



January 15, 2019

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Edward Gresser
Chairman
Trade Policy Staff Committee
Office of the United States Trade Representative
600 17th Street, NW
Washington, DC 20508

Re: Request for Comments on Negotiating Objectives for a U.S.-United Kingdom Trade Agreement, 83 Fed. Reg. 57790, pp. 57790-91 (November 16, 2018)

Dear Mr. Gresser:

The Entertainment Software Association (ESA) welcomes the opportunity to provide comments in response to the request for industry input by the Office of the U.S. Trade Representative (USTR) on U.S. government's negotiating objectives in the proposed free trade negotiation between the United States and the United Kingdom (UK). ESA is the U.S. trade association for companies that publish interactive entertainment software for video game consoles, handheld devices, personal computers, and the internet.¹ Our members not only create some of the world's most engaging interactive experiences for consumers, but also develop novel technologies that are at the cutting edge, such as virtual, augmented and mixed reality hardware and software as well as the latest consoles and handheld video game devices.

USTR's notice requesting industry input asks for general negotiating objectives, examples of barriers to trade and services between the U.S. and the UK, examples of measures or practices that undermine fair market opportunities, and experience with particular measures that should be addressed in the negotiations. Although the issue of Brexit is still as yet unresolved and the precise terms of the UK's exit from the European Union (EU) will shape the scope of the U.S.-UK negotiations, we think it is important to share our perspective on areas of potential negotiation that we hope would be useful to U.S. negotiators.

About the Industry

In 2017, the U.S. video game industry generated \$36 billion in overall revenue, with consumers spending \$29.1 billion on software, downloadable content and subscriptions, up from

¹ A list of ESA members is available at <http://www.theesa.com/about-esa/members/>.

24.5 billion in 2016.² The industry added more than \$11.7 billion in value to U.S. GDP in 2017 and directly employed more than 65,000 people nationwide who earned an average compensation of \$97,000 per year.³

Our members distribute their games, hardware and services globally, with overseas sales in some instances accounting for up to 70% of total sales. Through innovative subscription business models, some of our members have been able to achieve monthly totals of tens of millions of active users in continual and ongoing engagement with new and extra content and live services. Live services provide additional depth to the game and allow for enhancements, such as opportunities for in-game transactions, subscriptions and esports modes in sports franchises. This gamer-centric approach enables customers to try new games and experiences, which, in turn, spurs the development of innovative content and services. Some of our members are also investing in services and technology that enable players to broadcast their gameplay to fans, chat with friends, develop world-class video game platforms that enable interoperability across mobile, PC and console and engines that support game developers and professionals in other creative industries, such as movies. Some U.S. video game companies are also developing and testing next-generation technology, such as artificial intelligence and machine learning.

Digital trade has grown significantly for the video game industry, which has seen in the past few years marked shifts (from physical to digital formats) in the derivation of its revenue from the sale of video games and related services. Our members are an integral part of the digital economy and rely on rules and policies that promote principles of fairness and flexibility in order to succeed commercially on the modern internet. Gamers have made their preferences for digital gaming content and associated services known, and those choices are reflected in the increasing percentage of revenue from digital content and digital delivery of content. This digital transformation has created new opportunities for the delivery of video games to consumers as a service and to successfully leverage brands traditionally associated with consoles and PCs for play on mobile platforms.

Our industry is increasingly reliant upon the internet for content delivery and related services and, as such, we are affected, both domestically and internationally, by rules and policies covering data governance, privacy, cybersecurity and intellectual property, among others. For many video game companies, a significant portion, if not the majority, of revenue now originates from digital sales of games rather than the sale of physical products. In 2017, sales of digital content and services (including subscriptions, full game downloads, digital add-on content, mobile apps and social network games) outpaced the sales of physical product, a trend that has become more pronounced since 2012.⁴ Digital content constituted 79% of video game sales in 2017, up from 54% in 2013.⁵ Consumer spending on video game content and services delivered in innovative digital formats stood at \$9 billion in 2013; in contrast, by 2015 that number had climbed to \$11.2 billion.⁶

² Entertainment Software Association, *2018 Essential Facts about the Computer and Video Game Industry*, p. 9 available at http://www.theesa.com/wp-content/uploads/2018/05/EF2018_FINAL.pdf.

³ *Id.* at p. 13.

⁴ *Id.* at p. 10.

⁵ *Id.*

⁶ Entertainment Software Association, *2017 Essential Facts about the Computer and Video Game Industry*, p. 14 available at http://www.theesa.com/wp-content/uploads/2017/04/EF2017_FinalDigital.pdf.

