Stage 2 Cost Recovery Impact Statement

Proposal for funding the Office of Film and Literature Classification to support self-rating by Commercial Video on Demand providers

Agency Disclosure Statement

This Cost Recovery Impact Statement (CRIS) has been prepared by the Department of Internal Affairs (the Department). It provides an analysis of options to ensure that the Office of Film and Literature Classification (OFLC) is funded to provide services which support self-rating by Commercial Video on Demand (CVoD) providers.[1]

Background

In September 2019, Cabinet noted that the Department would address options for funding services supporting the rating of CVoD media content [CAB-19-MIN-0445 refers].

Companies which distribute online media content to New Zealanders are not subject to the New Zealand regulatory regime for classifying media content. The Government is extending the regime to specified CVoD providers.

Under the extended regime, specified CVoD providers will have the option of either rating their own media content, or using the existing classification system. OFLC activities covered by this CRIS will support CVoD providers who rate their own media content. Providers will receive a package of services which includes software support, audit and review, a provider interface, and liaison with the public.

Relevant legislation

The current regulatory regime for classifying media content is established by the Films, Videos, Publications and Classification Act 1993 (Classification Act).

The Films, Videos Publications and Classification (Commercial Video on Demand) Amendment Bill (the Amendment Bill) will require specified CVoD providers to meet New Zealand standards and systems for rating their media content. Schedule 1 of the Amendment Bill defines which companies are "specified providers." Parliament is scheduled to consider the Amendment Bill in 2020.

A review of funding of existing classification activities is out of scope

Cabinet has also directed the Department to review options for funding the classification and related activities currently specified in the Classification Act 1993 [CAB-19-MIN-1074.21 refers].

[1] "Self-rating" and "classification" both refer to the activity of defining media content according to its suitability for viewing by particular age groups. Under the Classification Act, only OFLC has the authority to issue a "classification."

Options not considered in this CRIS

Options discussed in this CRIS do not include alternative structural options for providing the services involved. For example, alternative organisational models or approaches to achieving the outcomes of the classification function are not considered.

Context: a changing market for media content

In recent years, consumers have shifted from using physical media such as DVDs to viewing media content via online platforms such as Netflix. As a direct consequence, OFLC's annual income from fees for classifying items such as DVDs and films for theatrical release has declined by 55 percent between 2009/10 and 2017/18, from $1.366 million to $0.616 million.

These market trends are projected to continue for the medium-term future. Commentators expect the media market to continue to show considerable fluidity, as distributors compete for customers while trying out different delivery models. Examples of recent industry changes are the entry into the New Zealand market of Disney+ in late 2019 and the 2020 merger of Sky's Neon with Spark's Lightbox.

Impact of COVID-19

In the short-term, COVID-19 may have a positive impact on the online media content industry. However, positive impacts may not last as wider factors make themselves felt.

There have already been reports of consumption of online media content increasing significantly in countries affected by COVID-19, as people self-isolate, work at home or otherwise seek forms of entertainment that don't involve large gatherings of people.

In the longer term, however, wider effects such as a reduction in disposable income and the total or partial closedown of some industries, including the movie industry, may result in a significant downturn in the online market.

These effects may impact on the recommendations in this CRIS, which were drafted at a time when the online entertainment industry was profitable and expanding. All recommendations in this CRIS involving financial impacts on CVoD providers will need to be regularly reviewed up to the point when the regulations are finalised, so that the impacts of COVID-19 can be factored in.

Key gaps, assumptions, dependencies and uncertainties

The analysis in this document is based on the best available information about CVoD activity and associated OFLC costs from 2020/21 onwards.

OFLC's estimates of future costs are based on a detailed project plan for its future CVoD-related activities. However, regulating self-rating systems is a new activity for OFLC and we have limited information on which to base estimates of future CVoD activity. This impacts on cost recovery options. In particular, the option of basing an OFLC fee on the number of items self-rated by providers is ruled out at this stage. Setting a fee on this basis could result in costs being over- or under-recovered.

The recommended option of a CVoD fee based on market share is also based on limited knowledge about the relationship between market share and the costs providers create for OFLC.

In the shorter term (two - three years), it is reasonable to expect that we will develop a better picture of the relationship between distributor activity and OFLC costs. This improved knowledge will enable us to enhance the system.

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Executive summary

This CRIS provides an analysis of options to ensure that OFLC is funded to provide services which support self-rating by CVoD providers.

The existing legislative framework for classifying media content does not apply to companies which distribute online media content to New Zealanders. Parliament will consider the Amendment Bill in 2020 which will extend the regulatory regime to CVoD providers specified in Schedule 1 of the Bill.

This proposed legislative change aims to protect the community from harmful media content.

