



# Regulating the BBC's impact on competition

Statement on requirements and guidelines

Statement

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# About this document

The role of the BBC is to produce high quality and distinctive programmes and services which educate, inform and entertain.

As a large publicly-funded organisation, the BBC inevitably has an impact on competition in the wider media market. It may have a positive effect by stimulating demand or encouraging sector wide innovation, for example. But in fulfilling its objectives, the BBC may also harm the ability of others to compete effectively.

In December 2016, we published four consultations setting out how we intended to regulate the BBC's impact on competition. In those consultations, we proposed requirements and guidance that we would use:

- when assessing if the BBC should be allowed to make proposed changes to its activities;
- when carrying out a review to assess the impact of ongoing BBC activities on competition;
- to ensure the BBC's commercial subsidiaries don't benefit from their relationship with the BBC public service in a way that gives them an unfair advantage over their competitors; and
- to ensure the BBC negotiates distribution arrangements with platforms on a fair, reasonable and non-discriminatory basis.

This document summarises the comments we received about those proposals, our responses to those comments, and the amendments we have made to the requirements and guidance as a result.

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## Section 1

# Executive Summary

- 1.1 The new BBC Charter and Agreement explain how the BBC will be governed and regulated over the next eleven years.<sup>1</sup> As part of the structure set out by the Government, from 3 April 2017 regulation of the BBC will pass from the BBC Trust to Ofcom. Our role is to set regulatory requirements as part of an operating framework to monitor the BBC's performance, protect fair and effective competition, uphold standards in all BBC programmes, and hold it to account when necessary.
- 1.2 The UK has a successful broadcasting sector, sustained by a competitive media landscape of which the BBC is a central part. The BBC is a unique institution, funded by a licence fee to deliver programmes and services that are integral to the wide range of high-quality and varied content UK audiences enjoy. It is the broad range of material which it offers to audiences across TV, radio and online that enables the BBC to play a central role within the UK's cultural life: some 96% of the UK's adult population will access one or more BBC services each week.<sup>2</sup>
- 1.3 Because of its remit and scale, the BBC inevitably has an impact on competition in the wider media market. We believe competition is good for audiences because it can increase choice and stimulate investment and innovation. It can also create incentives for business to deliver services more cost effectively. The effects of the BBC on competition may be positive: it may serve to stimulate demand and grow markets, as well as encouraging innovation within the sector to the benefit of audiences across the UK. However, as a large publicly-funded organisation, the BBC may also harm the ability of others to compete effectively, potentially by crowding out competition or deterring others from investing or innovating.
- 1.4 The Charter places duties on the BBC Board to consider the impact of the BBC's activities on UK media markets.<sup>3</sup> Additionally, Ofcom must set a range of requirements on the BBC to protect fair and effective competition as part of the BBC's operating framework.<sup>4</sup> In December 2016, we published four consultations (collectively, the 'Competition Consultations') outlining our regulatory approach. In the Competition Consultations, we set out how we intended to fulfil our competition duties in the areas in which the BBC operates, while acknowledging the BBC's duties, both in relation to competition and to deliver against its new Mission and Public Purposes.

## The Competition Consultations

- 1.5 In each of the Competition Consultations we proposed requirements and guidance to address different aspects of the BBC's activities that may give rise to competitive concerns:

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<sup>1</sup> The "Charter" is used in the rest of this document to refer to the Royal Charter for the continuance of the British Broadcasting Corporation. The Agreement between the Secretary of State for Culture, Media and Sport and the British Broadcasting Corporation is referred to as the "Agreement". Both are available at <https://www.gov.uk/government/publications/bbc-charter-and-framework-agreement>.

<sup>2</sup> BBC Annual Report and Accounts 2015/16, p.3.

<sup>3</sup> Charter, article 20.

<sup>4</sup> Charter, article 46.

- 1.5.1 **Assessing the impact of proposed changes to the BBC’s public service activities** – we set out how we planned to assess whether material changes proposed by the BBC to its public service activities<sup>5</sup> were justified in light of their potential public value and impact on fair and effective competition;<sup>6</sup>
- 1.5.2 **Assessing the impact of the BBC’s public service activities** – we set out how we proposed to examine existing services where the BBC had made incremental changes over time or where market conditions had undergone significant change, which may raise important questions about the impact of a service on markets;<sup>7</sup>
- 1.5.3 **The BBC’s commercial activities** – we set out the requirements we proposed to place on the BBC to avoid the relationship between the BBC and its commercial subsidiaries distorting markets or creating an unfair competitive advantage for its subsidiaries. We also set out guidance on how we intended to assess material changes to the BBC’s commercial activities, focussing on whether such changes could have an impact on fair and effective competition;<sup>8</sup> and
- 1.5.1 **Distribution of BBC public services** – we set out the requirements we proposed to place on the BBC about the distribution of public services. We also provided guidance on the factors we may consider when we assess complaints about the way the BBC distributes these services.<sup>9</sup>

## Responses to the Competition Consultations

- 1.6 We received responses from 19 stakeholders to our competition consultations: ten (including the BBC) were from organisations involved in the production, broadcast or distribution of content, seven were from trade associations, one from a manufacturer of consumer electronics devices and one from Ofcom’s Advisory Committee for Scotland. We have considered all responses in finalising our requirements and guidelines and have published all non-confidential responses in full on our website.<sup>10</sup>
- 1.7 Respondents made both general comments about Ofcom’s approach to BBC competition regulation and specific comments about individual aspects of the regulations and guidance proposed in the Competition Consultations.

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<sup>5</sup> The term “public service activities” refers to the UK Public Services (i.e. the television, radio and online services provided by the BBC) and the BBC’s non-service activities (i.e. services that support or enable the provision of the UK Public Services).

<sup>6</sup> See our consultation: *Assessing the impact of proposed changes to the BBC’s public service activities* at: [https://www.ofcom.org.uk/\\_data/assets/pdf\\_file/0022/95422/Assessing-the-impact-of-proposed-changes-to-the-BBCs-public-service-activities.pdf](https://www.ofcom.org.uk/_data/assets/pdf_file/0022/95422/Assessing-the-impact-of-proposed-changes-to-the-BBCs-public-service-activities.pdf).

<sup>7</sup> See our consultation: *Assessing the impact of the BBC’s public service activities* at: [https://www.ofcom.org.uk/\\_data/assets/pdf\\_file/0025/95434/Assessing-the-impact-of-the-BBCs-public-service-activities.pdf](https://www.ofcom.org.uk/_data/assets/pdf_file/0025/95434/Assessing-the-impact-of-the-BBCs-public-service-activities.pdf).

<sup>8</sup> See our consultation: *The BBC’s commercial activities* at: [https://www.ofcom.org.uk/\\_data/assets/pdf\\_file/0031/95386/BBCs-commercial-activities.pdf](https://www.ofcom.org.uk/_data/assets/pdf_file/0031/95386/BBCs-commercial-activities.pdf).

<sup>9</sup> See our consultation: *Distribution of BBC public services* at: [https://www.ofcom.org.uk/\\_data/assets/pdf\\_file/0030/95385/Distribution-of-BBC-public-services.pdf](https://www.ofcom.org.uk/_data/assets/pdf_file/0030/95385/Distribution-of-BBC-public-services.pdf).

<sup>10</sup> Non-confidential versions of the responses we received to the Competition Consultations can be found at: <https://www.ofcom.org.uk/consultations-and-statements/ofcom-and-the-bbc/bbc-competition-statement/>.

- 1.8 Overall, respondents agreed with Ofcom’s regulatory approach. Stakeholders welcomed the clarity offered by external regulation of the BBC, as well as the level of scrutiny of BBC activities proposed by Ofcom. Respondents requested clarification about some aspects, and proposed amendments to the requirements and guidance in places.
- 1.9 In this statement, we have summarised and responded where appropriate to the points which stakeholders have raised with us about our proposed requirements and guidance. Having considered those comments, we have concluded that it has not been necessary to make substantive changes to the proposals we set out in the Competition Consultations. However, we have made some minor amendments designed to clarify our requirements and guidance – in this statement we explain why we have done so. We have not sought to address comments which are not directly related to these requirements and guidance, (e.g. comments made by stakeholders about issues they consider we should investigate under the new regime) although we will take account of these points in our regulatory work after 3 April.
- 1.10 The remainder of this document is structured as follows:
- 1.10.1 In Sections 2 to 5 we summarise the comments made by stakeholders on each of the Competition Consultations in turn, assessing the arguments presented and outlining the conclusions we have reached which we have then reflected in our requirements and guidance; and
- 1.10.2 Section 6 sets out general comments about the regulatory framework made by respondents, relating to the practicality of meaningful engagement between the BBC and third parties and future monitoring of BBC activities.

## Status of this document

- 1.11 As noted in paragraph 1.9, in this statement we set out our response to stakeholder comments about our consultation proposals. The final requirements and guidance documents published alongside this statement, *Assessing the impact of proposed changes to the BBC’s public service activities*;<sup>11</sup> *Assessing the impact of the BBC’s public service activities*;<sup>12</sup> *The BBC’s commercial activities*;<sup>13</sup> and *Distribution of BBC public services*,<sup>14</sup> (further referred to in this document as ‘the Guidance’) form part of the Operating Framework for the BBC and take effect on 3 April 2017.
- 1.12 This statement does not itself form part of the Operating Framework. Its contents therefore provide background to the operative requirements and guidance set out in the Operating Framework.<sup>15</sup>

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<sup>11</sup> See our finalised guidance: *Assessing the impact of proposed changes to the BBC’s public service activities* at: [https://www.ofcom.org.uk/data/assets/pdf\\_file/0028/99415/bbc-public-service-activities-proposed.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0028/99415/bbc-public-service-activities-proposed.pdf).

<sup>12</sup> See our finalised guidance: *Assessing the impact of the BBC’s public service activities* at: [https://www.ofcom.org.uk/data/assets/pdf\\_file/0027/99414/bbc-public-service-activities.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0027/99414/bbc-public-service-activities.pdf).

<sup>13</sup> See our finalised guidance: *The BBC’s commercial activities* at: [https://www.ofcom.org.uk/data/assets/pdf\\_file/0034/99592/bbc-commercial.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0034/99592/bbc-commercial.pdf).

<sup>14</sup> See our finalised guidance: *Distribution of BBC public services* at: [https://www.ofcom.org.uk/data/assets/pdf\\_file/0026/99413/bbc-distribution.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0026/99413/bbc-distribution.pdf).

<sup>15</sup> See *Introduction to Ofcom’s Operating Framework for the BBC* at: [https://www.ofcom.org.uk/data/assets/pdf\\_file/0030/99408/bbc-framework.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0030/99408/bbc-framework.pdf).

- 1.13 Today we have also published a further consultation setting out requirements and guidance on the BBC's trading activities.<sup>16</sup> Separately, on 23 January 2017, we published a consultation on our draft *Procedures for Enforcement of BBC Competition Requirements*.<sup>17</sup> We will publish a statement summarising responses to that consultation, alongside our finalised procedures, in due course.

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<sup>16</sup> A copy of our consultation *The BBC's trading activities* can be found at: [https://www.ofcom.org.uk/data/assets/pdf\\_file/0036/99486/condoc.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0036/99486/condoc.pdf).

<sup>17</sup> <https://www.ofcom.org.uk/consultations-and-statements/category-2/procedures-enforcement-bbc-competition-requirements>

## Section 2

# Assessing the impact of proposed changes to the BBC's public service activities

- 2.1 In our consultation, '*Assessing the impact of proposed changes to the BBC's public service activities*' (the 'BCA Consultation'), we set out the procedures and guidance that we intended to adopt when assessing proposed changes to the BBC's 'public service activities',<sup>18</sup> taking into account its obligations to fulfil its Mission and promote the Public Purposes.
- 2.2 Stakeholders commented on a range of issues including:
- 2.2.1 the procedures for both the BBC's and Ofcom's assessments of materiality;
  - 2.2.2 stakeholder engagement with the BBC and Ofcom;
  - 2.2.3 Ofcom's use of shorter assessments; and
  - 2.2.4 Ofcom's analytical approach.
- 2.3 In this section, we summarise the comments made by stakeholders on these and other issues in the BCA Consultation, providing our view on the arguments presented and the conclusions we have reached.