The United Kingdom and the Video Game Industry

The video game industry is one of the fastest growing media and entertainment sectors in the UK, leading to the UK market's rating for video games as the 5th largest in the world in 2017, with over 32 million gamers projected to spend a record £5bn.⁷ In 2017, video game software achieved a record £3.56bn in sales, driven by both digital and online sales as well as mobile games, which reached revenues over £1bn for the first time, due, in part, by popular mobile games such as Candy Crush by London-based King. Boxed software remained a substantial factor in software sales and reversed recent trends to return a 3.4% increase in sales of £790m. Video game hardware sales also grew significantly by 27%, reaching a record of £1.43bn. This was driven by an increase in console sales, which were up 29% to £659m, as well as PC game hardware, also up 51% to £376m.⁸ Sales of virtual reality hardware saw a growth of 23% reaching £101m—an important milestone for this still relatively early stage industry. In addition, consumers spent £117m on video game-related toys, merchandise, books, movies and soundtracks, as well as video game-based events around the UK.⁹

Seventy-one percent of UK adults (approximately 40 million people) own a smartphone, and 59% of UK households own a tablet.¹⁰ Forty-seven percent of UK smartphone owners use apps on their phones to play games – more than those that use apps for online banking (40%), streaming music (32%) or videos (26%).¹¹ By 2020, total UK video game revenue is expected overtake total consumer spend on books.¹²

The video game industry also makes a positive economic contribution to the UK economy. As of August 2017, there were 1,483 active video game companies making mobile games in the UK, with 2,261 active companies overall¹³. The UK has the largest mobile games workforce in the EU with 5,000 full-time employees. This represents nearly a quarter of all 21,000 mobile game jobs across the EU.¹⁴ In October 2018, the British Film Institute published a report covering the video game industry's economic contribution to the UK economy in 2016.¹⁵ According to the report, in 2016, the UK video game industry provided 47,620 full-time jobs and contributed £2.87 billion in gross value added (GVA) to the UK economy.¹⁶ The industry also

⁷ Association for UK Interactive Entertainment, "UK Consumer Market", available at <https://ukie.org.uk/research#Contribution>, accessed Jan. 7, 2019.

⁸ *Id.*

⁹ *Id.*

¹⁰ Association for UK Interactive Entertainment, "UK Mobile Games", available at <https://ukie.org.uk/research#mobile>, accessed Jan. 7, 2019.

¹¹ *Id.*

¹² PricewaterhouseCoopers, "UK Entertainment and Media Sector to Grow by £8bn Over the Next Four Years—PwC forecasts", Jun. 6, 2018, at <https://www.pwc.co.uk/press-room/press-releases/UK-entertainment-and-media-sector-to-grow-by-8bn-over-the-next-four-years-PwC-forecasts.html>.

¹³ *Id.* at "UK Games Map", available at <https://ukie.org.uk/research#UK%20Games%20Map>, accessed Jan. 7, 2019.

¹⁴ *Id.*

¹⁵ BFI, *Screen Business Study*, "UK Screen Sector Economy", Oct. 2018, available at <https://www.bfi.org.uk/sites/bfi.org.uk/files/downloads/screen-business-full-report-2018-10-08.pdf>. Also cited by the Association for UK Interactive Entertainment in Denzel Dome, "UK Games Industry Generates £2.87bn for UK Economy", Oct. 8, 2018, at <https://ukie.org.uk/press-release/2018/10/uk-games-industry-generates-%C2%A3287bn-uk-economy>.

¹⁶ *Id.* at p. 137.

directly provided over 20,000 full-time jobs in video game development, publishing and retail, which contributed £1.52 billion in direct GVA to the UK economy.¹⁷ The economic impact of the growing UK esports sector was also assessed for the first time and was shown to have supported 470 full-time jobs and contributed £18.4m in GVA in 2016.¹⁸ The UK audience for competitive video-gaming (esports) is expected to grow to 8 million people by 2019, and as home to some of the world's top esports talent, UK esports has attracted attention from major sports franchises including U.S. basketball team, the Philadelphia 76ers and major UK football clubs, which have signed professional UK esports athletes.¹⁹