The activities covered by this CRIS would be provided by OFLC to support CVoD providers which rate and label their own media content.[2] OFLC will supply a package of services which includes software support for providers, audit and review, a provider interface, and liaison with the public.

The estimated annual cost to OFLC of its CVoD-related services is $0.745 million (GST exclusive). Analysis indicates that CVoD providers specified in the Amendment Bill should contribute 75 percent of these costs, or $0.559 million (GST exclusive). There are currently nine specified CVoD providers.

The preferred option is for OFLC's CVoD costs to be recovered via a market-based fee linked to subscriber/active user numbers. The proposed fee would be set using the following formula:

Annual fee for individual CVoD provider	equals	Estimated total annual costs of OFLC services provided to all CVoD providers	Multiplied by	(Number of active subscribers / active users of the distributor's CVoD content Divided by New Zealand total of active subscribers / active users of CVoD content offered by specified providers).

To give an example of the impact of the proposed fee: Netflix, currently the largest distributor operating in the New Zealand subscriber market, would pay approximately $0.390 million (GST exclusive) annually in CVoD fees to OFLC.[3]

Consideration was given to setting a charge for OFLC's CVoD-related services on a transaction-by-transaction basis, as is standard practice for charges for regulatory services. However, analysis indicates that a fee for transactions is not suitable for OFLC's CVoD-related services. These comprise a package which does not conveniently break down into predictable, chargeable transactions.

It is proposed to implement the fee from 1 January 2021.

The proposed changes would leave OFLC with an estimated operating deficit of $0.838 million over three years from 2020/21 to 2022/23. The shortfall would need to be met by an increase in Crown appropriation.

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[2] In this CRIS, "CVoD provider" refers to a CVoD provider specified in Schedule 1 of the Amendment Bill.

[3] A UMR survey carried out in October 2019 found that Netflix had approximately 70 percent of the subscriber market at the time.

Status quo

- **A description of the activity and why it is undertaken**

The overall purpose of classification and rating activities is to assist New Zealanders to make safe, informed choices about the media content they view.

CVoD providers will have the option of self-rating their own media content

The activities covered by this CRIS would be provided by OFLC to support self-rating by CVoD providers.

Under the Amendment Bill, CVoD providers will be required to rate and label media content before it is screened to New Zealand audiences. A label consists of a rating and description note. CVoD providers will have the option of self-rating the content on their platforms, under conditions specified in the Amendment Bill. For example, the self-rating tools used by providers must be approved by OFLC, which will also monitor and audit how individual providers rate their own media content.

The Amendment Bill also gives CVoD providers a choice between using their own in-house rating systems or a self-rating tool provided by OFLC. These options give rise to closely equivalent costs for OFLC. For the purposes of this CRIS, they are therefore treated as a single composite system.

CVoD providers will also have the option of having their media content classified using the current system, where items are submitted to the Film and Video Labelling Body (FVLB). OFLC advises on the basis of preliminary discussions with the industry that few providers will choose this option, which is out of scope for this CRIS.

OFLC's CVoD-related activities will support self-rating by CVoD providers

OFLC will provide CVoD distributors with a package of services which includes software support, audit and review, a provider interface, and liaison with the public.

- **What policy outcomes will the activity achieve?**

A cost recovery system operates to cover OFLC's costs of regulating CVoD provider's self-rating systems which aim to protect the community from harmful media content.

- **What is the rationale for government intervention?**

New Zealand and overseas surveys[4] show that the wider community values systems which rate media content. Such systems help to protect individuals, particularly children, from the harm which can arise from people viewing material that is inappropriate for their level of maturity. If the viewer doesn't have the psychological resources needed to take a healthy perspective on what they see, they may suffer personal harm or inflict harm on others.

Most distributors of media content apply some form of rating system, whether or not they are required to do so by legislation. Rating serves a useful function, enabling potential

[4] See, for example, *Changing media use and public perceptions of the classification system,* Colmar Brunton, 30 June 2016; *Filtering Glamour Content on Mobile Devices for Under 18 year olds*, British Board of Film Classification, 2015

consumers to make an informed choice about whether to access the material involved. Distributors also want to conform to community standards.

The rationale for government intervention is that distributors may rate their own material less stringently than the community and/or the Government would prefer. By requiring distributors to meet consistent standards which are known to match community preferences, the Government ensures that the “right” level of classification will be provided.

- **What relevant policy decisions have been made?**

On 2 September 2019, Cabinet noted that the Department was undertaking work to establish and set a CVoD charge as part of its review of fees payable under the Films, Videos and Publications Classification Act, 1993 [CAB-19-MIN-0445 refers].