## Assessing materiality

- 2.4 Under the Agreement, the BBC must prepare and publish a policy setting out how it will consider whether any proposed changes to its public service activities are material. The Agreement states that a proposed new UK Public Service will always be material.<sup>19</sup> To assess whether a proposed change to an existing activity (or the introduction of a new non-service activity) is material, the BBC must consider whether the change 'may have a significant adverse impact on fair and effective competition.'<sup>20</sup> If so, the BBC is then required to conduct a public interest test.<sup>21</sup>
- 2.5 In the BCA Consultation, we stated that we expect the BBC to look at factors such as novelty, duration, usage and scale in assessing the materiality of a proposed change. We also noted that we would be wary of reliance on artificial financial thresholds as they were likely to vary between sectors and organisations of different scale.<sup>22</sup>
- 2.6 We said if the BBC's public interest test was met, we would conduct our own materiality assessment and outlined some factors that may be relevant to that process.<sup>23</sup>

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<sup>18</sup> The BBC's public service activities comprise its UK Public Services and non-service activities.

<sup>19</sup> Agreement, clause 7(7)(a).

<sup>20</sup> Agreement, clauses 7(7)(b) and 16(6).

<sup>21</sup> Agreement, clauses 8 and 17.

<sup>22</sup> BCA Consultation, paragraph 4.9.

<sup>23</sup> BCA Consultation, paragraph 4.33.

## Summary of responses

- 2.7 Stakeholders generally supported our proposed approach to the assessment of materiality, but asked for further detail on how we would conduct assessments.
- 2.8 The BBC broadly agreed with our approach, but requested we reconsider some elements relating to our materiality assessment.<sup>24</sup> It proposed some amendments to the factors, for instance that we should examine ‘significant’ adverse impacts and only take into account future services where there was reliable evidence these would emerge.<sup>25</sup> It also said we should assess whether a proposal was complementary to existing offerings as the BBC may have a positive impact on competition by stimulating demand.<sup>26</sup>
- 2.9 Wireless Group and Global asked for clarification on what constituted a material change. Global also suggested the BBC seek informal feedback from Ofcom in the early stages of development so that consistent definitions of materiality were used.<sup>27</sup>
- 2.10 Some respondents expressed concern that the initial assessment of materiality was conducted by the BBC rather than by Ofcom. For example, ITV questioned the ability of any company to be ‘truly objective’ in its assessment of a new initiative, while Radiocentre considered that we should conduct our own research.<sup>28</sup>
- 2.11 Stakeholders, primarily in the radio sector, argued that we must consider the relative size of BBC activity in a sector in our materiality assessments, in order to acknowledge that a relatively small change from the BBC’s perspective may have a large impact on small players.<sup>29</sup> The BBC asked us to consider ‘the BBC’s share of supply (or some other metric indicating the BBC’s relative position...)’ alongside a high-level and forward looking assessment of the competitive conditions at play.<sup>30</sup> COBA also suggested that we amend our guidance to reflect that a change which affects an individual competitor could be a factor to determine materiality.<sup>31</sup> Global queried whether it was appropriate for the BBC to be able to proceed with a change in the absence of a response from Ofcom.<sup>32</sup>

## Ofcom’s response

- 2.12 Consistent with the Agreement, our Guidance reiterates that the introduction of a new public service would always be deemed material.<sup>33</sup> We recognise that deciding whether a new non-service activity, or a change to an existing public service or non-service activity is material may be complex. We set out a non-exhaustive list of criteria for assessing materiality of proposed changes in paragraph 4.33 of our Guidance. In response to Wireless Group and Global, we do not believe it is possible for Ofcom to provide further guidance as each case will be judged on its own merits.

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<sup>24</sup> BBC response, paragraphs 4.9-4.12.

<sup>25</sup> BBC response, paragraphs 4.10 and 4.12.

<sup>26</sup> BBC response, paragraph 4.11.

<sup>27</sup> Wireless Group response, paragraph 5; Global response, paragraphs 21 and 24.

<sup>28</sup> ITV response, p.5; Radiocentre response, paragraph 11.

<sup>29</sup> Global response, paragraph 20; Radiocentre response, paragraphs 5-7; COBA response, paragraph 11.

<sup>30</sup> BBC response, paragraph 4.8.

<sup>31</sup> COBA response, paragraph 11.

<sup>32</sup> Global response, paragraph 24.

<sup>33</sup> See paragraph 4.7 of our Guidance.

- 2.13 Nevertheless, we acknowledge stakeholder concerns that the BBC may be incentivised to proceed with changes that we would otherwise consider material. We discuss in Section 6 that we will develop a monitoring programme which will help ensure we are aware of future BBC plans. As a backstop, if the BBC made a change that we consider material, we can direct the BBC to freeze implementation of the proposed change and require it to carry out a public interest test.<sup>34</sup>
- 2.14 In cases where the BBC concludes a change is material and has satisfied its public interest test, we consider the factors we have outlined for determining materiality will be sufficiently robust to enable proper assessment, taking into account the facts of each case. However, we recognise additional clarity may be useful in some areas.
- 2.15 We agree with the BBC that our assessment of materiality should, in line with the Agreement, capture proposed changes that have a potentially *significant* adverse impact on fair and effective competition. Additionally, we agree that our assessment should take account of future services only where it is likely they will emerge.
- 2.16 In response to the BBC's query about proposals which complement existing offerings, we note that the threshold for 'material change' is 'any change to a UK public service which may have a significant adverse impact on fair and effective competition'.<sup>35</sup> We agree it is important we take account of the positive effects of any proposed activity, but consider it will be more relevant to our final determination than our assessment of materiality. We address this point further in paragraphs 2.40 to 2.42 of this document, below.
- 2.17 In response to queries from radio stakeholders, we confirm that we intend to consider the relative scale of BBC activity within any sector affected by a proposed change. We have also clarified in the Guidance that a change which affects an individual competitor could be a factor which impacts on our assessment of materiality. Further, we note that the text referring to the ability of the BBC to proceed with a change in the absence of a response from Ofcom was intended simply to reflect the wording in the Agreement.<sup>36</sup>

## Conclusion

- 2.18 For the reasons given above, we have amended paragraphs 4.9 and 4.33 of our Guidance. We provide further detail about our approach to monitoring the BBC in Section 6 below.

## Stakeholder engagement with the BBC and Ofcom about BCAs

- 2.19 In the BCA Consultation, we identified three main opportunities for third parties to comment on proposals by the BBC to introduce material changes. We noted that, when carrying out its public interest test, we expect the BBC to consult interested parties to understand and assess the scale of market impacts associated with its proposals. We made clear our expectation that third parties would engage 'effectively' with the BBC's work at this stage, and that the information shared by the BBC should be sufficiently detailed to allow stakeholders to understand a proposal fully and provide constructive input.<sup>37</sup> We also proposed to invite third parties to

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<sup>34</sup> See paragraph 4.12 of our Guidance.

<sup>35</sup> Agreement, clause 7(7)(b).

<sup>36</sup> Agreement, clause 9(4).

<sup>37</sup> BCA Consultation, paragraphs 4.16-4.17.

comment on whether they considered the BBC's published proposals to be material.<sup>38</sup> We said that if we undertook a BCA or shorter assessment, we would consult with third parties on our provisional views, typically for a period of four weeks.<sup>39</sup>

## Summary of responses

- 2.20 Although some stakeholders acknowledged the desirability of consultation by the BBC about its proposals, respondents also highlighted concerns about the practicality of engagement between the BBC and third parties. Sky, Radiocentre, COBA and others argued that stakeholders could not be expected to submit commercially sensitive information to the BBC;<sup>40</sup> Sky argued that consequently the BBC may make an incomplete and inaccurate assessment of public interest. The BBC agreed that Ofcom should have 'realistic expectations' about the extent to which third parties may be willing and able to provide information that could help mitigate competition concerns.<sup>41</sup>
- 2.21 Further, Pact called on Ofcom to set a clearer expectation on the BBC to provide appropriate timescales for consultation with third parties, whereas Global and Sky expressed concern that our proposed timescale for third party comments did not allow sufficient time for them to provide us with evidence.<sup>42</sup> Several stakeholders queried our comment in the BCA Consultation that 'third parties will need to engage effectively with the BBC... [and] should not assume our assessment of a proposal will provide a second opportunity to raise issues'.<sup>43</sup> Radiocentre requested that Ofcom provide a process where stakeholders could appeal directly to Ofcom if they disagreed with the BBC's conclusion that a matter was not material.<sup>44</sup>

## Ofcom's response

- 2.22 We expect that the BBC will conduct its own robust public interest test and it is in the interests of third parties to ensure that they raise their concerns during this process. To be clear, we do not anticipate or require that third parties will share commercially sensitive information with the BBC. However, third parties should be able to bring to the BBC's attention proposed changes that they consider will have an impact on fair and effective competition, particularly if an existing service may be affected. We also note that the BBC is required to publish a policy on how it will consider material changes and consult with interested third parties where appropriate.<sup>45</sup>
- 2.23 We acknowledge Sky's concern regarding timescales but we note that we are required to complete our initial assessment within six weeks. Further, third parties should already be familiar with the BBC's proposal and able to comment on the narrow range of issues appropriate at this stage. We provide further detail about our

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<sup>38</sup> BCA Consultation, paragraph 4.29.

<sup>39</sup> BCA Consultation, paragraphs 4.54-4.57.

<sup>40</sup> Sky response, paragraph 2.26; Radiocentre response, paragraph 36; COBA response, paragraphs 7-8.

<sup>41</sup> BBC response, paragraph 1.12.

<sup>42</sup> Pact response, paragraph 1.8; Global response, paragraph 30; Sky response, paragraph 2.27.

<sup>43</sup> BCA Consultation, paragraph 4.17; COBA response, paragraphs 5-6; Radiocentre response, paragraph 37.

<sup>44</sup> Radiocentre response, paragraph 40.

<sup>45</sup> Agreement, clauses 7(5) and 16(4).

approach to monitoring the BBC, including the opportunities third parties will have to raise matters with Ofcom, in Section 6 below.

## Conclusion

2.24 For the reasons given above, we have amended paragraph 4.17 of the Guidance.

## Shorter Assessments

2.25 The Agreement states that where we have determined that a proposed change is material, we must undertake either a BCA or a 'shorter assessment'.<sup>46</sup> In our BCA Consultation, we set out the factors we would consider when deciding whether to conduct a BCA or a shorter assessment. We explained that we would be more likely to conduct a full BCA where a proposal raised large, complex and/or contentious issues. We said we might undertake shorter assessments where there were a narrower range of issues to consider.<sup>47</sup>

## Summary of responses

- 2.26 Respondents asked us to clarify how we would use shorter assessments. Sky requested greater specificity around the factors we would consider when deciding whether to conduct a BCA or shorter assessment. Sky questioned why it would be appropriate for Ofcom to conduct a shorter assessment if we were not satisfied with the BBC's procedures in carrying out a public interest test.<sup>48</sup> Radiocentre queried whether a shorter assessment would be used to 'rubber stamp' changes that might be significant, either because the BBC had spent a long time considering issues as part of a public interest test or if Ofcom resources didn't allow a full BCA.<sup>49</sup>
- 2.27 Pact asked whether Ofcom would always consult with third parties during shorter assessments and COBA asked us to confirm that if a proposed change was material, we would complete either a BCA or a shorter assessment.<sup>50</sup>

## Ofcom's response

- 2.28 In our BCA Consultation, we identify the circumstances where shorter assessments may be appropriate.<sup>51</sup> For example, where a proposed change raises relatively narrow competition concerns, we may consider it will be sufficient to conduct a shorter assessment rather than a BCA. Because each proposed change published by the BBC will be treated on a case-by-case basis, it is not possible to provide more detail on the factors.
- 2.29 However, we have made some changes to clarify the Guidance as set out below:
- 2.29.1 we intend to consult on our provisional determinations, regardless of whether we are conducting either a shorter assessment or a BCA;

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<sup>46</sup> Agreement, clause 9(2) and clause 18(2).

<sup>47</sup> BCA Consultation, paragraphs 4.35-4.36.

<sup>48</sup> Sky response, paragraphs 2.29-2.30.

<sup>49</sup> Radiocentre response, paragraph 41.

<sup>50</sup> Pact response, paragraph 1.14; COBA response, paragraph 12.

<sup>51</sup> BCA Consultation, paragraph 4.35.

- 2.29.2 we explain why we may conduct a shorter assessment where we are not satisfied with the BBC's methodology or procedures in conducting a public interest test; and
- 2.29.3 where we conclude that a proposed change is material, we will always conduct either a BCA or a shorter assessment.

