

Submission to Ofcom's Proposed Annual
plan 2018/19

pact.

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Introduction

- 1) Pact is the UK trade association representing and promoting the commercial interests of over 500 independent television, feature film and digital content producers.
- 2) The UK independent television sector is one of the biggest in the world. Despite the difficult economic climate, independent television sector revenues have grown from £1.3 billion in 2005 to over £2.5 billion in 2016, making a major contribution to the UK creative economy and exports.¹
- 3) Given that Ofcom continues to have a significant impact on the communications market including the audio visual sector it will be important to our members that Ofcom's plans over the next year will continue to create the right conditions for the continued investment from the UK public service broadcasters (PSBs) into UK original content.
- 4) Pact welcomes this opportunity to consider and comment on Ofcom's proposed Annual Plan 2018/19.
- 5) For further information, please contact Pact's Head of Policy, Emily Oyama

¹ Pact Census Independent Production Sector Financial Census and Survey 2017, by Oliver & Ohlbaum Associates Ltd (November 2017).

1. Overview

1.1 We thank Ofcom for giving Pact the opportunity to comment on Ofcom's proposed annual plans 2018/19. We have focused our comments primarily on the responsibilities it acquired last year as the BBC's regulator.

1.2 We reiterate again for the need to review BBC Studios as soon as possible especially given the new merger with BBC Worldwide. There is also a need for Ofcom to investigate set up a new regulatory framework to monitor and oversee the BBC's transfer pricing arrangements which continue to follow the BBC Trust framework and has changed little over the last two years.

1.3 Below we outline in more detail are views and comments on the proposed work plan.

2. BBC Regulation

BBC Studios and fair transfer pricing

2.1 When Pact originally negotiated an agreed position on accepting BBC Studios as an entity we set out key principles that the BBC agreed on. These were enshrined in some form through the BBC Charter and Agreement. These were:

- no direct or indirect cross-subsidy;
- demonstrable separation between the finances and operations of BBC public service and BBC Studios;
- arm's length commissioning;
- fair transfer pricing and fair and transparent competition for new commissions between BBC Studios and third party producers.

2.2 We continue to have considerable concerns about fair transfer pricing and indirect cross subsidy. This is especially important now that BBC Studios has merged with BBC Worldwide.

2.3 We look forward to Ofcom completing their work on the BBC and their continued oversight especially through the Ofcom annual report on BBC compliance. We also welcome Ofcom's work on developing the right regulatory and reporting controls to ensure added transparency. But we also insist on an early review of Studios especially given the recent market developments i.e. the merger of BBC Worldwide and BBC Studios. Any relationship between BBC Public Service (BBC PS) and its commercial subsidiaries must not distort competition.

2.4 There is a lack of transparency in relation to BBC transfer pricing arrangements. Ofcom should use its powers to investigate to ensure comfort in the market. We want the BBC to be clearer about how they use benchmarks to set prices for the goods and services they offer to their commercial subsidiaries. For the market to have comfort we would like Ofcom to carry out a review as soon as possible. We are particularly concerned about the robustness of any BBC and/or Ofcom monitoring systems to manage transfer pricing. We know that the BBC has had a mixed record when it comes to reporting. For example in the previous regime the BBC Trust commissioned EY to review the transfer pricing arrangement. The BBC Trust commissioned report by EY found:

- BBC systems allowed for significant transfer pricing relationships to be overlooked because it entirely relies on a self regulatory system which has no comprehensive documentation processes which meant that when EY came to review the relationships there was no systematic way for them to assess the relationships.
- A lack of transparency in how decisions are being made and ambiguous guidance means risks are overlooked. E.g. BBC divisions decide themselves what transactions are 'significant'. Although BBC documentation confirms that it has outlined what this means it continues to rely on self regulation.

2.5 Most recently in the NAO report 'Managing the BBC's workforce' it also criticised the systems or lack of systems the BBC had on how it reported and documented variable staff. In their report they highlighted the lack of a coherent and centrally managed way of measuring the change of and cost of variable staff. In a similar vein we worry that a lack of record keeping could occur when managing transfer pricing arrangements. BBC could use similar practices to record keeping and due diligence as they have done with variable staff.

2.6 Pact welcomes the raft of BBC documents on transfer pricing published at the end of last year. But there continues to be a lack of detail. We acknowledge that the BBC is adhering to Ofcom requirements on trading and separation which in turn is heavily based on the previous fair trading regime. But our concerns from last year's response to Ofcom's proposed annual plan 2017 have yet to be alleviated and we continue to have a lack of faith in the arrangements. We hope that as part of Ofcom's on-going role to monitor the BBC's compliance with requirements preventing the BBC's commercial subsidiaries from gaining an unfair competitive advantage it will thoroughly review the procedures. For example the recent BBC transfer pricing principles document overlooks two key Ofcom requirements:

- A lack of acknowledgement that in all cases when BBC PS provides goods and services to commercial subsidiaries it must be on a arms length commercial terms basis;
- Under cost based approaches – they do not agree to Ofcom’s requirements on including cost of capital and a reinvestment into the BBC Public Service.