- **What is the statutory authority to charge ie, the Act that gives the power to cost recover?**

The Films, Videos, and Publications Classification (CVoD) Amendment Bill will include a charging mechanism for CVoD.

- **Is this a new or amended fee?**

A new fee.

Cost Recovery Principles and Objectives

The objective of the funding review (the Review) was to identify and implement a funding model that financially supports OFLC to enable New Zealanders to make informed viewing choices and minimise the availability of harmful media content.

The following principles were included in the Consultation document developed for the Review. The principles have been used as criteria for assessing cost recovery levels and options.

Principle	Comment
Effectiveness	How well does the funding option achieve the Review’s objective? Does it produce any unwanted consequences?
Efficiency	The services provided by OFLC are produced to the required standard at the least cost.
Transparency	Transparency means operating in such a way that it is easy for others to see what and how many activities OFLC is carrying out, why, and at what cost. It implies openness, communication, and accountability.
Equity and fairness	This criterion asks whether stakeholders will be treated fairly and reasonably under the options being tested.
Simplicity	Is the cost-recovery option easy to understand and work with for stakeholders? Is it administratively simple and cost effective to administer?
Stakeholder engagement	Have stakeholders been involved in the process of informing the Government’s decision?

Based on feedback received during the consultation process, the following additional principles were also used to assess options identified by the Review.

Principle	Comment
Sector impact	This criterion is made up of the following related threads: • **Freedom of expression**: the activities authorised under the Classification Act seek to prevent harm to the public by restricting the availability of harmful material in a manner consistent with the right to freedom of expression • **A cultural value factor** - media content is a conduit for the expression of cultural diversity, and also of a uniquely New Zealand 'voice' • **A financial impact factor** - if the cost of classification has a significant negative impact on the financial viability of organisations distributing media content, eg, where potential new entrants into the sector are deterred or current participants are driven out, this counts as an unintended and undesirable effect.
New Zealand and overseas precedents	Good practice involves considering how similar offices and other jurisdictions charge for online activities, as a guide for developing an approach suitable for New Zealand.

Policy Rationale: Why a user charge? And what type is most appropriate?

- **Why is cost recovery appropriate for the activity (over and above the legal authority to charge) ie, why should it be third party funded rather than funded by the Crown?**
- **Is full or partial cost recovery being proposed? What is the rationale for proposing full or partial cost recovery?**

A partial cost recovery system operates for OFLC's physical media classification activities. It is recommended that partial cost recovery be extended to recover OFLC's costs from regulating CVoD providers. The principles of the Review suggest that users of OFLC's services and the Government share these costs. A partial cost recovery system recognises that CVoD providers and the community both receive benefits from OFLC's CVoD activities. It also ensures users pay the costs they give rise to.

The Department has assessed different levels of cost recovery from the sector against the principles of the Review. The Department's conclusions about the appropriate level of cost recovery are in Table 1. The assessment arrived at a range, within which the sector contribution could be set.

The sector's contribution to costs should be within a range of 35 to 100 percent

The discussion in Table 1 indicate that the preferred contribution should lie within a range between 35 percent to 100 percent. 35 percent is the level of contribution projected for the physical media sector in 2020/21 if no fee increase is imposed, and considerations of equity and relativity argue for CVoD providers contributing at least as much as physical media providers. 100 percent is the upper level of funding from CVoD media providers indicated by two of six criteria in Table 1.

Table 1: Appropriate sector contribution

Criterion	Comment	Appropriate sector contribution
Efficiency	The Crown and the sector should share costs, so that the sector exerts a positive influence on OFLC's efficiency.	In a range around a middle point of 50 percent
Equity and fairness	A "risk exacerbator" argument supports a contribution towards OFLC costs from the sector. According to this approach, it is fair and equitable to expect those who create risks (in this case, the risk of harm from media content) to pay the costs of the risks created. One submitter put forward a counter-argument that the Government should pay the additional costs to CVoD providers of meeting regulatory standards of classification.	Up to 100 percent
	Relativity should be maintained between the contributions of CVoD and physical media providers. Physical media providers currently contribute approximately 35 percent of the costs of commercial classification.	35 percent or higher
Sector impact	While the COVID-19 pandemic has introduced considerable uncertainty about the prospects for the CVoD market overall, the sector has been expanding rapidly for some years prior to February 2020. It is reasonable to assume that prospects for the CVoD market are better than the prospects for the physical media content market. The contributions of the two sectors to OFLC costs should reflect this.	A higher contribution than that from the physical media content sector (i.e., above 35 percent)
Stakeholder views	Submissions conceded that providers should make some contribution to OFLC's CVoD-related costs, but considered that this should be minimal, particularly because: • those participating in the system experience a market disadvantage relative to online video distributors not covered by the classification system established by the Amendment Bill; and • distributors are self-rating their own media content.	Less than 50 percent
New Zealand precedents	The sector has in the past contributed 100 percent of the costs of Commercial classification. As late as 2018/19, the sector contributed 62 percent of costs, despite the decline in the physical media content market. OFLC's CVoD-related services differ from the services provided by Commercial classification, because CVoD providers rate their media content. However, OFLC's CVoD-related services are an integral part of the proposed self-rating system.	Between 35 to 100 percent
International precedents	International precedents support the sector contributing to the costs of classification. However, self-rating systems like that proposed for New Zealand are a recent innovation.	Some contribution from the sector
Overall assessment	**The criterion-based analysis of the appropriate level of cost recovery indicates a level in a range between 35 to 100 percent**	**35 to 100 percent**