The Digital Economy

Data consumption in the UK is projected to grow by 22% year-on-year until 2022, overtaking its closest competitor, France, making the UK the largest market in Western Europe.²⁰ As such, we urge the UK government to support the promulgation of global norms necessary to grow and support electronic commerce and digital trade. As the UK will have the opportunity to formulate its own independent trade policy, it has the opportunity to be a leader on digital economy policy that balances the interests of industry and users. The video game industry supports ongoing efforts in this space in multilateral fora, such as the World Trade Organization and its discussions on trade-related aspects of electronic commerce. As noted previously, the video game industry plays an integral role in the digital economy, with a global footprint of \$137.9 billion in 2018 and with 2.3 billion active gamers in the world.²¹ Therefore, we take a keen interest in the promulgation of norms that promote healthy digital trade in content, goods and services, the results of which are beneficial for both industry and consumers. As innovators and creators in the digital space, we support strong protection and enforcement of intellectual property rights, enabling the free flow of data across borders, prohibiting data localization, preventing forced transfers of source code and other technology as a condition of doing business, and strengthening market access, including the reduction of tariffs on technology hardware and software-related goods and prohibition of the imposition of customs duties on electronically-transmitted content.

On customs duties, we urge both governments of the U.S. and the UK to cooperate, bilaterally and multilaterally, on strengthening the norms prohibiting the imposition of customs duties on electronic transmissions. This call for action is critical in light of the move by certain countries to create tariff lines for digital content as well as signals by others of the desire and intent not to renew the World Trade Organization's moratorium on electronic commerce at its next ministerial meeting. Given the global nature of video game services, delivery of content and player engagement, prohibiting customs duties on digital transmissions is of ultimate importance.

¹⁷ *Id.* at p. 134.

¹⁸ Association for UK Interactive Entertainment, "UK Esports", available at <https://ukie.org.uk/research#esports>, accessed Jan. 7, 2019.

¹⁹ *Id.*

²⁰ PricewaterhouseCoopers, "UK Entertainment and Media Sector to Grow by £8bn Over the Next Four Years—PwC forecasts", Jun. 6, 2018, at <https://www.pwc.co.uk/press-room/press-releases/UK-entertainment-and-media-sector-to-grow-by-8bn-over-the-next-four-years-PwC-forecasts.html>.

²¹ Newzoo's 2018 Report: Insights Into the \$137.9 Billion Global Games Market available at <https://newzoo.com/insights/articles/newzoos-2018-report-insights-into-the-137-9-billion-global-games-market/>.

In a related filing, we had briefly discussed the EU's proposal to impose taxes on digital services; that plan would have taxed 3% of a firm's revenues attributed to EU member states. Although that proposal appears to no longer be current, several EU member states have now undertaken that effort, formulating their own versions of a digital services tax, including France and the UK. In its Budget 2018, the UK government announced that, starting in April 2020, it will introduce a new 2% tax on the revenue of certain digital business models, which derive value from their UK users.²² Among other things, the tax will:

- (1) apply to revenues generated from the search engines, social media platforms and online marketplaces;
- (2) apply to revenues from those activities that are linked to the participation of UK users, subject to a £25m per year allowance; and
- (3) only apply to groups that generate global revenues from in-scope business activities in excess of £500m per annum.

As with the EU's tax proposal, we echo many of the same concerns here with the UK proposal. Video game platforms often provide users the ability to upload and share digital content with others, for example, and that may include other features similar to what is offered by social media sites and online marketplaces. Although the primary purpose of video games continues to be playing those games, the modern gaming experience is now much more than simply playing the game itself; it is also about connecting with other players. These are a few reasons this proposal, and others like it, may place innovative internet-native companies, like those who supply and make available video game content and services, at a disadvantage through potential over-taxation. For example, game discs as well as downloadable game content are already subject to the value-added tax (VAT).

We urge the U.S. to reaffirm the principle, present in U.S. e-commerce trade agreement chapters, of non-discriminatory treatment of digital products as well as language ensuring that laws on taxation of digital services do not themselves become a barrier to legitimate trade. We also believe that all efforts in this space, both in the European Commission, at the member-state level and in the UK, should be paused in favor of similar deliberations on digital economy taxation at the Organisation for Economic Co-operation and Development (OECD).