## Conclusion

- 2.30 For the reasons given above, we have amended the text of paragraphs 4.35 and 4.55 of our Guidance.

## Guidance on our analytical approach

- 2.31 The Agreement sets out that, as part of a BCA, Ofcom must assess whether the public value of the proposed change justifies any adverse impact on fair and effective competition.<sup>52</sup> The BCA will include a review of the BBC's assessment of public value and an assessment of the adverse impact on fair and effective competition.
- 2.32 In the BCA Consultation, we outlined the analytical approach we expected to apply to these assessments, including; potential competition concerns, the scope of our work and the factors we might typically consider as part of our analysis.<sup>53</sup>
- 2.33 Stakeholder comments on different aspects of our analytical approach and our responses to them are set out below.

## Assessment of non-service activities

- 2.34 The BBC noted that its non-service activities had historically involved partnerships with third parties. The BBC considered Ofcom's regulatory role should only apply to the BBC's own activity. For example, the BBC considered that an assessment of a new TV platform launched as part of a joint venture should look only at the impact of the BBC's involvement in the platform, rather than the impact of the platform joint venture in the round.<sup>54</sup>
- 2.35 In response, we note the framework set out in our Guidance is applicable to both UK Public Services and non-service activities, including joint ventures. The approach to joint ventures may depend on the nature of the BBC's involvement. In some cases, we may look at the BBC's impact alone and in others it may be appropriate to look at the impact of the joint venture as a whole.

## Shorter and longer term impacts

- 2.36 The BBC considered that Ofcom's analytical approach should emphasise that its analysis will focus on the process of competition as well as shorter term impacts on the revenues of individual competitors. The BBC argued that this would better reflect both longer term dynamic impacts (e.g. consequences of reductions in commercial revenues and incentives to innovate or exit the market) and the short term 'static'

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<sup>52</sup> Agreement, clauses 10(3) and 17(1).

<sup>53</sup> BCA Consultation, paragraphs 5.4-5.25.

<sup>54</sup> BBC response, paragraphs 4.18-4.20.

impacts (e.g. impacts on commercial revenues and competitor profitability) identified by Ofcom as potential competition concerns.<sup>55</sup>

- 2.37 In response, we agree that analysis of both types of impact will be important to the overall assessment of adverse effects on fair and effective competition, which is why we described these processes in our discussion of competition concerns in the BCA Consultation. We do not consider that further references are required.

### **Review of BBC public value assessment**

- 2.38 ITV and Global questioned the extent to which we should consider audience take up in addition to other factors, including distinctiveness, in assessing public value.<sup>56</sup>
- 2.39 In response, we note that overall take up is only one factor amongst others that would form part of the evidence base we consider.<sup>57</sup>

### **Consideration of the BBC's positive effects**

- 2.40 Although the BBC acknowledged that Ofcom's role was to consider the potential adverse effects of the BBC's activities on competition, it argued that Ofcom's approach should reflect the positive impacts that the BBC can have on competition in a more explicit and systematic way.<sup>58</sup>
- 2.41 In response, part of our role in the context of a BCA is to assess whether the public value of a proposal justifies any adverse impact on fair and effective competition. We agree that positive factors should form part of our overall assessment.
- 2.42 To address this point, we have amended paragraph 5.25 of our Guidance to clarify that other factors – including those which may have positive impacts (e.g. the ability of a BBC service to increase interest and familiarity with new technology) – may be relevant.

## **Other issues**

### **Proposed changes to Ofcom's process**

- 2.43 The BBC asked if we would commit to 'fast tracking' a proposal if it had previously been considered and subsequently returned by Ofcom for re-evaluation by the BBC.<sup>59</sup> The BBC also asked if we would include a formal 'pre-notification' stage to agree common approaches to modelling and research.<sup>60</sup>
- 2.44 In response, we consider that the Guidance is sufficiently clear on these points. In the event the BBC submits a revised public interest test, we may decide to undertake a shorter assessment that, depending on their scale, focussed on the modifications to the original proposal. Although we do not think it is necessary to include a formal pre-notification stage, we will liaise with the BBC as appropriate.<sup>61</sup>

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<sup>55</sup> BBC response, paragraphs 3.18-3.19.

<sup>56</sup> ITV response, p.7; Global response, paragraph 14.

<sup>57</sup> BCA Consultation, paragraph 5.6.

<sup>58</sup> BBC response, paragraphs 3.4-3.8.

<sup>59</sup> BBC response, paragraph 4.25.

<sup>60</sup> BBC response, paragraphs 4.15-4.17.

<sup>61</sup> BCA Consultation, paragraphs 4.65-4.66.

## Section 3

# Assessing the impact of the BBC's public service activities

- 3.1 In our consultation, '*Assessing the impact of the BBC's public service activities*' (the 'BCR Consultation'), we set out the procedures and guidance that we intended to adopt when assessing the impact of the BBC's existing public service activities on fair and effective competition, taking into account its obligations to fulfil its Mission and promote the Public Purposes.
- 3.2 Stakeholders commented on a range of issues including:
- 3.2.1 the threshold for initiating a competition review ('BCR');
  - 3.2.2 the conduct of a BCR and its implications on the market; and
  - 3.2.3 our analytical approach to substantive assessments.
- 3.3 In this section, we summarise the comments made by stakeholders on these and other issues in the BCR Consultation, providing our view on the arguments presented and the conclusions we have reached.

## Threshold for initiating a BCR

- 3.4 The Agreement states that we may carry out a BCR where there are reasonable grounds for believing a UK Public Service or non-service activity is having a significant adverse impact on fair and effective competition.<sup>62</sup>
- 3.5 In the BCR Consultation, we explained that we may decide to initiate a BCR in response to requests from stakeholders, or on our own initiative.<sup>63</sup> This could be relevant, for example, where our work in other areas (such as performance monitoring or broader market research) provides evidence to suggest a public service activity is impacting fair and effective competition.
- 3.6 We set out a non-exhaustive list of factors that we are likely to consider in deciding whether to initiate a BCR. Factors included the likely scale of the adverse impact, the potential for it to reduce or increase in the future, the existence of alternative mechanisms to address concerns and the resources required for a BCR.<sup>64</sup>

## Summary of responses

- 3.7 Stakeholders broadly agreed with our proposed approach, but questioned the circumstances in which we would launch a BCR. Global asked that we define how the term 'significant' would be used in the context of launching a BCR.<sup>65</sup> Radiocentre said that Ofcom should take into account the BBC's size within the UK radio market on the grounds that 'a small matter for an organisation of the BBC's scale may be

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<sup>62</sup> Agreement, clause 12.

<sup>63</sup> BCR Consultation, paragraph 4.2.

<sup>64</sup> BCR Consultation, paragraph 4.15.

<sup>65</sup> Global response, paragraph 12.

large for some others in a particular market.<sup>66</sup> Sky and the News Media Association (NMA) argued that we should not set too high a bar on the initiation of BCRs. Sky considered that BCRs should not be limited to an exceptional event in response to major concerns, as such an approach might unduly restrict access to the process.<sup>67</sup>

- 3.8 Pact and ITV asked for confirmation that resource constraints would not impact the decision to initiate a BCR.<sup>68</sup> Pact also considered that complainants should be able to provide information to Ofcom on a confidential basis, potentially via representative organisations such as itself. It suggested that certain parties may be reluctant to come forward with a request for a BCR as this could damage their future opportunities at the BBC.<sup>69</sup>

## Ofcom's response

- 3.9 It is not possible for us to provide general guidance on the meaning of 'significant' in the context of a BCR because each stakeholder complaint or potential issue will be considered individually. Nevertheless, we acknowledge respondents' concerns that a BCR may only be triggered in a limited set of circumstances. In particular, we will take account of the fact a relatively minor development for a large operator such as the BBC may be significant (and have a material impact) for other players and have amended the Guidance to clarify this.
- 3.10 At the same time, as our Guidance makes clear, a BCR is likely to be a substantial procedure, which will place an administrative burden on us, the BBC and others – we therefore remain of the view that resourcing constraints are one of a number of relevant factors for us in deciding whether to initiate a BCR. Equally, we note the Charter and Agreement have set a clear role for the BBC over the next decade: the BCR is not intended as a tool with which to rewrite this settlement. Accordingly, we expect stakeholders requesting a BCR to identify the nature of the adverse impact on fair and effective competition (i.e. the competition concerns involved) and the evidence of an actual adverse impact on fair and effective competition.
- 3.11 Organisations will be able to put forward confidential information to Ofcom, including via third party representatives such as Pact. As we explain at paragraph 4.11 of our Guidance, however, we will generally seek the BBC's views when considering whether to initiate a BCR and provide it with a non-confidential version of any complaint. This is to enable the BBC to provide a view to Ofcom on the existence of reasonable grounds for believing that a public service activity is having a significant adverse effect on competition.

## Conclusion

- 3.12 For the reasons given above, we have amended paragraph 4.15 of our Guidance.

## Conduct of a BCR

- 3.13 Unlike a BCA, the Agreement does not specify a timescale for a BCR. In the BCR Consultation, we explained that BCR procedures and timescales will be decided on a case by case basis. However, our expectation was, once a project had been scoped, that the assessment would generally be completed within six months. We also noted

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<sup>66</sup> Radiocentre response, paragraph 48.

<sup>67</sup> News Media Association (NMA) response, p.1; Sky response, paragraph 2.39.

<sup>68</sup> Pact response, paragraph 1.16; ITV response, p.10.

<sup>69</sup> Pact response, paragraphs 1.6-1.7.

it may be appropriate, for the period of the BCR, for us to require the BBC not to make changes to the relevant public service activities without our consent.

## Summary of responses

- 3.14 Stakeholders questioned the potential duration of a BCR. The BBC considered the absence of definitive guidance about timescales created uncertainty for the BBC, its partners and audiences. Sky said we should be mindful of the need to act swiftly where a potentially significant impact on competition had been identified.<sup>70</sup>
- 3.15 Radiocentre commented on the scope of the process. It argued a BCR should be flexible enough to consider incremental changes over several years (including prior to the current Charter period), as they may be relevant to the impact of a service.<sup>71</sup>
- 3.16 On the issue of interim measures, Pact suggested changes to relevant public service activities be restricted as soon as a substantive BCR request had been lodged.<sup>72</sup>

## Ofcom's response

- 3.17 Although we acknowledge the points made by respondents, it is not possible to provide definitive guidance on the timescale for a BCR as our approach will depend on the factors in each case. Nevertheless, as we stated in the BCR Consultation, we are conscious the process may lead to a degree of uncertainty for the UK media sector and we will seek to complete any investigation in a timely manner.<sup>73</sup>
- 3.18 For similar reasons, it is not possible to provide specific guidance about the scope of a BCR, as the process is flexible enough to cover both incremental and wider market changes that have occurred over a period of months or years. However, as we stated in the BCR Consultation, Ofcom's role is not 'about revisiting historic matters settled in the Charter or the fundamental role of the BBC.'<sup>74</sup>
- 3.19 In relation to interim measures, we do not consider it appropriate for Ofcom, following a BCR request, to place restrictions on changes to relevant activities as a matter of course. Again, our approach will depend on the issue in question.

## Conclusion

- 3.20 For the reasons set out above, we have made no amendments to the Guidance on this issue.

## Guidance on our analytical approach

- 3.21 In the BCR Consultation, we set out the analytical approach we expected to apply in our assessment of whether the public value of an existing public service activity justifies any adverse effect on fair and effective competition.<sup>75</sup>

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<sup>70</sup> BBC response, paragraph 5.7; Sky response, paragraph 2.42.

<sup>71</sup> Radiocentre response, paragraph 56.

<sup>72</sup> Pact response, paragraph 1.12.

<sup>73</sup> BCR Consultation, paragraph 4.3.

<sup>74</sup> BCR Consultation, paragraph 1.11.

<sup>75</sup> BCR Consultation, Section 5.

- 3.22 Stakeholder comments on different aspects of our analytical approach and our responses to them are set out below.