A sector contribution of 75 percent is recommended

From starting at the midpoint of the 35 to 100 percent range, of 67.5 percent, the Department recommends a sector contribution of 75 percent. This 7.5 percent adjustment from the midpoint recognises that a key rationale for cost recovery is that CVoD media content gives rise to risks to the community, and that those responsible for distributing such content for commercial purposes should bear a part of the cost of minimising harm.

- **What is the nature of the output from the activity (the characteristics of the good or service)?**

The Department has assessed classification services as having the characteristics of a merit good. The output for OFLC's CVoD services is a bundle of services, such as software and auditing which support CVoD providers who are self-rating. The Treasury's *Guidelines for Setting Charges in the Public Sector* defines a merit good as follows: "a merit good has the property that the community as a whole desires the higher use of the output than would be likely if it were charged for at full cost." A merit good is one that is likely to be produced at a lower level than the community desires in a free market situation.

With some merit goods there may be a case for charging at less than full cost or not charging at all for merit goods.

- **What type of charge is being proposed eg, fee, levy, hourly charge? What is the rationale behind selecting this type of charge?**

The proposed charge is a fee according to Treasury and Legislative Development Advisory Committee (LDAC) guidelines, as distinct from a levy. Appendix One presents an assessment of the proposed cost recovery approach against LDAC guidelines.

Consideration was given to setting a fee on a transaction-by-transaction basis. Fees for processing individual passport applications are an example of this approach, which is standard practice for cost recovery for government services.

However, analysis indicates that a fee for transactions is not suitable for OFLC's CVoD-related services. These comprise a package which does not conveniently break down into predictable, chargeable transactions with a single identifiable category of client. Individual services include:

- a range of software-related services to set up and maintain OFLC's Self-Rating Tool (one of two self-rating options available to providers in terms of the Amendment Bill) and also the interface between OFLC and providers' self-rating systems;
- audit and review of the ratings produced by providers' self-rating systems;
- training and liaison with providers; and
- liaison with the public over complaints and enquiries relating to the operation of providers' self-rating systems.

The individual services listed above support self-rating rather than involving the classification of media content. They nevertheless collectively make up an integral part of the self-rating system established under the Amendment Bill.

With a transaction-by transaction option being ruled out, the Department identified the following main cost recovery options:

- charge a flat fee for OFLC services which divides the total cost equally between distributors; and
- charge a fee which varies according to a measure of rating activity.

Options are assessed in Table 2 below, using relevant criteria taken from the Consultation document. The preferred option is to charge each CVoD provider an annual fee to recover a share of OFLC's CVoD-related costs, based on a measure of an individual distributor's presence in the CVoD market in New Zealand. Using the number of subscribers / active users as a measure of the costs that are likely to arise for OFLC, is preferred over other measures such a catalogue size. This is because there is more of a connection between the number of people using online media content and the level of risk.

