



Ofcom Review of the Interaction between BBC Studios and the BBC Public Service

Sky's response to Ofcom's Call for Evidence

December 2020

Executive summary

This is the response of Sky UK Limited (“Sky”) to Ofcom’s call for evidence on its review of the interaction between BBC Studios (“BBCS”) and the BBC Public Service (“Public Service”), dated 9 October 2020 (“Call for Evidence”).

In Sky’s experience, the existing arrangements between the BBC’s commercial subsidiaries and the Public Service risk distorting the market, in breach of the BBC’s regulatory obligations under the Royal Charter and Framework Agreement. Sky’s main concerns include:

- a. the lack of meaningful separation between the management and direction of the Public Service and the BBC’s commercial subsidiaries, including BBCS;
- b. the exclusive supply of key content to BritBox, in which the BBC holds a 10% shareholding;
- c. the risk that such exclusivity undermines the ability of BBCS to earn a commercial rate of return, in accordance with the Trading and Separation requirements imposed by Ofcom (“the Requirements”);¹ and
- d. the lack of transparency in the supply of goods and services from the Public Service to BBCS.

This response outlines the need for greater separation and transparency between BBCS and the Public Service in order to safeguard against the distortion of the market and/or the granting of an unfair competitive advantage to the BBC’s commercial activities.

¹ Ofcom, The BBC’s commercial and trading activities: requirements and guidance, 11 February 2019. Available at: https://www.ofcom.org.uk/_data/assets/pdf_file/0018/136071/BBC-commercial-trading-updated-requirements.pdf

The BBC's regulatory obligations

As a publicly funded broadcaster, the BBC is subject to a range of regulatory obligations under the Charter and the Framework Agreement which, amongst other things, require the BBC to:

- have particular regard to the effects of its activities on competition in the UK;²
- “seek to avoid adverse impacts on competition which are not necessary for the effective fulfilment of the Mission and the promotion of the Public Purposes”;³
- “have regard to promoting positive impacts on the wider market”;⁴
- act in the public interest;⁵
- observe high standards of openness and seek to maximise transparency and accountability;⁶ and
- ensure that its commercial activities do not, as a result of their relationship with the UK Public Services, distort the market or gain an unfair competitive advantage.⁷

In addition, the Requirements impose detailed obligations on the BBC which are designed to allow it, as a publicly funded broadcaster, to operate commercial services without infringing its Charter obligations and state aid rules:

1. The BBC must operate commercial subsidiaries at ‘arm’s length’

Fundamental to the BBC undertaking commercial activities are the concepts of separate legal personality and operational separation.⁸ The BBC is required to act only through separate commercial subsidiaries, to ensure that subsidiaries do not have access to commercially sensitive information from the Public Service, and to ensure that those subsidiaries are governed by boards and executive committees which are “distinct and separate” from the BBC.⁹

2. The BBC must supply goods and services on ‘arm’s length’ terms

The BBC must supply goods and services to its commercial subsidiaries and joint ventures (including BritBox) at ‘arm’s length’ and on commercial terms, and it must not discriminate unduly against third parties.¹⁰

3. The BBC’s commercial activities must earn a commercial rate of return

In order to ensure that public funding is not used to finance commercial activities and that such activities are at ‘arm’s length’, the BBC’s commercial activities must earn an appropriate commercial rate of return (as determined by the BBC). Ofcom recognises that new activities may project a loss in the early years but should forecast a “commercial rate of return over an appropriate period of time”.¹¹ Also, one business could generate indirect returns elsewhere, but Ofcom would expect the BBC “to be able to demonstrate how low returns on one line of business supported

² Charter, Article 11.

³ Ibid.

⁴ Ibid.

⁵ Charter, Articles 9 and 18.

⁶ Charter, Articles 12 and 18.

⁷ Charter, Article 18; Framework Agreement, Clause 23(5)(d).

⁸ Requirements A.1, A.2 and A.5.

⁹ Requirements A.4 and A.5.

¹⁰ Requirements B.1 and B.2.

¹¹ Requirement C.10(a).