### **Sequencing within a BCR**

- 3.23 The BBC considered that the BCR Consultation did not reflect the sequential approach outlined in the Framework Agreement for conducting a BCR. The BBC stated we must establish during the review that there was actual evidence of a significant adverse impact on fair and effective competition before considering whether the public value of a service justified that impact.<sup>76</sup>
- 3.24 In response, we are likely to request a BCR submission seeking the BBC's view on both the public value associated with the activity in question and its justification of any potential adverse impact at the information gathering stage, as set out in paragraphs 4.25 to 4.28 of the Guidance. We consider this to be in the interest of conducting an efficient process. We will seek this information from the BBC without pre-determining the outcome of our assessment.
- 3.25 Based on the above, we have amended paragraph 4.27 of the Guidance to reflect that, when we request the BBC to provide us with a BCR submission, we will request that the BBC explains why the public value of the relevant activities justifies the *potential* adverse impacts on fair and effective competition.

### **Use of Alternative Scenarios**

- 3.26 In the BCR Consultation, we explained that as part of our analytical approach we would compare a situation in which we do not intervene, with hypothetical scenarios where the competition concern is addressed (defined as an 'Alternative Scenario').<sup>77</sup>
- 3.27 The BBC suggested that we should seek its input to identify 'appropriate' Alternative Scenarios.<sup>78</sup>
- 3.28 We recognise the BBC is well placed to identify aspects of a public service activity it considers generate the highest public value. Where appropriate, we will discuss Alternative Scenarios with the BBC when undertaking our analysis.

### **Shorter and longer term impacts**

- 3.29 As set out in greater detail in relation to the BCA at paragraph 2.36 above, the BBC considered that Ofcom's analytical approach should 'emphasise that its analysis will focus on the process of competition as well as shorter term impacts on the revenues of individual competitors and requested greater emphasis in the Guidance.'<sup>79</sup>
- 3.30 In response, and as set out in relation to the BCA at paragraph 2.37 above, we agree that analysis of both types of impact will be important to the overall assessment of adverse effects on fair and effective competition, which is why we describe these processes in Section 3 of our Guidance. We do not consider additional amendments to the text are required.

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<sup>76</sup> BBC response, paragraphs 5.9-5.10.

<sup>77</sup> BCR Consultation, paragraph 5.3.

<sup>78</sup> BBC response, paragraph 5.11.

<sup>79</sup> BBC response, paragraph 3.19.

## Consideration of the BBC's positive effects

- 3.31 As set out in relation to BCAs at paragraph 2.40 above, although the BBC acknowledged our role was to consider the potential adverse effects of the BBC's activities on competition, it argued that Ofcom's approach should 'reflect the positive impacts that the BBC can have on competition in a more explicit and systematic way.'<sup>80</sup>
- 3.32 In response, and as explained at paragraphs 2.41 to 2.42 above in relation to BCAs, part of our role in the context of a BCR is to assess whether the public value of a service justifies any adverse impact on fair and effective competition. We agree that positive factors should form part of our overall assessment.
- 3.33 To address this point, we have amended paragraph 5.27 of our Guidance to clarify that other factors – including those which may have positive impacts (e.g. the ability of a BBC service to increase interest and familiarity with new technology) – may be relevant.

## Treatment of costs

- 3.34 The BBC agreed with the position outlined in the BCR Consultation that it may be necessary to take into account the costs of an activity as part of a BCR. However, the BBC considered that references to lowering the licence fee, for example in the event that the BBC was required to scale back a service, were not appropriate.<sup>81</sup>
- 3.35 In response, we acknowledge the BCR process is independent of the licence fee settlement. We have therefore removed the reference to the licence fee in paragraph 5.27 of our Guidance.

## Other issues

### Ensuring regulatory certainty

- 3.36 BT requested that we clarify how the BCR process applied to non-service activities, including joint ventures between the BBC and commercial partners. It argued the risk of regulatory intervention could have 'an overall negative impact on the BBC's attractiveness as a partner' and suggested that we consider how we can 'shape the BCR process to give any future BBC partners appropriate certainty and security.'<sup>82</sup>
- 3.37 In response, we recognise that investors welcome stability in the environment in which they are operating. However, the Agreement makes clear that BCRs are intended to examine whether public service activities are having a significant adverse impact on competition. If we consider there are reasonable grounds for believing a public service activity (including an applicable joint venture) is having an impact of this kind, we will aim to complete our review in a timely manner and provide the sector with as much regulatory certainty as we can.

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<sup>80</sup> BBC response, paragraph 1.6.

<sup>81</sup> BBC response, paragraph 5.12.

<sup>82</sup> BT response, paragraphs 4-5.

## Section 4

# The BBC's commercial activities

- 4.1 In our consultation, *The BBC's commercial activities* (referred to in this section as 'the consultation'), we consulted on requirements we intend to place on the BBC to avoid the BBC's public funding being used to subsidise or unfairly benefit its commercial subsidiaries. We also set out the procedures and guidance that we intended to adopt when assessing whether material changes to the BBC's commercial activities can go ahead.
- 4.2 Stakeholders commented on several issues including:
- 4.2.1 transfer pricing, the supply of goods and services between the BBC Public Service<sup>83</sup> and its commercial subsidiaries;<sup>84</sup> and transparency around these arrangements;
  - 4.2.2 the appropriate rate of return for the BBC's commercial activities;
  - 4.2.3 reporting arrangements to monitor the relationship between the BBC Public Service and its commercial subsidiaries;
  - 4.2.4 operational separation between the BBC Public Service and its commercial subsidiaries, including information sharing and governance arrangements;
  - 4.2.5 processes to assess material changes to the BBC's commercial activities; and
  - 4.2.6 a range of other issues, including a review of BBC Studios, international activities and references to State Aid law.
- 4.3 In this section, we summarise the comments made by stakeholders on these issues in the consultation, providing our view on the arguments presented and the conclusions we have reached.

## Supply of goods and services, transfer pricing and transparency

- 4.4 Under the Agreement, Ofcom must set trading and separation rules to ensure that the commercial activities do not, as a result of their relationship with the UK Public Service, trading activities or non-service activities, distort the market or gain an unfair competitive advantage.<sup>85</sup>
- 4.5 In our consultation, we set out requirements for the supply of goods and services to address this concern. We explained that, where possible, the BBC Public Service must make goods and services supplied to the commercial subsidiaries available to the wider market. It may supply goods and services solely to the commercial

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<sup>83</sup> The definitions of the UK Public Services and commercial activities are outlined in Article 7 of the Charter. References to the 'Public Service' should be read as references to BBC's UK Public Services, trading activities and non-service activities.

<sup>84</sup> Where we refer to commercial subsidiaries, we mean the four commercial entities and any which may come into existence in the future. Where we refer to commercial activities, we adopt the definition contained in article 7(6) of the Charter and clause 23(2) of the Agreement.

<sup>85</sup> Agreement, clause 28(1).

subsidiaries, only if there is a clear reason for exclusivity or where they are shared for reasons of operational efficiency (such as business support services).

- 4.6 Where the Public Service provides goods and services to commercial subsidiaries, it must ensure that arrangements are made on arm's length commercial terms, equivalent to those offered to third parties. It must set the pricing for goods and services as if they were sold on the open market, or using any verifiable, comparable information on prevailing market practices wherever possible.
- 4.7 We said where it was not possible for the BBC to price by reference to market benchmarks (e.g. because the asset had no close comparators), it may be appropriate to adopt a cost-based approach. We stated that the BBC must publish the methodologies it uses to establish its transfer prices.

## **Access to BBC goods and services**

### Summary of responses

- 4.8 Several respondents were concerned about the BBC restricting access to goods and services to its commercial subsidiaries alone.<sup>86</sup> BT argued the BBC should explain to Ofcom why Public Service goods and services were not made available to the wider market.<sup>87</sup> Sky argued there was a risk that the BBC would never supply goods and assets to the wider market, on the basis that it would therefore not have to make these available on equivalent terms and prices to its commercial subsidiaries.<sup>88</sup>
- 4.9 The BBC agreed that where access was essential for third parties to compete on a level playing field, it should be provided on equivalent terms, but argued it should be able to restrict access to BBC Group assets and services to the BBC Group (i.e. the Public Service and commercial subsidiaries) unless it would distort the market.<sup>89</sup> It also noted its constraints under the Charter and Agreement<sup>90</sup> which mean that the Public Service would not generally provide its goods and services more widely to the market; namely, that unless the BBC is provided with a specific mandate (e.g. training) or the activity can be done within the parameters of Trading Activities (such as spare capacity dealing) then the BBC is limited in the commercial activity it can undertake from within the Public Service to the external market.<sup>91</sup>

### Ofcom's response

- 4.10 In response to the comments above regarding access to Public Service goods and services, we think it is appropriate to clarify our Guidance in respect of those services which we consider that the BBC should not have to supply to the wider market.
- 4.11 We consider that the BBC should be able both to procure what we have termed 'business support services' (such as payroll, HR, legal, ICT functions) for the BBC Group and to share them with its commercial subsidiaries. As we note in our Guidance, the Public Service may wish to do this to maximise economies of scale.<sup>92</sup>

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<sup>86</sup> Sky response, paragraph 4.23; BT response, point 5; Guardian Media Group response, p.4; NMA response, p.2.

<sup>87</sup> BT response, point 5.

<sup>88</sup> Sky response, paragraph 4.23-4.24.

<sup>89</sup> BBC response, paragraph 5.12.

<sup>90</sup> Agreement, clauses 23(4) and 31.

<sup>91</sup> BBC response, paragraph 4.3

<sup>92</sup> Guidance, paragraph 3.26.

Further, we do not consider that the BBC is required to supply such centralised 'business support' functions to third parties. This is because we recognise that the Public Service is constrained by the Agreement as to the range of goods and services it can 'trade' in the wider market and because the BBC is not 'in the business' of selling such services.<sup>93</sup> The commercial subsidiaries must nevertheless be subject to appropriate transfer pricing for these services.

- 4.12 We do not think it would be proportionate for the BBC to provide an explanation to Ofcom for each good or service that is not offered to the wider market. Our Guidance sets out the requirements we have placed on the BBC to ensure that where goods and services are provided to both commercial subsidiaries and third parties it is done on equivalent terms and prices. Below, we provide further clarification on Public Service content rights.
- 4.13 We have amended paragraphs 3.28 and 3.30 in the Guidance to provide additional clarification about the supply of business support services and to ensure consistency with our requirements for equivalent access and prices where goods and services are sold to both commercial subsidiaries and third parties.

## Transfer pricing

### Summary of responses

- 4.14 Some respondents emphasised the importance of a market based pricing approach to ensure the commercial subsidiaries do not receive an unfair advantage by paying less than a market rate for Public Service goods and services. Several respondents argued the BBC should be required to report any exceptions to a market based price to Ofcom.<sup>94</sup> Radiocentre and Sky referenced the importance of market based pricing for BBC programme rights. Sky was concerned that the BBC would rely excessively on cost based pricing which would risk undervaluing the benefit of such rights to the commercial subsidiaries as it would not resemble a market price.<sup>95</sup>
- 4.15 The BBC questioned Ofcom's expectation that market benchmarking should be used to value secondary and ancillary rights of its originated content. It said that, as BBC Studios would enter into commercial arrangements with BBC Worldwide or other distributors, there would no longer be a need for the Public Service to undertake a market benchmarking exercise.<sup>96</sup>
- 4.16 The BBC agreed that to ensure a level playing field, it should charge its commercial subsidiaries the same price as third parties if making the same goods and services available. However, it argued that there was no justification to require the BBC to set prices for group assets and services only sold to commercial subsidiaries as if they were selling to the open market. The BBC argued that BBC Group assets were either procured at market rates or tended to be BBC-specific and did not lend themselves to 'meaningful market comparisons'.<sup>97</sup> It said that to avoid a cross subsidy it was

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<sup>93</sup> Agreement, clause 31(2)

<sup>94</sup> ITV response, p.10; BT response, point 5.

<sup>95</sup> Radiocentre response, paragraph 64; Sky response, paragraphs 4.14(c) and 4.34-4.36.

<sup>96</sup> BBC response, paragraph 5.14.