Table 2: Cost recovery options for OFLC's CVoD services

	CRITERIA:		
Option	**Pros**	**Cons**	**Ranking between 1 - 5**
1. Fee based on subscriber numbers (audited information provided by providers)	**Equitable**: charges providers according to a risk-related measure. Specifying that subscriber numbers must be audited ensures that information is accurate. **Simplicity**: an easy-to-understand approach.	**Stakeholder views**: there is a risk that providers would object to having to provide commercially sensitive information.	1. The most preferred of the market-share-based approaches, particularly on equity grounds. This conclusion prioritises accuracy of information about subscriber numbers over stakeholder views. The risk of stakeholder opposition is noted.
2. Fee based on subscriber numbers (information obtained by market survey)	**Equitable**: charges providers according to a risk-related measure **Simplicity**: an easy-to-understand approach **Stakeholder views**: supported by a major stakeholder	**Equity**: Market surveys comprise a less accurate measure of subscriber numbers than the alternative of obtaining audited information from providers.	2. Ranked second after option 1, with this ranking prioritising stakeholder views over accuracy of information about subscriber numbers.
3. Fee based on subscriber numbers (information provided by distributor on a voluntary basis)	**Equitable**: charges providers according to a risk-related measure. **Simplicity**: an easy-to-understand approach.	**Equity, effectiveness**: relies on distributors providing good quality information**.** **Stakeholder views**: not tested with stakeholders, but there is a risk that providers would object to having to provide commercially sensitive information.	3. Option 3 is a compromise between options 1 and 2, but still involves some equity and effectiveness risks around the accuracy of information and a risk of stakeholder opposition.
4. Fee based on size of catalogue	**Equitable**: charges providers according to a risk-related measure. **Simplicity**: an easy-to-understand approach.	**Equity, effectiveness**: relies on distributors providing good quality information. Catalogue size is less directly related to the potential risk from media content than subscriber numbers. Two providers could have the same catalogue size but give rise to different levels of risk because many more people access the catalogue of one of the providers. **Stakeholder views**: not tested with stakeholders, but there is a risk that providers would object to having to provide commercially sensitive information	4. This option is less equitable and effective than options 1.-3., and there is a risk of stakeholder opposition.
5. Charge a flat fee	**Simplicity**: a simple, easy-to-understand approach. **Stakeholder views**: Partially supported by a major provider.	**Effectiveness**: Under a flat fee system, distributors adding relatively low numbers of new titles to their catalogue would have a strong financial incentive to use the current classification method rather than self-rating. The Government has a positive interest in making the self-rating system an attractive option for providers, and providers electing to use the existing classification system would drive up the cost for others. **Equity**: less equitable. This approach does not charge providers according to a risk-related measure.	5. The least preferred of the alternatives assessed in this table, on effectiveness and equity grounds.

- **Who will pay the cost recovery charges? Include data on the number and size of businesses, individuals etc, if possible.**

The proposed cost recovery charges will be paid by CVoD providers named in Schedule 1 the Amendment Bill. At present, nine companies are proposed for naming in the Schedule to the Amendment Bill.[5]

One distributor has said they intend to absorb the costs of self-rating rather than pass them to consumers.

The majority of specified CVoD distributors are companies based in the USA specialising in media content. There is likely to be at least one New Zealand-based media company on the list.

- **Assessment of proposed user charges against objectives**

The proposed user charges will fulfil the Review's objective to ensure OFLC is adequately funded. The level of cost recovery proposed has been guided by principles based analysis and set at a level, combined with an increased contribution from the Crown, that will cover OFLC's costs.

The level of the proposed fee and its cost components (cost recovery model)

- **Design of cost recovery charges. What are the proposed charge levels?**

The proposed fee would be set using the following formula:

Annual fee for individual CVoD provider	equals	Estimated total annual costs of OFLC services provided to all CVoD providers	Multiplied by	(Number of active subscribers / active users of the provider's CVoD content Divided by New Zealand total of active subscribers / active users of CVoD content offered by specified providers)

Definitions of the terms used in the formula will be refined at the design stage when the proposed charge is being written into Regulations.

- **Outputs and processes of the activity. What are the main cost drivers of the activity? ie, what are the outputs of the activity and the business processes that are used to produce those outputs?**

The main cost drivers of the activity are:

- personnel costs (29.6 percent)
- operating expenditure (31.0 percent); and
- overheads (36.6 percent).

A detailed table of output costs is included at Appendix Two.

[5] Although two of the companies named, Neon and Lightbox, have recently merged.

- **Present forecast total revenue and revenue over the first three years**

Table 3: forecast total revenue and revenue for OFLC's CVoD-related services

Item	2020/21 $ million	2021/22 $ million	2022/23 $ million
Expenses	**0.745**	**0.745**	**0.745**
Income			
- Crown	0.466	0.186	0.186
- CVoD distributors	0.279	0.559	0.559
Net surplus/deficit	**0.000**	**0.000**	**0.000**

In Table 3, OFLC's income represents its costs in providing its CVoD services.

- **Discuss how changes in the underlying assumptions will affect financial estimates.**

Under the fee setting formula above, a significant variation in the number of active users, or the entry into or exit from the market of a provider or providers, would impact on OFLC's income. This possibility will need to be factored into the detailed design of the fee at the Regulations stage, so that income flows are smoothed out over multiple years.

Fees will be calculated on the basis of OFLC's costs. Variations in the number of providers within a range around nine providers are not expected to have a significant impact on OFLC's CVoD-related costs.