2.7 The method they use to calculate the range of internal costs is also vague and confusing. Pact wants confirmation that Ofcom will get access to assess this with actual numbers. We are also unsure about how they know what the range of internal costs represent and what methodology is used to calculate. For example on market prices – what are the ranges and will Ofcom get reports on usage- because that will determine the prices and the range. Also will this be included in the BBC’s financial reporting to Ofcom? What do they mean by verifiable data – will Ofcom get access to see these? We presume all the documents are non confidential but is Ofcom are privy to more detail? We are also surprised that previous commitments made in 2016 as BBC Studios was approved for regulatory approval have not been replicated in the new transfer pricing documents. These referred to recommendations including:

- Robust transfer pricing arrangements with transparency and communication with industry stakeholders;
- Demonstrate its reasoning behind individual transfer pricing decisions, such as why a specific value has been used in setting payments;
- Benchmarking analysis should be updated regularly, and a formal review process and should be built into long-term contracts.

2.8 Given these significant concerns there is a real need for a thorough review and stock take before any new regulatory controls or monitoring framework is put in place – we urge Ofcom to take time in deliberating over previous reports on transfer pricing and the BBC’s fair trading carried out over the years to ensure a robust and trustworthy framework will be created.

BBC Operating Licence

2.9 Pact is deeply concerned that the operating licence will be opened up again after and if the programmes commissioned for the proposed new BBC Scotland channel could be classed as network programmes. As the BBC highlights in its submission this is counterintuitive and would be counterproductive – reducing the BBC’s investment in the UK’s nations and regions by setting local content against a network quota:

'definitions of regional and network programming in the BBC Agreement taken together confine regional programming to only those programmes shown on a variation to an existing service. Under these definitions we would expect that programmes on the proposed BBC Scotland channel would, somewhat counter-intuitively, be classed as network programmes.

2.10 Pact would welcome being included in this important consultation process and we welcome further information about timings for decision making. Ofcom should classify programmes on the channel as non-network for the purposes of monitoring the BBC's percentage of network production produced outside of London, in line with its current treatment of BBC Alba. Doing otherwise, could have important repercussions for both network investment in Scotland but potentially the wider out of London quotas too.

BBC Three

2.11 Ofcom should immediately carry out an adhoc review on BBC3 given that a review is now outstanding² and we consider Ofcom should be responsible for carrying out a review based on its responsibilities for performance and competition. At the time of the BBC Trust consultation on the proposed service licence amendments for changes to BBC Three Pact was opposed to the move to an online only service especially given that the terms of digital content rights were assigned in perpetuity for digital content. Pact and the BBC have reached agreement on commissioning terms applicable to so-called long-form content (which is also transmitted on BBC1 or 2). Given the proportion of the BBC3 content spend dedicated to online only content (short-form) it is necessary for online content to receive the same operational oversight. The contract terms issued to online content continue to be an issue for our members and we believe Ofcom should use their powers to carry out adhoc reviews to make sure the full impact of BBC three moving to an online environment is reviewed.

3. Diversity

3.1 We look forward to reading the report on diversity and equality of opportunity in broadcasting. Pact has a strong commitment to diversity across the TV/Film

² The BBC Trust endeavoured to undertake a review of BBC Three within 18 months of their final decision made 26 November 2015

production sector and our CEO as Chair of the Creative Diversity Network works with senior industry partners to drive forward greater inclusion.

3.2 Our members are engaged in delivering on Project Diamond and we are working closely with the CDN to increase awareness and to improve return rates. We continue to develop our work on diversity and inclusion; through our website which offers guidance and resources to the whole industry, with production companies on a new cultural change programme and inclusive leadership lab and also through our diversity training scheme. We call on PSB broadcaster to remain vigilant in ensuring there is diversity off screen throughout their organisations and not just on screen. We look forward to Ofcom's second annual report on the UK TV industry to promote diversity and equality of opportunity in broadcasting.

4. Nations and Regions

4.1 Pact has always championed the need for all PSBs to implement a strong nations and regions strategy so that a local and vibrant production sector can be sustainably maintained within the nations and regions. How PSBs are monitored on this creates considerable opportunities for Indies who in turn are a positive catalyst across the country.

4.2 We are encouraged by Ofcom's plans to review Made out of London guidance for production outside of London and have already fed into the initial stakeholder consultation meetings on the subject. Pact's current view is that the definition and guidance currently offers balance and flexibility benefitting companies in the nations and regions and London. However, we are in the process of gathering evidence and consulting with members before the likely formal Ofcom consultation in Q1 2018. We are aware of feedback from companies based in the nations and regions for example, that transitory or minimal representation of key executives as a substantive base isn't delivering on the original purpose of the definition. There are a number of ways in which Ofcom could tighten up the way that it monitors and audits broadcaster compliance with the guidance.

4.3 We also accept that Ofcom has decided to go through a full BCA process for the new BBC Scotland Channel although there is some concern amongst producers around the possible delay of the launch of the channel. However, Pact has a keen interest if the outcome of this process means we need to revisit the BBC operating licence and insists that we are involved with consultations on this along with other third parties.