<sup>97</sup> BBC response, paragraphs 5.9-5.12.

essential only that the cost was passed on to the commercial subsidiaries based on their use.<sup>98</sup>

- 4.17 Several respondents referred to the findings of a review by Ernst & Young ('EY') who were commissioned by the BBC Trust to review transfer pricing between the BBC Public Service and the commercial subsidiaries. These respondents recommended that Ofcom consider the issues raised by the EY report.<sup>99</sup> For example, ITN referred to the specific finding that there was inadequate record keeping of deals and inconsistency of pricing between BBC Public Service Group and BBC Worldwide.<sup>100</sup> Guardian Media Group (GMG) and the NMA also noted our plan, set out in the consultation, to conduct fact-finding work on transfer pricing.<sup>101</sup>

### Ofcom's response

- 4.18 As set out in our consultation, there is a risk of unfair competitive advantage and market distortion if the commercial subsidiaries were to pay less than market rate for Public Service assets, goods or services. Therefore, our requirements on transfer pricing emphasise the importance of market based pricing (either through an open sale and/or market benchmark) and we do not think this emphasis should be changed.
- 4.19 We understand that not all licence fee funded content rights will sit within BBC Studios (e.g. for genres that remain in-house in the BBC Public Service), and we would expect the BBC Public Service to make these rights available to the market where appropriate. An open market sale process would ensure the Public Service receives a market price for those assets. Absent an open market process, as set out in the Guidance, the Public Service should carry out appropriate market benchmarking. Previous sales conducted by the Public Service may be acceptable market benchmarks, however these should be regularly reviewed to ensure they continue to represent a market price.
- 4.20 We expect the BBC to have explored whether prices for goods and services that are only supplied to the commercial subsidiaries (and have not been competed for in the open market) can be set with reference to market benchmarks before it utilises a cost based approach. We recognise in some cases there might not be a distinction in practical terms between a 'market price' for a service and a charge based on the direct cost, plus an appropriate contribution to the relevant overheads and capital costs to a commercial subsidiary (for example a payroll processing contract procured in the market by BBC Group and then recharged across to the commercial services). The BBC should be able to demonstrate that those assets which it deems to be 'BBC-specific' cannot be benchmarked.
- 4.21 We have clarified the pricing requirements in our Guidance to make it clearer as to the order in which each approach should be considered; there is no substantive change to the methodologies. We have also added a footnote to confirm that there should also be arm's length arrangements where the Public Service is purchasing

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<sup>98</sup> Including direct cost plus an appropriate share of overheads.

<sup>99</sup> See: *A review of the BBC's transfer pricing regime: EY report for the BBC Trust* at: [http://downloads.bbc.co.uk/bbctrust/assets/files/pdf/our\\_work/transfer\\_pricing/bbc\\_transfer\\_pricing.pdf](http://downloads.bbc.co.uk/bbctrust/assets/files/pdf/our_work/transfer_pricing/bbc_transfer_pricing.pdf)

<sup>100</sup> ITN response, p.4.

<sup>101</sup> Guardian Media Group (GMG) response, p.3; NMA response, p.2.

goods and services from the commercial subsidiaries (e.g. purchase of studio space from BBC Studioworks).

- 4.22 As noted in paragraph 4.78 below, we will be undertaking further work on the BBC's transfer pricing arrangements; as part of this we will consider the findings of EY's review and the BBC's response to it.

## **Transparency of transfer pricing**

### Summary of responses

- 4.23 Respondents commented on a lack of transparency in transfer pricing under the current arrangements and welcomed our proposals for improvement including publication of methodologies. ITV and Pact said that actual prices or price ranges should be published to give the market increased visibility.<sup>102</sup> ITN discussed the importance of transparency, particularly with regards to BBC Studios, noting that it would allow the industry to be clear that it was not operating with an inbuilt advantage or subsidy.<sup>103</sup>
- 4.24 GMG, the NMA and ITV raised concerns that the amount of information made public by the BBC may not be sufficient for complainants to demonstrate to Ofcom when the BBC's arrangements were outside of market norms.<sup>104</sup> ITV recommended that where there was a concern, the burden of proof should lie on the BBC to demonstrate it was compliant rather than on third parties.<sup>105</sup> The BBC noted that it was already working on improving transparency in response to the BBC Trust's review of transfer pricing and pointed to the published BBC Studios Four Commercial Criteria case which included detail on transfer pricing methodologies for specific areas.<sup>106</sup> The BBC argued that transparency should be balanced with the ability of its subsidiaries to 'operate effectively' in the market.<sup>107</sup>

### Ofcom's response

- 4.25 In our consultation, we recognised the importance of transparency in providing confidence to the market and the need for balance between transparency and ensuring commercial subsidiaries can compete effectively in the market. We consider that publication of actual transfer prices could affect commercial confidentiality, e.g. if the price of secondary rights paid by BBC Worldwide was published this could affect its ability to commercially exploit those rights effectively.
- 4.26 We recognise that the use of cost based pricing is of particular interest to many stakeholders. We consider that the market will be informed of where and how cost based pricing is applied through the requirement on the BBC to publish transfer pricing methodologies. In addition, as we continue to engage with the BBC on its transfer pricing methodologies, we will consider whether any further publication is needed.

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<sup>102</sup> ITV response, p.9; Pact response, paragraph 3.1.

<sup>103</sup> ITN response, p.3.

<sup>104</sup> GMG response, p.3; NMA response, p.1; ITV response, p.9.

<sup>105</sup> ITV response, pp.8-9.

<sup>106</sup> See:

[http://downloads.bbc.co.uk/bbctrust/assets/files/pdf/our\\_work/bbc\\_studios/2016/bbc\\_submission.pdf](http://downloads.bbc.co.uk/bbctrust/assets/files/pdf/our_work/bbc_studios/2016/bbc_submission.pdf)

<sup>107</sup> BBC response, paragraph 4.7.

## Rate of return

- 4.27 The Agreement states that Ofcom may set requirements to ensure that the commercial activities are carried out in accordance with normal market principles, including making a commercial rate of return.<sup>108</sup> In our consultation, we proposed a requirement that the BBC commercial activities earn a commercial rate of return for two reasons: to help ensure BBC public funding is not used to subsidise a loss making commercial activity; and to ensure these activities are undertaken on an arm's length basis and in accordance with normal market principles (and that we would consider this at a line of business level).
- 4.28 We explained that when considering whether the rate of return of a commercial activity is appropriate, we would consider whether a rational private investor would invest in the activity. We noted that, although a commercial activity would not necessarily make a profit every year, we would expect a business plan to forecast a profit over an appropriate period. We also accepted that in some circumstances an investment in one activity could generate indirect returns elsewhere, but we would expect the BBC to be able to demonstrate the business case in this scenario.<sup>109</sup>

## Summary of responses

- 4.29 The BBC accepted that it should not be able to subsidise a failing business for 'unfair competitive advantage'. However, it argued that the baseline rate of return that a market operator would find acceptable for each commercial subsidiary would vary by market and over time. It said that rational market operators would also take account of strategic advantages for the group in assessing performance.<sup>110</sup>
- 4.30 Some respondents questioned whether low returns by the BBC could be justified. GMG and NMA argued that the BBC incentives for investment in its commercial subsidiaries were not necessarily aligned to those of commercial organisations; GMG said the BBC's Global News subsidiary should not be able to sustain losses 'purely on the basis of the BBC's contribution to soft power'.<sup>111</sup> Pact argued that BBC Studios had been established as a mature, scale business and so should maximise profits as soon as possible.<sup>112</sup> TAC was concerned that it could be allowed to run at a loss for a period that would be unsustainable for an independent company and sought clarification on what Ofcom considered to be 'an appropriate period of time'.<sup>113</sup>
- 4.31 Pact and ITV agreed that commercial rates of return should be considered at the line of business level rather than at subsidiary level.<sup>114</sup>

## Ofcom's response

### Requirements associated with commercial rate of return

- 4.32 A key aspect of the return earned by a commercial activity will be the price it has paid for its inputs. It is therefore necessary to consider a commercial activity's rate of

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<sup>108</sup> Agreement, clause 28(1)(a).

<sup>109</sup> Commercial Activities consultation, paragraph 3.40-3.43.

<sup>110</sup> BBC response, paragraph 5.7.

<sup>111</sup> NMA response, p.2; GMG response, p.5.

<sup>112</sup> PACT response, paragraph 4.2.

<sup>113</sup> TAC response, pp.3-4.

<sup>114</sup> Pact response, paragraph 4.1; ITV response, p.8.

return in combination with transfer pricing to assess whether the relationship between the public service and a commercial activity has had a market distorting effect.

### Strategic Alignment and Contribution to BBC's Public Purposes

- 4.33 As set out in the consultation, our starting point is that a line of business should earn a commercial rate of return. The BBC should consider the most appropriate level of return bearing in mind the specific characteristics of each line of business and the markets in which they operate. Furthermore, considering the range of activities undertaken by the different BBC subsidiaries, it is unlikely to be appropriate to focus on just one specific rate of return measure: it would be more appropriate to use the rate of return metric most relevant to the market/line of business in question.<sup>115</sup>
- 4.34 Although we acknowledge the points made by stakeholders about return levels, we also note the BBC exists to deliver a defined Mission and Public Purposes. Accordingly, it may be appropriate for the BBC to take into account certain indirect returns<sup>116</sup> in assessing its activities.
- 4.35 In situations where such indirect returns could be a relevant consideration, our starting point would still be that we expect a commercial activity to earn a commercial rate of return and that it would be up to the BBC to make the case why a lower rate of return was appropriate. That is, we would expect the BBC to put forward arguments about the nature of the indirect returns, and explain the impact on the rate of return of the commercial activity.
- 4.36 To the extent that the BBC argued that a lower rate of return may be required to assist in the delivery of its Public Purposes, we would want to understand why the BBC had chosen to deliver against the Public Purposes in that way, given that commercial activities are only required by the Agreement to fit with the Mission and Public Purposes.<sup>117</sup> Ofcom would take such arguments into account if assessing whether the relationship between the BBC Public Services and a commercial activity was leading to a market distortion or an unfair competitive impact.

### **Conclusion**

- 4.37 We have amended our Guidance at paragraph 3.42 and 3.48 to clarify the points set out above.

### **Reporting**

- 4.38 The consultation set out requirements for transparency and reporting. We set out that the BBC Board must publish annual reports and accounts covering each commercial subsidiary. The BBC must also inform Ofcom annually of the forward-looking commercial rate of return it considers appropriate for each line of business and, on a quarterly basis, report on the financial performance of each line of business.

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<sup>115</sup> For example, rates of return can be measured in terms of: return on capital employed; return on sales; return on investment etc.

<sup>116</sup> An investment in one line of business could generate indirect returns elsewhere, and a rational investor may accept low returns on a specific investment if this investment produces high returns for the same investor from other assets.

<sup>117</sup> Agreement, clause 23(2)(a).

- 4.39 Our consultation also noted that the BBC may be required to provide, and if necessary publish, additional information to fulfil its regulatory responsibilities.

### Summary of responses

- 4.40 The BBC questioned the frequency and granularity of financial reporting set out in the consultation. It argued that the requirement to provide Ofcom a report on financial performance and against a target commercial rate of return on a quarterly basis for each line of business was disproportionate to the risk of cross-subsidy and said it was unclear why the reporting requirements proposed by Ofcom were necessary or proportionate for regulatory oversight.<sup>118</sup>
- 4.41 BT suggested there should be a requirement for the BBC to report on the split of commercial revenues generated from BBC and non-BBC customers.<sup>119</sup> GMG and NMA welcomed the consistent monitoring of the BBC's commercial performance against targets.<sup>120</sup> COBA called for more clarity in BBC Worldwide's reporting noting that regional reporting made it impossible to tell whether major investments in production, channels or other areas were delivering value for money.<sup>121</sup>

### Ofcom's response

- 4.42 We acknowledge that we should only seek the information necessary to secure appropriate regulatory oversight. However, to do so, we must receive sufficient reporting from the BBC to allow us to monitor the ongoing relationships between the Public Service and the commercial activities.
- 4.43 At this time, we expect the BBC to provide us with the same financial reports in terms of granularity and frequency as have historically been provided to the BBC Trust. However, over time we may require different and/or additional reporting to ensure we have the relevant information needed to address any issues that arise; this may include different categorisation of revenue streams. The principles we will follow with respect to reporting and monitoring are set out in our Guidance.
- 4.44 Our Guidance states that we require rate of return data by line of business. We think this is appropriate given the range of activities undertaken and the different markets that the commercial subsidiaries operate in (particularly BBC Worldwide). This would also enable us to identify where there may be consideration of indirect returns between lines of business, as well as additional visibility of the impact of transfer pricing in each area, and to compare performance to market norms. However, we recognise that we will need to engage with the BBC further to understand its lines of business and to ensure its data provides sufficient information.
- 4.45 For clarity, we are referring to provision of financial reporting by the BBC to Ofcom, and not for publication. However, as we develop our reporting requirements, we will in future consider whether publication would aid transparency and confidence that BBC commercial activities were operating within the regulatory framework.