Impact analysis

- **What is the impact of the proposed fee? How many people, businesses etc. will be affected? What is the change in cost they will face?**

The proposed cost recovery charges will be paid by CVoD distributors specified in a schedule to the Amendment Bill. At present, nine companies are proposed for naming in the schedule.

Specified distributors will share between them estimated costs of approximately $0.560 million (GST exclusive) per year. The largest distributor, Netflix, with approximately 70 percent of the New Zealand subscriber market, would pay approximately $0.390 million (GST exclusive) in annual CVoD fees to OFLC.

OFLC estimates that New Zealanders aged over 18 hold a collective total of approximately 5 million subscriptions (one individual may have multiple subscriptions), with the average estimated number of subscribers per provider being approximately 830,000.[6]

[6] Figures based on a UMR survey carried out in October 2019.

If a provider with 830,000 subscribers decided to pass on the entire cost of its fee, this would result in an additional cost over a year to an individual subscriber of approximately 13 cents ($0.13).

- **Impacts/risks on the regulator eg, service performance risks.**

Providing CVoD-related services is not expected to give rise to significant impacts or risks for OFLC. OFLC has indicated to the Department that its CVoD-related services will be ready for an implementation date of 1 January 2021, and that the services themselves will create manageable demands in terms of the resources required for delivery.

OFLC has indicated a preference for a market share-based fee, as the approach most guaranteed to avoid under-recovery of costs from providers.

- **Expected effects on demand for services.**

The Australia New Zealand Screen Association submitted that an OFLC fee would reduce the delivery of media content to the NZ market, on the grounds that providers operating in this market are not currently showing a profit because they are competing for market share. On the evidence available, this impact may be relatively small. The New Zealand market for CVoD is estimated to generate $361 million (GST inclusive) in revenue annually.[7] OFLC's CVoD- related costs proposed to be cost recovered are estimated to be approximately $0.642 million (GST inclusive) annually. This is a small percentage (0.18 percent) of estimated annual revenue from New Zealand based CVoD subscribers.

What is the evidence that the cost recovery arrangements are reasonable? Eg, comparison to privately provided services or an international comparison if feasible.

It is difficult to make direct comparisons between systems operated overseas and the proposed New Zealand approach of authorising CVoD providers to self-rate their media content.

Only Australia has a closely comparable scheme, for Netflix only. This system was introduced in 2019 after two years of trials. Under the scheme, the Australian Federal government incurs the costs for auditing the results of Netflix' self-rating system only.

According to its website, the British Board of Film Classification is developing a similar scheme, also for Netflix only.

Two stakeholders have expressed concerns at having to contribute to the costs of OFLC's CVoD-related services, particularly beyond the first year. This position is based on the view that providers who develop and use their own self-rating tool would not create any ongoing costs for OFLC. The Department has noted these views but considers OFLC will incur ongoing costs[8] from CVoD providers who use their own self-rating tool. Making service costs and income from fees transparent should go some way to address these concerns.

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[7] This estimate is based on the number of New Zealand based subscribers to Netflix, Sky TV, Lightbox, Vodafone TV, YouTube Premium and Amazon Prime in 2018 http://www.roymorgan.com/findings/7701-roy-morgan-pay-tv-subscription-tv-netflix-lightbox-skytv-neon-vodafonetv-youtube-june-2018-201808100738.

[8] The costs to providers who use their own self-rating tool arise from software, audit and review services, liaison with providers, and liaison with the public.

Consultation

Public consultation was held between 13 December 2019 and 2 February 2020. The options consulted on were the level of cost recovery (full, partial, or no cost recovery) from the sector, and mechanisms (fees and/or a levy) to fund OFLC's:

- current classification activities for DVDs, physical (boxed) games with restricted content, and films for cinematic release, prescribed in the Fees Regulations; and
- classification activities related to regulating CVoD content.

The consultation also sought feedback on the implementation of any fee increases and the current waiver and group reductions for physical media.

The consultation document did not present a preferred option and potential fees were indicated for a range of cost recovery scenarios. For example, if cost recovery was shared equally by the Crown and the sector, the likely fees a provider would pay at 50 percent cost recovery were demonstrated. For CVoD, the scenarios were based on volume of classifications, rather than the CVoD fee calculated using subscriber numbers recommended.

Nine submissions were received from the stakeholder groups as indicated in **Table 4**.

Table 4: Stakeholder groups and submitters to the consultation

Stakeholder group	Submissions
Physical	Three*
Charitable	Two
CVoD	Five*
Regulator	One

** Some submissions were from stakeholders who have an interest in more than one group.*

The consultation highlighted the following themes related to charging for OFLC's CVoD services:

The charging regime should reflect OFLC's actual costs of providing a good or service. Stakeholders want charges to be proportionate, and to only pay the costs of the service they are using and receiving.

