run DVD deals are struck with VoD providers.** The vast majority of films presently available for legal download are library titles. What consumers really want is to be able to download the latest blockbusters at the same time as, or before, they are available for sale on DVD. This will become increasingly possible as major studios sign digital licensing agreements for their first run DVD product.

All of which suggests that reports of DVD's imminent demise are premature, although in the longer-term (five years+) the prospects for downloading look very promising.

**f. Which arrangements are likely to find favour with film distributors, and therefore stand the greatest chance of success?**

In general, industry prefers voluntary to statutory controls, and we should not forget that the major studios operate their own self-regulatory classification system in the US (the MPAA'S CARA ratings). In practice, however, a legal framework can work and find favour with business provided it does not place too onerous a burden on companies.

Any classification proposition for digital distribution must be cost effective and classification decisions need to be reached speedily if they are to find favour with distributors. Distributors are likely to welcome a system that seamlessly covers all distribution platforms, enabling them to manage classification of

their works right through the distribution value chain- cinema, pay TV, video/DVD, online etc.

The fact that the IFCO system has high consumer awareness and is known to distributors is certainly a key strength. There would be little sense in distributors developing new classification standards for online distribution, or simply imposing existing systems like the US CARA ratings, when local alternatives are available (provided, of course, they meet distributors' expectations over cost, speed and flexibility).

**g. What level of protection and information may be required by consumers accessing film through new digital platforms?**

The matter of protection can be dealt with relatively straightforwardly. All current internet-based VoD services offering downloads for sale or rental require users to register their credit or debit card details when they become members (or at the virtual checkout). This acts as a *de facto* point of sale age restriction as payment cards are only available to persons aged 18 years and over.

In terms of classification information it is fair to assume consumers will expect the same as currently provided for theatrical and video works. In other words, a recognisable classification symbol indicating age suitability and some form of consumer advice.

By harnessing the visual and interactive features of the web, what can differ, however, is the means of presenting that information to make it more prominent and user-friendly. Thus, animated classification symbols could be deployed on websites to draw the user's eye, and user-selected pop-up boxes or similar could display more detailed information about a classification decision. Alternatively, a simple hyperlink from an IFCO symbol on a VoD website could take the user to the main IFCO website for further information. There are plenty of possibilities, many of which would not pose an onerous burden on VoD operators.

**h. What are other classification authorities and media regulators doing to meet these challenges?**

In preparing this report I have had a number of conversations with Pete Johnson, the BBFC's Head of Policy. As previously mentioned, the BBFC is developing a voluntary system for classifying downloads in discussion with major distributors. The Board has also been in discussion with download services about carrying classification symbols on their websites. The BBFC has offered to meet with IFCO to discuss its plans, if that would be helpful.

I have yet to see concrete evidence of the approach taken to download films by the MPAA's CARA ratings system in the US. However, most US-based VoD services carry CARA ratings information onscreen.

**i. Is greater international co-operation required (and practical) to meet the challenges of globalisation in the supply of filmed entertainment?**

Beyond sharing intelligence and information about new models of classification it is unclear what specific issues might benefit from formal international co-operation. The forthcoming International Ratings Conference in Sydney should prove helpful in clarifying areas of mutual interest among the international classification community, pointing the way for possible future co-operation.

## **5.2 Options**

The following options are not intended to be exhaustive and further detail is required in specifying the exact arrangements to be developed:

### 5.2.1 Option 1: the status quo

Leaving things as they stand is not really an option, as by commissioning this scoping report IFCO has already signalled its intention to meet the challenges posed by digital distribution.

In the long-term (five years +) internet-based VoD (and other new media platforms) will be a significant distribution channel, and may even eclipse DVD. There is nothing to gain by inaction at this stage, and potentially everything to lose.

**Strengths: None**

**Weaknesses: Risks leaving IFCO marginalised as digital distribution becomes more firmly established.**

### 5.2.2 Option 2: develop statutory classification arrangements for digital distribution

Ireland has a history of seeking statutory solutions to content classification. But as the foregoing discussion illustrates, the extent to which effective legal remedies can be found for the challenges posed by cross-border eCommerce is questionable.