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<sup>118</sup> BBC response, paragraphs 1.12 and 5.6.

<sup>119</sup> BT response, point 7.

<sup>120</sup> NMA response, p.2; GMG response, p.5.

<sup>121</sup> COBA response, paragraph 2.

## Conclusion

- 4.46 We have noted in our Guidance at paragraph 3.66 that our reporting framework is likely to evolve over time.

## Operational separation

- 4.47 As set out at paragraph 4.4, Ofcom may set requirements to ensure that relationships between the Public Service and the subsidiaries operate at arms-length.<sup>122</sup> The consultation proposed four requirements to address the competition concern we identified in this area: that the commercial subsidiaries could be privy to information from the Public Service which gave them an unfair advantage. Our requirements are also to ensure the commercial subsidiaries are independent in their objective setting, strategy and decision making.<sup>123</sup>
- 4.48 In relation to information exchange, we set out that the BBC must ensure its subsidiaries do not normally have access to information about the BBC Public Service's strategy and activities which is not available to the wider market. The only exception is information strictly required to ensure their activities fit with the Mission and Public Purposes, or for the fulfilment of any existing commercial relationship. Where subsidiaries do have access to such information, we said the BBC must put in place mechanisms to ensure information is only used for the specific purpose for which it was obtained.<sup>124</sup>
- 4.49 In respect of independent decision-making, we said that the BBC must ensure the boards and executive committees of subsidiaries are distinct and separate from the BBC Board and its committees. We stated that the boards of subsidiaries should consist of an appropriate number of directors with an emphasis on those who were separate from the BBC Board and its executive committees. We also proposed that the BBC put in place appropriate conflict of interest procedures to manage instances where a Director served on the board of both the Public Service and a subsidiary.<sup>125</sup>

## Summary of responses

- 4.50 Most respondents agreed Ofcom should set requirements in this area. The BBC noted that it already had 'well-established separation mechanisms in place' and questioned the rationale for the proposed requirements arguing that we had not taken account of the market norm for strategic alignment.<sup>126</sup>
- 4.51 On information exchange, the BBC argued a more reasonable starting position would be that its subsidiaries have access to BBC public service information which supports the delivery of the BBC's strategic objectives, provided it presents no risk of unfair advantage or market distortion. It proposed we change the requirement wording from what is 'strictly' required to what is 'reasonably' required to ensure commercial activities fit with the Mission and Public Purposes, or the fulfilment of an existing commercial relationship. On cross-directorships, the BBC questioned whether it was

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<sup>122</sup> Agreement, clause 28.

<sup>123</sup> Commercial Activities Consultation, paragraphs 3.19-3.24.

<sup>124</sup> Commercial Activities Consultation, paragraphs 3.21-3.22.

<sup>125</sup> Commercial Activities Consultation, paragraphs 3.23-3.24.

<sup>126</sup> BBC response, paragraph 4.1.

proportionate to have subsidiary boards' membership largely separate from the BBC Board.<sup>127</sup>

- 4.52 In contrast, other respondents felt that we should impose more prescriptive requirements around the exchange of information and cross-directorships. Sky contended that the subsidiaries should only have access to public service information to fulfil an existing commercial relationship, and not for reasons related to ensuring the activities of the commercial subsidiaries fit with the Mission and Public Purposes. On cross-directorships, Sky argued that the requirement that subsidiaries are run by Directors who are distinct and separate from the BBC Board and its executive committee should not be further qualified.<sup>128</sup>
- 4.53 Other respondents raised similar concerns about cross directorships undermining separation principles, particularly in relation to representation of commercial subsidiary directors on the BBC Board. COBA regarded this as 'wholly inappropriate' and Pact argued that Ofcom should require the 'overwhelming majority' of commercial directors to be separate from the public service.<sup>129</sup>
- 4.54 Respondents also commented that Ofcom should provide more detail on the mechanisms we regard as appropriate for (i) ensuring any public service information made available to the commercial subsidiaries was only used for a specific purpose and (ii) managing any conflicts of interests in the case of cross-directorships.<sup>130</sup>

### **Ofcom's response**

- 4.55 The key competition concern in this area is the risk of inappropriate exchanges of information occurring which have an impact on fair and effective competition. We do not consider it necessary to make significant changes to the information exchange requirement as we believe it is proportionate to address the competition concern. We have, however, deleted the word 'normally' to make it clear that we expect the commercial subsidiaries only to have access to public service information when strictly required to ensure fit with the Mission and Public Purposes or for the fulfilment of existing relationships.
- 4.56 We do not think it appropriate to set additional requirements on cross-directorships to prevent inappropriate information exchange. At this time, we believe our four requirements are sufficient to ensure the relationship between the Public Service and its commercial subsidiaries is at arm's length. It is the responsibility of the BBC Board and the boards of the commercial subsidiaries to ensure compliance with these requirements. This includes putting in place mechanisms to manage information exchanges and conflicts of interest. We expect the BBC Board will want to consider the issue further in the first instance; however, it is an area we will continue to look at.

### **Conclusion**

- 4.57 We have clarified the information exchange requirement on page 13 of the Guidance.

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<sup>127</sup> BBC response, paragraphs 1.11, 4.2 and 5.4-5.5.

<sup>128</sup> Sky response, paragraph 4.21.

<sup>129</sup> COBA response, paragraphs 5-7; ITN response, p.2; Pact response, paragraphs 2.2-2.3.

<sup>130</sup> Sky response, paragraphs 4.18 – 4.19; Pact response paragraphs 2.1- 2.2.

## Material changes to commercial activities

- 4.58 Ofcom has a role in considering material changes to commercial activities to ensure they do not distort the market or create an unfair competitive advantage. The Agreement requires the BBC to publish a policy setting out how it will consider material changes to commercial activities and how it will consult with interested parties. The BBC must test whether proposed material changes meet the commercial criteria ('the commercial test'). If the test is satisfied, the BBC must publish the proposed change and send a copy to Ofcom.<sup>131</sup>
- 4.59 We said in our consultation that, as part of our initial assessment to determine whether the BBC has provided adequate information and undertaken a sufficient assessment of materiality, we would invite third parties to comment on the BBC's proposal. We explained that we expected responses to set out any concerns with the BBC's proposal, whether the BBC had allowed third parties to input meaningfully and whether it had made errors of fact or assessment in the commercial test.
- 4.60 As set out in the consultation, Ofcom is responsible for overseeing a two-stage assessment process of any material changes to the BBC's commercial activities; an initial assessment and if required, a Trading and Separation assessment.<sup>132</sup>

### Summary of responses

- 4.61 Respondents generally welcomed the ability to participate in the process through which material changes to the BBC's commercial activities are approved. However, there were also concerns that the BBC would determine proposed changes were not material and so would not be fully scrutinised.<sup>133</sup> Some respondents wanted to guarantee their ability to make representations about prospective changes at different stages of the process or when the BBC didn't consider a change to be material. Pact also asked for confirmation that Ofcom could carry out own-initiative investigations of changes.<sup>134</sup>
- 4.62 Respondents discussed the threshold for material changes; ITN suggested that every proposed new BBC service should be subject to an approvals process.<sup>135</sup> COBA and the Radiocentre both supported the materiality test taking into account whether the change appeared to particularly affect an individual competitor or a small market.<sup>136</sup>
- 4.63 Sky and ITN recommended that Ofcom conduct its own analysis rather than relying on the BBC's.<sup>137</sup> Pact considered that there should be an explicit requirement on the BBC to consult on proposals for material changes to commercial activities.<sup>138</sup> TAC was concerned about providing confidential information to the BBC as part of any consultation process. It suggested Ofcom handle confidential information from third parties and pass on a verdict on its materiality to the BBC.<sup>139</sup>

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<sup>131</sup> Agreement, clauses 23-25.

<sup>132</sup> Section 4 of the Commercial Activities Consultation.

<sup>133</sup> Sky response, paragraph 4.40.

<sup>134</sup> Radiocentre response, paragraphs 68-69; PACT response, paragraph 6.3.

<sup>135</sup> ITN response, p.6.

<sup>136</sup> COBA response, paragraph 4, p.3; Radiocentre response, paragraph 69.

<sup>137</sup> Sky response, paragraph 4.40; ITN response, p.6.

<sup>138</sup> Pact response, paragraphs 6.2-6.3.

<sup>139</sup> TAC response, p.4.

- 4.64 The BBC also expressed concern about what commercially confidential information it would be expected to share with third parties during the material change consultation process. The BBC said that the level and timing of any consultation should be balanced with appropriate commercial confidentiality and should not disadvantage the BBC's commercial subsidiaries and its potential partners.<sup>140</sup>

### **Ofcom's response**

- 4.65 We recognise the BBC must strike a balance between openly consulting on the materiality of proposed changes and its legitimate concerns about commercial sensitivity. The BBC is required to publish a policy setting out how it will consider material changes, including how it will consult with interested parties where appropriate. The terms of this policy, including the circumstances in which the BBC consults with third parties, are a matter for the BBC Board.
- 4.66 Ofcom's role is to determine in each case whether the BBC has provided sufficient information for us to undertake an initial assessment about materiality. We expect the BBC to keep us apprised of planned developments, which may lead to material changes, to reduce the chances of the BBC failing to publish a material change.<sup>141</sup> We also note that Ofcom can address any breaches of our requirements through complaints from third parties as well as own initiative investigations. Therefore, we consider our existing powers and guidance are sufficient to strike an appropriate balance between using the BBC's analysis and our own in reaching any decisions.
- 4.67 Our materiality assessment can take account of potential impacts on individual competitors or small markets. However, we recognise our role here is to ensure that the proposed change is not likely to distort the market or create an unfair competitive advantage as a result of the relationship between the BBC Public Service and the commercial activity.

### **Conclusion**

- 4.68 Given our response above, we are not making any substantive changes to the final guidance. We have made minor amendments to paragraph 4.28 of our Guidance.

### **Other points**

#### **BBC Studios**

- 4.69 Several respondents referred to the imminent change which will see BBC Studios converted into a wholly-owned commercial subsidiary of the BBC.<sup>142</sup> Respondents requested a commitment from Ofcom to review compliance by the new subsidiary with trading and separation requirements.
- 4.70 Under the Agreement we must consider, within two years of the establishment of BBC Studios, whether to carry out a review to assess compliance with our trading and separation requirements.<sup>143</sup> During this period, Ofcom intends to increase our understanding of the relationship between the Public Service and the commercial subsidiaries more generally, as well as to put in place a monitoring regime (as set out

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<sup>140</sup> BBC response, paragraph 5.19.

<sup>141</sup> This is also discussed further in section 6 below.

<sup>142</sup> BBC Studios, a new commercial activity, was approved by the BBC Trust in December 2016. It will launch in April 2017.

<sup>143</sup> Agreement, clause 30.

in section 6). We will take all of this work into account before deciding whether a formal review of BBC Studios is required.

## International activities

- 4.71 In our consultation, and in line with our duties under the Act and the Charter,<sup>144</sup> we explained that our regulatory focus would be on potential distortions which may affect competition in the UK.<sup>145</sup> However, Pact and BT requested clarification on whether we would assess the impact in the UK of the BBC's international commercial activities and the BBC asked whether our requirements should apply at all to its commercial activities operating exclusively internationally.<sup>146</sup>
- 4.72 As respondents noted, the BBC and its commercial subsidiaries have an international reach, and the BBC competes in overseas markets with UK-based organisations. Although, under the Charter and Agreement our functions in relation to commercial activities extend beyond the UK, we said in our consultation that our focus would be on potential distortions which may affect competition in the UK. Where a company's UK and international operations are linked, unfair competition from BBC subsidiaries in international markets could affect these third parties' UK activities.
- 4.73 Therefore, we may consider the impact of BBC's commercial activities outside the UK, where it is necessary to do so to protect UK competition, which is our primary concern. When making complaints, third parties would need to be able to show that the relationship between the BBC and its commercial activities (even if the activities are overseas) are distorting markets in the UK. We have amended paragraph 1.20 in our Guidance to clarify this point.