The video game industry supports the protection of personal information, including language present in modern digital trade chapters which state that measures protecting personal information and any attendant restrictions on cross-border data flows on data be necessary and proportionate to the risks presented rather than blanket carve-outs. In addition, we support language on measures inconsistent with free flow of data be necessary to achieve a legitimate public policy objective, not be applied in a manner that would constitute arbitrary or unjustifiable discrimination or act as disguised restraints on trade. Additionally, any such measure should not impose restrictions on transfers of information greater than are necessary to achieve the objective or that permits the exception to swallow the rule, such as that proposed by the European Commission for inclusion in EU-negotiated trade agreements. Instead, provisions that reflect the

²² Her Majesty's Treasury, Budget 2018: Digital Services Tax *available at* https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/752172/DST_web.pdf, accessed Jan. 7, 2019.

principles of fairness and non-discrimination, as articulated above, should guide UK policy in this space both within a U.S-UK negotiation and in other UK trade negotiations.

We support cooperation between the U.S. and the UK on digital trade, including information exchanges on experiences and best practices, promotion of digital trade in multilateral fora, recognition and acknowledgment of private sector methods of self-regulation which foster trust in the digital economy. Focusing on digital trade principles as an area of cooperation and convergence between the two governments also sets a crucial example for other countries to follow in contexts beyond bilateral trade relationships. Achieving high-standard rules would assist USTR in fulfilling the Administration's intent, as articulated in its Congressional notification letter, to support high-paying jobs in the U.S. and grow the U.S. economy by improving opportunities for trade and investment.

On privacy, we ask the USTR to affirm sectoral and private sector-oriented approaches, reaffirm principles found in the APEC Cross-Border Privacy Rules system and seek compatibility between the different privacy regimes in a manner that fosters commercial integration rather than fragmentation.

Intellectual Property

The video game industry is a beneficiary of strong protection and enforcement of intellectual property rights and considers these rights to be an important component of free trade. Because the U.S. and the UK both have high standards of intellectual property protection and enforcement, negotiations on an intellectual property chapter should be an exercise in the affirmance of high-level principles on IP, in a manner that would not otherwise effectuate harmful outcomes and which recognizes the overall effectiveness of the IP regimes of both parties. Below, we highlight subject matter areas in IP crucial to the success of the video game industry.

Patents and Trademarks

In April 2018, the UK government ratified the Agreement on the Unified Patent Court, an international court that will have jurisdiction over patent disputes across its contracting states on unitary patents granted by the European Patent Office. Although the UK's membership in the unitary patent system is subject to negotiation as a result of Brexit, we nevertheless recommend that the UK government maintain its membership in that system in order to minimize disruption to video game patent owners seeking to acquire and enforce their rights. Maintenance of access to the European Union Trademark system in the UK is also of great importance to video game companies who protect and enforce rights in trademarks in both the UK and other EU member states.

Copyright

We recognize that the UK's provisions on copyright are strongly tied to the EU directive on copyright and that the UK may continue to implement that directive even after Brexit and the subsequent transition. Therefore, we briefly note the following articles in the draft EU copyright directive are still under consideration but present challenges to the video game industry.

EU's Draft Copyright Directive

While we commend the updating of copyright for the digital age, draft articles 14 (transparency) and 15 (contractual adjustment mechanism/"best seller" clause) of the draft directive would potentially impose significant reporting, accounting and payment obligations on video game companies.

Article 14 mandates that EU member states, including the UK, must ensure that authors and performers receive, at least once a year, reports covering all modes of exploitation and all revenue derived from exploitation of their works and performances. Authors or their representatives would have the right to approach third-party licensees and ask for information about the exploitation of their works. This proposed right to intervene with licensees and transferees may interfere with contractual relations and may impose financial and administrative burdens on licensees and licensors. Transparency requirements already exist in the EU therefore enhanced obligations in Article 14 of timeliness and accuracy of reporting only increase compliance burdens for video game companies.

Article 15 would permit adjustment of remuneration in contracts where the remuneration originally agreed to under a license or transfer of rights is "disproportionately low" compared to the revenue generated by the work at issue. This provision has the potential to cause uncertainty and sow disruption in contractual relationships surrounding a copyrighted work and could result in contracts being picked apart years after negotiations have concluded.

We urge USTR to reaffirm strong provisions on the importance of freedom of contract for copyright and related rights in any intellectual property negotiation. Such language is already part of U.S. free trade agreements. USTR should press for the non-inclusion of these provisions in a U.S.-UK agreement and non-implementation in UK law post-Brexit.

Other Copyright Principles

In addition, the following are certain principles the video game industry prefers for inclusion in all U.S.-negotiated free trade agreements to strengthen copyright-intensive industries both in the U.S. and in the UK.