There was no clear preference for how costs should be recovered. Some CVoD providers had strong responses against a levy. Respondents who preferred partial cost recovery gave mixed feedback on how the costs could be shared between Government and the sector.

OFLC's classification processes and charging system should be efficient as possible. OFLC and the Department should consider what improvements and enhancements can be made to processes to achieve savings over time.

Feedback received on charging for OFLC's physical media activities is included in the CRIS related to charging for physical media content.

OFLC's submission to the consultation process

OFLC's submission to the consultation process indicated a preference for a levy from specified CVoD providers. Since its submission, OFLC has agreed to support a subscriber-based approach to fees, as this best matches the number of New Zealanders using each service with the cost of ensuring the public receive appropriate consumer information.

OFLC's least preferred option for recovery of its CVoD costs is a volume or transaction-based charge. This option would be administratively burdensome and difficult to forecast income. It may also disadvantage smaller providers, who have large catalogues but a small number of subscribers/active users. The Department notes it is challenging to design a fee that is equally advantageous to all providers.

Through the consultation process, it was identified that CVoD providers may be reluctant to provide subscriber/active user numbers, or other data, that they perceive to be commercially sensitive. The Official Information Act, 1982 offers some protections for commercially sensitive information. Subscriber/active user numbers could be provided to OFLC as a range and this may ease some provider's concerns.

Conclusions and recommendations

The Department recommends as follows:

a. services provided by OFLC to support self-rating by CVoD providers should be funded by a combination of Crown funding and cost recovery from specified CVoD providers;

b. specified CVoD providers should contribute 75 percent of the costs to OFLC of providing CVoD-related services;

c. specified CVoD providers should contribute via an annual fee rather than a transaction-by transaction charge;

d. the fee should be based on an individual provider's share of the New Zealand CVoD content market;

e. market share would be based on information about the number of subscribers/ active users per individual provider; and

f. the fee would be calculated using a formula as follows:

Annual fee for individual CVoD providers	equals	Estimated total annual costs of OFLC services provided to all CVoD providers	Multiplied by	(Number of active subscribers / active users of the provider's CVoD content Divided by New Zealand total of active subscribers / active users of CVoD content offered by specified providers);

g. the requirement to pay the proposed fee should come into effect from 1 January 2021.

Implementation plan

A new regulation making power in the Classification Act to compel CVoD organisations to provide their subscriber/active user numbers to OFLC is needed. A Supplementary Order Paper (SOP) to update the Amendment Bill during consideration of the Bill by the Committee of the Whole House would achieve this. Use of a market survey to obtain subscriber/active user numbers would also require a SOP to change the Amendment Bill.

Prevention, regulation and enforcement of the censorship provisions of the Classification Act are the responsibility of the Department, New Zealand Police and Customs Service.

The CVoD fee will be designed so that OFLC can withhold its service to the CVoD provider if the fee is not paid. The new fees will be communicated to the nine providers impacted using OFLC's networks.

The CVoD fees will take effect from 1 January 2021. As part of the regulatory process, the 28-day rule following notification in the *Gazette* will be applied to the new fees.

Monitoring and evaluation

OFLC has regular interactions with the CVoD industry. OFLC will monitor sector responses to fee levels, the media content environment and implementation of the CVoD fee. Potential modifications and improvements to the process can be discussed with the Department.

OFLC's forecasted financial position is available through its annual Statement of Performance Expectations process. Third-party revenue is recorded as a separate line item in OFLC's financial statements. This will reflect income from CVoD providers.

Financial and non-financial performance is reported to the Minister of Internal Affairs quarterly during the year and in OFLC's Annual Report. OFLC's Annual Report is tabled in the House of Representatives each year.

OFLC's has approximately 15 to 18 annual performance measures and these are also reported on to the Minister of Internal Affairs quarterly. Once the Amendment Bill is enacted, the Department will discuss additional suitable performance measures to reflect OFLC's CVoD activities for inclusion in the Statement of Performance Expectations from 2021/22.

Review

The next review of the cost recovery regime will be no later than 30 June 2023, and will follow the *Treasury's Guidelines for Setting Charges in the Public Sector*.

Decisions required as part of the next funding review will be made by Cabinet, following a public consultation.

Appendix One: Should the charge for OFLC's CVoD-related services be a fee or levy?

The Legislation Design and Advisory Committee (LDAC) has guidelines[9] for deciding whether regulatory services should be charged for via a fee or other mechanism. The table below applies these guidelines to charges to recover the cost of OFLC's CVoD-related services.