## State Aid

- 4.74 Under EU law, 'any aid granted by a Member State... which distorts or threatens to distort competition by favouring certain undertakings shall, in so far as it affects trade between Member States, be incompatible with the internal market.'<sup>147</sup>
- 4.75 The BBC argued that existing frameworks for the regulation of state aid would be sufficient to address any risk that the BBC would subsidise a failing commercial entity, without additional requirements by Ofcom.<sup>148</sup> In contrast, other stakeholders, including Sky, GMG and the NMA suggested that Ofcom should consider the BBC's compliance with state aid law.<sup>149</sup>
- 4.76 We note that the Charter and Agreement do not assign Ofcom a role in enforcing compliance with state aid law (this is a matter for the BBC and government). However, we observe there are clear parallels between our requirements and state aid requirements.
- 4.77 We have amended paragraph 1.14 of the Guidance to clarify this point.

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<sup>144</sup> Charter, Article 45(2).

<sup>145</sup> Commercial Activities Consultation, paragraph 1.16.

<sup>146</sup> Pact response, paragraph 1.1; BT response, p.2; BBC response, paragraph 5.2.

<sup>147</sup> Consolidated Version of the Treaty on the Functioning of the European Union, 2008 O.J. C 115/47, Article 107(1).

<sup>148</sup> BBC response, paragraph 5.6.

<sup>149</sup> Sky response, paragraph 4.12; GMG response, p.2, p.5; NMA response, p.2.

## Next steps

- 4.78 We have identified several areas where additional fact-finding and evidence-gathering work will enable Ofcom to ensure our requirements are appropriate to meet the obligations in the Charter and Agreement to regulate the BBC's commercial activities. Initially we will focus on areas including transfer pricing, appropriate definitions of line of business for calculation of a commercial rate of return, and reporting framework. We will also consider the effectiveness of the organisational separation mechanisms put in place by the BBC Board.
- 4.79 We also note that the Agreement makes provision for us to consider whether it would be appropriate to set requirements, to protect fair and effective competition, in relation to the commissioning of programmes for the UK Public Service.<sup>150</sup> We therefore expect to assess the need for regulation in this area.

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<sup>150</sup> Agreement, clause 15(4)(b).

## Section 5

# Distribution of BBC Public Services

- 5.1 In our consultation *Distribution of BBC Public Services* (the ‘Distribution Consultation’), we set out the requirements and guidance that we proposed to impose in relation to the distribution of the public services to protect fair and effective competition, taking into account the object of the BBC to fulfil its Mission and promote the Public Purposes.
- 5.2 Stakeholders commented on a range of issues including:
- 5.2.1 the potential competition concerns we identified and our proposed requirements on the BBC;
  - 5.2.2 the circumstances in which Ofcom would consider enforcement action; and
  - 5.2.3 the range of factors we expect may be relevant in assessing complaints.
- 5.3 In this section, we summarise the comments made by stakeholders on these and other issues in the Distribution Consultation, providing our view on the arguments presented and the conclusions we have reached.

## Potential competition concerns and proposed requirements

- 5.4 In the Distribution Consultation, we noted that, given the importance and popularity of the BBC public services, access to them was likely to be a key factor in competition between platforms and media providers. As a result, we considered there was a risk that the way in which the BBC made its public services available could place commercial platforms at a disadvantage and distort overall competition.<sup>151</sup> We therefore proposed to set the following requirements on the BBC:
- 5.4.1 Ofcom requires that the BBC must offer the public services to third parties in response to reasonable requests for supply, except where the BBC has an objective justification for not doing so.
  - 5.4.2 In offering the public services for supply, and in supplying those services, the BBC must act on a fair, reasonable and non-discriminatory basis.

## Summary of responses

- 5.5 Respondents broadly agreed with the three potential competition concerns we identified in our consultations. There was also general agreement that our two proposed requirements effectively addressed those concerns.
- 5.6 The BBC stated it was appropriate that the requirements were set at a high-level given the complexity of the BBC’s distribution arrangements, ongoing technological developments and changing audience consumption patterns.<sup>152</sup> It was concerned however, that the first requirement could be misinterpreted, with Ofcom potentially asked to play a more extensive role in commercial negotiations than envisaged under

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<sup>151</sup> Distribution Consultation, paragraph 3.17.

<sup>152</sup> BBC response, paragraph 5.4.

the Charter and Agreement.<sup>153</sup> It stated the BBC Board was responsible for setting the 'reasonable conditions' and said the proposed wording could imply Ofcom was 'the ultimate arbiter' of what was reasonable, absent any evidence of material adverse impact.<sup>154</sup> The BBC asked Ofcom to add a reference to fair and effective competition at the front of the requirement.<sup>155</sup>

- 5.7 Sky argued that the first requirement should be changed so it stated only that the BBC should be required to supply all reasonable requests for content. Rather than citing an 'objective justification' for non-supply, Sky argued that the BBC should be required to demonstrate that a request was unreasonable.<sup>156</sup> Sky also stated that Ofcom should consider giving guidance to the BBC as to what was reasonable or unreasonable. In particular, Sky argued Ofcom should clarify that platforms which did not accept the BBC's preferred approach to online distribution through a standard product (currently BBC iPlayer) were not acting in an unreasonable manner.<sup>157</sup>
- 5.8 Virgin Media raised a similar concern that the absence of 'sufficiently defined boundaries' in Ofcom's regulatory framework could allow the BBC too much scope to refuse to distribute its content.<sup>158</sup> Ofcom's Advisory Committee for Scotland urged that any decisions taken on the BBC's distribution activities should not focus solely on competition factors but also consider the impact on audiences.<sup>159</sup> Radiocentre sought confirmation that our proposed Guidance would also apply to the radio sector.<sup>160</sup>

## Ofcom's response

- 5.9 In response to the BBC's comments, we note that the requirements we have set are intended to address the potential competition concerns we identified in the Distribution Consultation. They are therefore the requirements which we have decided are necessary to protect fair and effective competition in relation to the distribution of the public services. Our Guidance should be read in this context.<sup>161</sup>
- 5.10 In response to Sky's comments, it remains our view that both of the requirements are appropriate as drafted. The condition that a request for supply should be 'reasonable' targets proposed terms which would be considered as unacceptable during ordinary commercial negotiations. This condition would also prevent the BBC rejecting outright those proposals which have the potential to come to fruition.
- 5.11 It is Ofcom's view, however, that the BBC's obligation to supply can only be a starting point, given the BBC's object to fulfil its Mission and Public Purposes. In other words, it is possible that the BBC may have objective justifications for rejecting a reasonable request, which we would take into account when considering complaints about BBC compliance.
- 5.12 We note the suggestions that Ofcom provide more guidance to the BBC or set strict and defined parameters as to what constitutes a 'reasonable request'. We consider that it would not be possible for Ofcom to define these boundaries precisely without

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<sup>153</sup> BBC response, paragraph 5.8.

<sup>154</sup> BBC response, paragraph 5.11.

<sup>155</sup> BBC response, paragraph 5.12.

<sup>156</sup> Sky response, paragraphs 3.29-3.34.

<sup>157</sup> Sky response, paragraph 3.34.

<sup>158</sup> Virgin Media response, p.3.

<sup>159</sup> Advisory Committee for Scotland response, pp.1-2.

<sup>160</sup> Radiocentre response, paragraph 17.

<sup>161</sup> Distribution Consultation, paragraphs 1.8-1.13 and paragraphs 2.4-2.15.

becoming involved in the setting of commercial terms. However, to provide a sense of scale, we have revised the text of our Guidance to indicate that the type of requests that we would consider unreasonable include vexatious, nonsensical or impractical requests.

- 5.13 In response to the Advisory Committee for Scotland's concern that the impact on audiences was not given sufficient consideration, we stated in the consultation that, in carrying out our competition role, Ofcom must also take into account the object of the BBC to fulfil its Mission and promote the Public Purposes.
- 5.14 In response to the concerns of Wireless Group and Radiocentre as to the scope of the guidance, we note that we define 'public services' in paragraph 1.4 of the Guidance. In paragraphs 1.7-1.10 we set out our role in dealing with competition complaints about the way the BBC distributes its public services, which include its radio services.

## Conclusion

- 5.15 For the reasons set out above, we have not made any changes to the requirements. We have revised paragraph 3.29 of the Guidance to clarify why we refer to both 'reasonable requests' and 'objective justification' in the first requirement.

## Enforcement by Ofcom

- 5.16 The Agreement requires the BBC set procedures for the handling and resolution of complaints about its compliance with the obligations specified within the Operating Framework.<sup>162</sup> This includes any requirements we place on the BBC about its distribution of the public services. The Agreement also states that Ofcom can consider complaints raised by stakeholders; and may carry out the investigations we consider appropriate to determine the BBC's compliance with the requirements we set.<sup>163</sup>
- 5.17 In the Distribution Consultation, we stated that we expected most disagreements between the BBC and third parties to be resolved through commercial negotiations or the BBC's complaints process. We also stated that, where third parties do submit a complaint to Ofcom, before opening an investigation we will consider whether the parties have exhausted all available routes as well as their conduct during the negotiations when considering whether to accept a complaint.<sup>164</sup>
- 5.18 We also set out in the Distribution Consultation that, as the focus of Ofcom's role in this area is the protection of competition, we would be unlikely to intervene and take enforcement action unless a material effect on competition could be identified.<sup>165</sup>

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<sup>162</sup> Agreement, clause 56.

<sup>163</sup> Agreement, clauses 57-58.

<sup>164</sup> Distribution Consultation, paragraphs 4.3-4.4. The section on enforcement procedures set out in the Distribution Guidance (paragraphs 4.2 to 4.5) should be read alongside our *Procedures for Enforcement of BBC Competition Requirements* consultation, available at: <https://www.ofcom.org.uk/consultations-and-statements/category-2/procedures-enforcement-bbc-competition-requirements>.

<sup>165</sup> Distribution Consultation, paragraph 4.7.

## Summary of responses

- 5.19 Several respondents asked for additional information as to when Ofcom would use its enforcement powers. techUK asked for greater clarity on the Ofcom process and what it and device manufacturers would need to do ‘to trigger the process in the event of a dispute’.<sup>166</sup> Sky and Virgin Media highlighted the potential harm to competition they believed may arise from a delay in involvement by Ofcom.<sup>167</sup> In particular, Virgin Media was concerned by the apparent lack of a ‘fast-track’ process (i.e. one which was not first considered by the BBC) for urgent cases, including where BBC content could be withdrawn from consumers or where the BBC delayed distribution of content to a new service.<sup>168</sup>
- 5.20 Virgin Media also noted that the Distribution Consultation stated that we were ‘unlikely to intervene unless a material effect on competition can be identified.’<sup>169</sup> It considered Ofcom’s role in relation to distribution was broader and argued, as an example, that a decision by the BBC to refuse to syndicate content to a new device should merit our consideration as it could serve to stifle innovation.<sup>170</sup>

## Ofcom’s response

- 5.21 In January, Ofcom published a consultation on procedures that we would expect to normally follow when enforcing compliance by the BBC of competition requirements.<sup>171</sup> Those procedures set out in more detail when and how we would use our enforcement powers, including when we might open a case on our own initiative. They also set out that, in exceptional circumstances, we could intervene at any earlier stage to handle a complaint which has not been resolved by the BBC. However, we expect parties to make every effort to engage in a timely and constructive manner with each other in any case.
- 5.22 In response to Virgin Media’s concern that our definition of the material effect on competition could restrict our ability to intervene, we will consider not just short-term (i.e. static) effects when assessing the impact of the BBC’s position on competition, but also longer term impacts on investment and innovation (i.e. dynamic effects). As such, the specific concerns that Virgin Media raised about the supply of content to new devices and potential stifling of innovation would fall within the scope of our analysis.

## Conclusion

- 5.23 We have revised paragraphs 4.3 and 4.8 of the Guidance to clarify the issues raised above.

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<sup>166</sup> techUK response, p.6.

<sup>167</sup> Sky response, paragraphs 3.35-3.38; Virgin Media response, p.5.

<sup>168</sup> Virgin Media response, p.5.

<sup>169</sup> Distribution Consultation, paragraph 4.7.

<sup>170</sup> Virgin Media response, p.6

<sup>171</sup> See our consultation, *Procedures for enforcement of BBC Competition requirements* at: <https://www.ofcom.org.uk/consultations-and-statements/category-2/procedures-enforcement-bbc-competition-requirements>.