Nonetheless, three possible approaches have been discussed, each requiring more detailed consideration if they are to move beyond this preliminary scoping exercise. Briefly these are:

a). Extend wholesale and retail licensing under the VRA to cover existing online DVD rental and internet-based VoD services.

**Strengths: Builds on existing legislation; licensing regime is already in place.**

**Weaknesses: Enforcement is difficult (impossible?) for companies based outside Ireland.**

b). Develop an enforcement mechanism based on the Notice & Takedown model, by requiring Irish ISPs to remove VoD sites offering unclassified content from their servers, or block access by their subscribers to such sites hosted abroad.

**Strengths: ISPs are usefully placed as gatekeepers over Internet access, and therefore offer a point of control for enforcement.**

**Weaknesses: As employed currently, NTOs only apply to ISPs hosting illegal material, which means ISPs based outside a national jurisdiction have to be dealt with through international co-operation. The alternative of requiring Irish ISPs to block consumer access to sites based in other countries may not be realistic or practical.**

c). Develop an enforcement mechanism that targets payment services providers by requiring them to block transactions to internet-based VoD sites supplying unclassified content.

**Strengths: Commercial VoD (as opposed to free downloads) requires the participation of payment services providers, who offer a point of control for enforcement (provided they are based in Ireland).**

**Weaknesses: There is considerable doubt about the likelihood of effective enforcement of such measures, as seen in the case of the recent US Internet gambling crackdown.**

#### 5.2.3 Option 3: develop voluntary classification arrangements for digital distribution

A voluntary system could be developed to run alongside existing statutory classification.

**Strengths: Likely to find favour with distributors; does not require any new legislation; once in place the system could more easily adapt to suit the changing market as new services develop.**

**Weaknesses: Requires industry co-operation to be effective; distributors may not consider Ireland as a significant enough market to support local classification arrangements.**



## 6. Conclusion

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### 6.1 Summary

A great deal of evidence has been presented in this report, covering a wide range of topics. Perhaps the most useful way to conclude is to offer a thumbnail sketch of the main points as I see them:

- DVD will continue to be a force to be reckoned with for the foreseeable future.
- At the same time, there is no escaping the fact that digital distribution, by whatever means (but primarily Internet-based VoD), is set to grow at a rapid rate and so the challenges posed to national classifications systems are real. *Inaction is not an option!*
- Development of digital distribution may be slower in Ireland given the relatively small number of consumers and low broadband penetration. *There is still time to act while the market is in its infancy and before VoD services become firmly established.*
- Two main options are open to ensure IFCO has a continuing role to play in content classification: extending statutory classification to internet-based VoD or developing a voluntary system. *On the balance of evidence presented here, the latter option has a more realistic chance of success, although expert legal opinion should be sought before discounting the statutory route.*

### 6.2 Recommendations for next steps

#### As a matter of priority:

- If you have not already done so, initiate discussions with distributors operating in Ireland about their plans for digital download services and their views on classifying films for download.

It is vitally important that any new classification proposals are developed in partnership with distributors, to ensure they are fully signed up and, therefore, less likely to seek ways of circumventing legal or voluntary solutions.

- As Ireland already has a video retail and wholesale licensing regime in place under the VRA it may be worth approaching online DVD rental companies to sound out their willingness to apply for a licence to cover their existing business and any planned VoD services (I note that Busy Bee DVD already has a retail licence from IFCO, in which case you may already have this matter in hand).

#### Non-essential, but worth considering:

- It may be advisable to commission a survey to determine the extent to which Irish consumers want to see classification extended to online content, and to explore what type of classification information they require.

In turn this could be a valuable tool in discussion with stakeholders, like distributors, demonstrating the weight and direction of public opinion.

- It may be appropriate for IFCO to explore co-regulatory options for TV-based VoD classification in discussion with Irish providers and broadcasting authorities (e.g. the Broadcasting Commission of Ireland).

[end]