Table 1: LDAC guidelines applied to OFLC's CVoD services

(LDAC guidelines are highlighted in green)

Fees may be appropriate	Fees may be inappropriate	Guidelines applied to OFLC's CVoD-related services
Service or function is rendered to an individual and confers a benefit	Service or function is provided to the community as a whole	Services are provided directly to specific individuals and confer a benefit (although some distributors dispute whether they receive a positive benefit). Conclusion: **Fee**
Service or function is rendered by request	Service or function is non-voluntary	Use of the services recovered via the charge is voluntary. CVoD providers have the option of having media content classified by OFLC, which would not be covered by the proposed new charge. Conclusion: **Fee**
Fee is easily quantifiable	Impractical to quantify the fee	Costs of services are fully quantified Conclusion: **Fee**
Fee is easy to recover	Impractical to recover the fee	Fee is practical to recover Conclusion: **Fee**

[9] *Legislation Guidelines*, Legislation Design and Advisory Committee, 2018.

Appendix Two: OFLC's CVOD costs 2020/21 – 2022/23

Item				Notes	Line item costs (annual)	Sub-item costs (annual)	Item costs (annual)
1	**Operating Self-rating Tool (Technical)**						
1.1		Maintain technical infrastructure	People	*1*	$8,000		
			Opex-Maintain	*2*	$40,000		
			Opex - Enhance	*3,4*	$40,000	$88,000	
1.2		Maintain interface - browser based	People	*5*	$4,000		
			Opex		$20,000	$24,000	
1.3		Maintain interface - API	People	*5*	$4,000		
			Opex		$20,000	$24,000	
1.4		Algorithms and tools logic	People	*6*	$4,750		
			Opex		$1,280		
						$6,030	
1.5		FVLB database contribution	People		$0		
			Opex		$20,000		
						$20,000	**$162,030**
2	**Audit and review**						
2.1		Review and sample of content for accuracy and consistency	People	*7,8,9*	$40,000		
			Opex		$0		
						$40,000	
2.2		Review and amend tool logic as necessary	People	*9*	$24,000		
			Opex		$0		
						$24,000	**$64,000**
3	**Public interface**						
3.1		Public inquiries/Complaints	People	*10*	$40,000		
			Opex		$0		

						$40,000	
3.2		Review of provider self-ratings following complaint	People	*11*	$6,400		
			Opex		$0		
						$6,400	**$46,400**
4	**Provider Engagement**						
4.1		Provider service and enquiries	People	*12*	$47,500		
			Opex	*13*	$50,000		
						$97,500	
4.2		Provider on-boarding and training	People	*14*	$20,000		
			Opex	*13*	$20,000		
						$40,000	
4.3		Assessment of ratings systems embedded in a provider system	People	*14*	$20,000		
			Opex	*14*	$20,000		
						$40,000	
4.4		Dispute resolution	People	*15*	$22,500		
			Opex		$0		
						$22,500	**$200,000**
5	**Overhead contribution**				$272,772		
						$272,772	**$272,772**
	TOTAL FOR 2020/21			*16*			**$745,202**

Notes

Note	Description	FTE Count	Salary	Pro Rata
1	Requires 0.1 Technical FTE @ 80k salary, to liaise with software provider(s)	0.10	$80,000	$8,000
2	Includes, provision for software licencing, security, patching, interoperability support etc			
3	Includes scalability and enhancements (functional and non-functional requirements)			
4	Costs based on 4x sprints per year @ $20k per sprint. Expected to decrease once platform & adoption is mature			
5	Requires 0.05 Technical FTE @ 80k salary, to liaise with software provider(s)	0.05	$80,000	$4,000
6	Requires 0.05 Senior Classification Staff FTE @ 95k salary (being 1 week per 1/2 year)	0.05	$95,000	$4,750
7	Sample rate of 15 percent (linked to current performance standard), Expected to reduce over time			
8	Some new shows will include multi-episode series/seasons requiring longer time for examination			
9	Requires Classification Staff FTE @ 80k salary (staff for 2.1)	0.50	$80,000	$40,000
	(staff for 2.2)	0.30	$80,000	$24,000
10	Expect 0.5FTE Classification Staff FTE @ $80k salary	0.50	$80,000	$40,000
11	Requires 2.5 days for three items per month	0.08	$80,000	$6,400
12	0.5FTE snr staff member at 95K - Expected to reduce over time	0.50	$95,000	$47,500
13	Travel required, includes specialist, external advice e.g. legal and technical support			$20,000
14	0.25 Classification staff FTE (people) and 20k data scientist contributions (opex) - Expected to reduce over time	0.25	$80,000	$20,000

15	Estimated costs for OFLC	0.25	$90,000	$22,500
16	Total annual costs are assumed to be the same for 2020/21 - 2022/23			
	TOTAL FTEs	2.58		