## Factors used in assessing complaints

- 5.24 In the Distribution Consultation, we said that the focus of Ofcom’s role in this area was the protection of fair and effective competition.<sup>172</sup> We also stated that in assessing complaints, we would consider the BBC’s duties and obligations under the Charter and Agreement, and how the BBC believes it best to meet its Mission and Public Purposes.<sup>173</sup>
- 5.25 We made clear that we would consider each case on its merits and that our assessment was likely to depend on the specific circumstances in question. However, to help inform our analysis, we proposed a non-exhaustive list of factors we considered could be relevant to determine whether intervention was necessary.<sup>174</sup>

### Summary of responses

- 5.26 Most stakeholders were content that the factors set out in the Distribution Consultation were likely to be relevant to our assessment of complaints. Although Sky agreed with this position, it stated that the factors should not be treated as a set of ‘conditions’ which the BBC was able to impose on third parties.<sup>175</sup>
- 5.27 Some respondents commented on the individual factors we set out in the Distribution Consultation. We have summarised comments by factor below.
- 5.27.1 **Platform compatibility** – the BBC noted that different types of platforms and devices have different capabilities and audiences use them in different ways. It therefore suggested Ofcom look at ‘comparable platforms’ rather than ‘other platforms’.<sup>176</sup> Sky said that an area of consideration under this factor – whether the BBC would need to provide a degree of customisation – could, as drafted, be viewed as giving the BBC tacit approval to adopt a very narrow approach and to refuse to supply content to platforms which did not meet its exact technical specifications.<sup>177</sup> BT asked Ofcom to issue guidance about the timeframe over which the BBC would be expected to support its older service platforms.<sup>178</sup>
- 5.27.2 **Editorial control** – The BBC stated the ability to take down content for legal or compliance reasons, including compliance with its rights restrictions, was an important consideration.<sup>179</sup> Pact questioned why the BBC should be able to retain control over content distributed by third parties if they were not the underlying rights holder.<sup>180</sup>
- 5.27.3 **Curation** – While recognising that the BBC would want to ensure appropriate curation of its content, Virgin Media argued that Ofcom needed

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<sup>172</sup> Distribution Consultation, paragraph 4.7.

<sup>173</sup> Distribution Consultation, paragraph 4.8.

<sup>174</sup> Distribution Consultation, paragraph 4.7ff. The non-exhaustive list of factors we proposed were ‘Platform Compatibility’, ‘Costs of Distribution’, ‘Consumer Experience’, ‘Editorial Control’, ‘Curation of the Public Services’, ‘Technical and Service Innovation’, ‘Market Norms’ and ‘Openness and Transparency’.

<sup>175</sup> Sky response, paragraph 3.24(c).

<sup>176</sup> BBC response, paragraph 5.16.

<sup>177</sup> Sky response, paragraphs 3.46-3.48.

<sup>178</sup> BT response, paragraph 8.

<sup>179</sup> BBC response, paragraph 5.16.

<sup>180</sup> Pact response, paragraphs 1.9 and 1.11.

to set out clearly the restrictions on the level of control the BBC could impose on third parties. It argued the BBC should not be able to dictate platform functionality such as search and recommendation or the ‘look and feel’ of an EPG.<sup>181</sup> Sky stated that we should consider whether the BBC’s preferences for curation may unduly harm others in the sector.<sup>182</sup> The BBC considered reasonable access to accurate and timely platform data was an important consideration for it to fulfil its curatorial role.<sup>183</sup>

- 5.27.4 **Technical and service innovation** – The BBC referenced examples of how it enabled platform innovation and argued it was important to consider both service and platform innovation over time.<sup>184</sup> techUK considered that BBC should not be permitted to operate as a separate and unique entity when setting technology standards and platform specifications.<sup>185</sup> Sky stated an insistence that a platform adopted the BBC’s preferred user interface journey could negatively impact attempts to implement innovative approaches.<sup>186</sup>
- 5.27.5 **Market norms** – The BBC said that our guidance on market norms should recognise online content service providers such as Netflix as parties whose distribution arrangements are ‘likely to be most comparable to the BBC’.<sup>187</sup>

## Ofcom’s response

- 5.28 In response to Sky’s concern that we treat the factors as ‘conditions’ which the BBC can impose on third parties, we made clear in the consultation that these factors are areas which we would expect a complainant and/or the BBC to refer to in their respective submissions as part of any enforcement process. This is also captured in our Guidance.
- 5.29 In relation to the specific points made by respondents about the individual factors:
- 5.29.1 **Platform compatibility:** We believe that the question of whether (or not) the BBC will need to provide any customisation may be relevant to a complaint. However, the *degree* of customisation requested will also be an important consideration and we have amended our Guidance to clarify this. Additionally, we have retained the term ‘other platforms’ as we believe we have the flexibility to take account of any comparable service or platform that is relevant to our assessment of a complaint. We consider that the period for which the BBC supports service platforms is in the first instance a matter for the BBC Board and its distribution policy.
- 5.29.2 **Editorial control:** The ‘editorial control’ factor relates to the BBC’s compliance requirements, rather than wider issues of ownership and control of content rights. We have amended our Guidance at paragraph 4.17 to clarify this point.

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<sup>181</sup> Virgin Media response, p.7.

<sup>182</sup> Sky response, paragraphs 3.58 and 3.59.

<sup>183</sup> BBC response, paragraph 5.16.

<sup>184</sup> BBC response, paragraph 5.16.

<sup>185</sup> techUK response, p.3.

<sup>186</sup> Sky response, paragraph 3.61.

<sup>187</sup> BBC response, paragraph 5.16.

- 5.29.3 **Curation:** We note the views of respondents and will consider the details of specific circumstances as they arise.
- 5.29.4 **Technical and service innovation:** We have amended the text in paragraphs 4.19 and 4.20 to emphasise that, as well as driving innovation itself, the BBC should not hinder innovations being pursued by third parties which may have benefits for audiences. We further note the need to consider dynamic impacts on innovation and market behaviour when assessing a complaint.
- 5.29.5 **Market Norms:** We recognise that other content providers who are not broadcasters may have comparable distribution arrangements and parties may wish to reference such comparators as part of any complaint proceedings.

## Conclusion

- 5.30 We have revised the Guidance to clarify the supporting descriptions of some of the factors which could be relevant to our assessment of complaints. However, the factors we set out in our Guidance remain non-exhaustive and we may consider other factors or issues if appropriate.

## Section 6

# Future engagement between Ofcom, the BBC and third parties

6.1 In this final section, we summarise and respond to similar comments made across all four competition consultations on future engagement between Ofcom, the BBC and third parties. We also set out how we intend to monitor the BBC's activities and potential emerging issues to determine if and when it is appropriate to intervene.

## Engagement between the BBC and third parties

### Summary of responses

6.2 Many of the responses we received to the competition consultations highlighted stakeholder concerns that they would be expected in the first instance to engage with the BBC, as opposed to Ofcom, under the new regulatory regime. The principle concern raised related to sharing commercially sensitive information with the BBC for materiality assessments, the BBC's public interest test or complaints.

6.3 For example, COBA argued that it would be 'wholly unreasonable' to expect commercial stakeholders to provide the BBC Board with relevant information which may be financially sensitive in order to assist the BBC's consideration of a public interest test.<sup>188</sup> TAC was concerned about companies having to share confidential information with the BBC for its commercial test.<sup>189</sup> Sky considered the complaints process set out in the Distribution Consultation, could affect fair and effective competition due to long timescales, unless complainants could bring cases to Ofcom directly.<sup>190</sup>

6.4 The BBC agreed that, although it would 'endeavour' to engage with stakeholders, there may be circumstances when third parties would be unwilling to do so and that Ofcom should have realistic expectations as a result.<sup>191</sup> The BBC was also concerned that regulatory expectations about operational transparency should not place it at a competitive disadvantage.<sup>192</sup>

### Ofcom's response

6.5 The Charter and Agreement require the BBC to take account of the impact on fair and effective competition of its activities, both at a general level,<sup>193</sup> and as part of certain procedures.<sup>194</sup> In order for the BBC to do so, it is also required under the Charter and Agreement to consult on its proposals where appropriate, before formally engaging with Ofcom.<sup>195</sup> In addition, the BBC must consider complaints by third parties before complaints are made to Ofcom.

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<sup>188</sup> COBA response to the BCA Consultation, paragraph 7.

<sup>189</sup> TAC response to the Commercial Activities Consultation, p.4.

<sup>190</sup> Sky response, paragraph 3.36.

<sup>191</sup> BBC response to the BCA and BCR consultations, paragraphs 4.13-14.

<sup>192</sup> BBC Commercial Activities response, paragraph 4.7.

<sup>193</sup> Charter, Article 11.

<sup>194</sup> Agreement, clause 8, clause 17 and clause 31.

<sup>195</sup> Agreement, clause 7(5), clause 16(4) and clause 23(11).

- 6.6 We appreciate there may be cases where stakeholders feel they cannot engage effectively with the BBC due to commercial sensitivities. Although Ofcom does not expect third parties to share commercially sensitive information with the BBC, it remains our view that they should engage as much as practically possible with the BBC to enable it to assess the potential impacts on fair and effective competition. For example, it may be possible for third parties to indicate the existence of their concerns without necessarily having to disclose commercially sensitive information.
- 6.7 In relation to Sky's concern about long timescales, the Charter and Agreement specify a BBC first model for enforcement.<sup>196</sup> This means stakeholders must first seek to resolve issues directly with the BBC, before bringing a complaint to Ofcom. In exceptional circumstances, Ofcom may intervene at an earlier stage if a complaint has not been resolved by the BBC.<sup>197</sup> However, as discussed at paragraph 5.21 above, we expect parties to make every effort to engage in a timely and constructive manner with each other in any case.
- 6.8 In relation to material changes to the BBC's commercial activities, we also acknowledge the need to protect commercially sensitive information. We expect the BBC to consider what information it can share with third parties about its trading and separation arrangements with the Public Service.

## Transparency and ongoing monitoring programme

- 6.9 In the Competition Consultations, we set out a range of requirements designed to ensure stakeholders have adequate knowledge about the BBC's proposals to make material changes to its activities, and where appropriate increased transparency about its existing arrangements, for example between the Public Service and the commercial subsidiaries.

## Summary of responses

- 6.10 Respondents emphasised the importance of sufficient scrutiny and transparency of BBC operations which might have an adverse impact on fair and effective competition. ITV argued that the new regulatory framework would require a change in culture and approach at the BBC, as it believed there was insufficient transparency around the way the BBC operated. It said that Ofcom should make it clear at the outset that monitoring and enforcement would be rigorous.<sup>198</sup>
- 6.11 Sky considered there was a need for robust checks and balances in Ofcom's approach to regulation, given the incentives for the BBC to underplay any potential market impact in its proposals.<sup>199</sup> Sky also suggested it had had little information or understanding as to the approach taken by the BBC towards transfer pricing and had therefore been unable to challenge BBC assessments.<sup>200</sup> Pact considered it was important for us to closely monitor BBC developments as we would have access to significantly more information than other parties.<sup>201</sup>

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<sup>196</sup> Agreement clause 56(4)(a)

<sup>197</sup> Agreement clause 57(2)

<sup>198</sup> ITV response, pp.2-3.

<sup>199</sup> Sky response, paragraph 5.

<sup>200</sup> Sky response, paragraph 4.37.

<sup>201</sup> Pact response to BCR Consultation, paragraph 1.10.

- 6.12 The BBC acknowledged that certain information about its plans, including, for example, when it intended to make changes to the public services, would be helpful to us in undertaking our regulatory duties.<sup>202</sup>

### **Ofcom's response**

- 6.13 We agree that for Ofcom to be able to scrutinise BBC activities effectively, it is important that we have sufficient transparency of both existing operations and the BBC's future plans. We will monitor the BBC's activities using a variety of sources of information.
- 6.14 Firstly, the BBC's annual plan will provide information about its future plans. Regular formal engagement between Ofcom and the BBC, together with this annual plan, will help ensure we are aware of all plans for changes to services which have the potential to have a material impact.
- 6.15 Further, we will analyse the data we collect, through our performance assessment and complaints. We will supplement this data with our information gathering powers as appropriate. Our monitoring programme will also include stakeholder engagement as well as research into the market to ensure that issues facing both the BBC and its competitors are understood.
- 6.16 Finally, we will use the knowledge we gain from these and other processes to ensure our focus is on the right level of regulation to provide all industry stakeholders, including the BBC, with the opportunity to compete to deliver innovative services and content which meet the needs of UK audiences.

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<sup>202</sup> BBC response to the BCA and BCR consultations, paragraph 4.21-4.23.