- ***Exceptions and Limitations*** – The provision on limitations and exception should adhere strictly to the three-step test as articulated in the Berne Convention. The "balance" language found in TPP should not be included in this negotiation because the word now stands as a euphemism for the weakening of exclusive rights and would likely have negative ramifications for copyright-intensive industries, such as video games. Inclusion would also send a damaging signal to other countries as it would encourage the pattern of promoting exceptions and limitations in jurisdictions where copyright laws are already weak and should instead be strengthened. Limiting language on exceptions to the Berne three-step test leads to downstream beneficial effects for our members.

- *Intermediary Liability/Notice-and-Takedown* – With the increase of digital distribution, copyright owners, particularly video game companies, have sought to attach liability to online intermediaries (such as ISPs) where their activities have facilitated infringement. In general, provisions that track U.S. law, such as secondary liability for copyright infringement and the DMCA, represent strong steps towards addressing infringing conduct. Conditioning eligibility for safe harbors upon ISPs adopting and implementing a repeat infringer policy, not receiving a financial benefit attributable to the infringement and not interfering with rights holders’ standard technical measures are all helpful to the video game industry. We would like to point out that our members are currently satisfied with the operation of this system in the UK and are not seeking any particular changes, simply a reaffirmation of common and shared principles on online enforcement.
- *Technological Protection Measures (TPMs)* – The protection from mass infringement afforded to video games and consoles by access controls and digital rights management has unleashed new methods of making games available to players across a multitude of platforms and devices and its protection is of utmost importance to the industry. Technological protection measures have long been fundamental to protecting and rewarding the investments made in improving console technology and enabling innovation in game hardware, such as virtual and mixed reality headsets, accessories and systems and augmented reality devices. In order to continue to push the envelope in innovation and pioneer the adoption of new technologies, video game companies continue to rely on robust rules governing technological protection measures and anti-circumvention. Provisions that state that parties must provide that any person who knowingly circumvents TPMs without authorization or who manufactures, imports, distributes or offers for sale circumvention devices and services must be found civilly liable are crucial. Another important rule is that criminal liability attaches when that person is found to have circumvented those protections willfully and for the purposes of commercial advantage or private financial gain. The provisions on TPMs exceptions should adopt a “closed list” form, meaning that the parties must have the exceptions that are in the text in their law; no other exceptions to TPMs can be considered except in a legislative, regulatory or administrative proceeding. As frequent participants in the U.S. Copyright Office’s triennial Section 1201 rulemaking proceedings, we constantly face requests for proliferating and overbroad exceptions that would either promote infringing uses or that constitute backdoor attempts to jailbreak consoles in order to play infringing games. Without the use of confined exceptions to TPMs protection, countries often feel free to implement wide exceptions that swallow the rule, as some did in domestic TPP implementation.

Enforcement

The UK already possesses an advanced regime on enforcement, particularly enforcement online. As such, provisions in this section should mandate high standards, but take care to allow room for stronger enforcement rules tailored for and acceptable in each jurisdiction. That said, there are some provisions important to our industry in enforcement. Those include the reaffirmation of the principle that enforcement remedies apply to online infringement the same way they do to hard goods infringement. This is important because the vast majority of video game infringement takes place online and with the growth of digital consumption, enforcement

rules should extend to the digital environment. Seizure, detention and destruction of infringing and counterfeit goods and the immediate communication between enforcement authorities and rights holders if goods suspected of being infringing or counterfeit have been detained at the border are vital as well. Our members, particularly those that manufacture consoles and device accessories, consider the latter rule regarding communication to rights holders about infringing imports to be extremely important in effective enforcement.


Provisions on enforcement should also deepen cooperation between the two governments on enforcement concerns in third countries possibly under the auspices of the U.S.-UK Trade and Investment Working Group, similar to bilateral talks that already occur between the U.S. and the EU in the Transatlantic Intellectual Property Rights Working Group.

Conclusion

We believe that advancing high standards and well-crafted rules in the areas of digital trade and intellectual property can have a beneficial impact on the creation and distribution of American entertainment software and hardware in international markets. As USTR advances a comprehensive free trade agreement between the United States and the United Kingdom, we urge USTR to seek cutting-edge rules on the protection of intellectual property rights on the internet and the free flow of cross-border data to further enhance the digital economy. These, in turn, will help American video game companies continue to contribute to the growth of the U.S. economy and create high-wage jobs.

Thank you for your leadership on this important matter. We are available to answer any additional questions you may have.

Respectfully submitted,



Stanley Pierre-Louis
Interim President and CEO
Senior Vice President and General Counsel