*higher returns elsewhere, in order to show that the low returns nevertheless represent appropriate commercial rates of return”.*¹²

The Requirements also include monitoring, reporting and transparency obligations.

The meaningful operation of this framework is essential to the proper functioning of the UK audio-visual sector. Given the enormity of the intervention represented by the BBC, the Requirements ought to protect the sector from the distortive effects of the BBC public subsidy. This is more important now than ever before. In recent years, the BBC has increased the size and scope of its commercial services. Initially through the transformation of the BBC’s public service production activities into a commercial subsidiary, and then their subsequent merger with BBC Worldwide, creating a successful commercial production and distribution business to support the BBC, operating commercially in the wider market. These changes, together with the acquisition of sole control over the UKTV pay TV business, mean that the BBC’s commercial activities have significantly increased, as have the interactions with the Public Service.

Sky’s role as a platform operator and pay TV retailer means that it has long standing relationships with both ‘sides’ of the BBC: giving access to the BBC’s public services where the BBC is willing to allow its content to be made available, and distributing the UKTV channels and content on a pay-basis. The dividing line between the BBC’s public and commercial services is therefore a crucial distinction for Sky. On one side, the BBC is obliged to make its content available at no charge, and on the other Sky must pay. Both as platform operator and retailer, Sky competes fiercely against a range of free and pay services provided by the BBC and third parties to provide the most attractive offering to audiences. How the BBC interacts with other platforms and services has a direct impact on the competitiveness of Sky’s offering.

It is therefore in light of its experiences in dealing with the Public Service and BBCS that Sky makes the comments set out in this response to the Call for Evidence.

Lack of meaningful operational separation between the Public Service and BBCS

There is a clear lack of meaningful separation between the management and direction of the Public Service and BBCS. This results primarily from the BBC’s failure to engage adequately with Ofcom’s Requirements, leading to cross-contamination of the BBC’s boards and executive committees, and making it impossible for the BBC to comply with the Requirements to operate “*distinct and separate*” boards and executive committees, to have an “*appropriate number of directors who are not members of the BBC Board and/or its executive committees*” and to limit information sharing in a proper and effective manner or to avoid conflicts of interest. See Annex 1 for further detail.

The BBC’s defence of the current position pre-dates Ofcom’s revised Requirements,¹³ and is based on a view of the world before the current Charter; namely that as the Director-General is chief executive of “*all of the BBC’s activities – commercial and public service*”, and his executives have “*group, rather than purely public service, remit*”, they are somehow exempt from obligations relating to fair and effective competition. Ofcom dismissed these arguments in its public statement when imposing the Requirements on the BBC to address its concerns that “*the relationship between the Public Service and the commercial subsidiaries*

¹² Requirement C.10(b).

¹³ BBC, ‘The BBC’s commercial and trading activities: A consultation on proposed modifications to Ofcom’s requirements and guidance’, September 2018, page 7. Available at: https://www.ofcom.org.uk/data/assets/pdf_file/0015/122505/BBC.pdf.

could distort competition by giving the commercial subsidiaries an unfair advantage compared to their rivals".¹⁴ Ofcom went further in its guidance noting:

*"Ofcom recognises that the BBC Board has duties which require it have a degree of oversight over the governance of the Commercial Subsidiaries. Therefore, a reporting line between the BBC Board and the board(s) of the Commercial Subsidiaries, and **the presence of one or more BBC Board member(s) and/or executives with Public Service roles on the boards of the Commercial Subsidiaries is not prohibited** pursuant to the Requirements, **provided the BBC ensures that it complies with those Requirements.**"¹⁵ (emphasis added)*

Sky submits that the BBC has failed to address Ofcom's concerns and none of the policies/statements that emerge from the BBC justify its breach of the requirement for distinct and separate governance for the BBC's commercial activities.¹⁶ Worse, they risk creating a veneer of adherence to the regulatory framework.

Ofcom's stated purpose in imposing the governance arrangement through the Requirements was to "ensure that the governance of the Commercial Subsidiaries is consistent with an arm's length relationship with the Public Service, and that Commercial Subsidiaries are sufficiently independent in objective setting, strategy and decision making" and to support compliance with the other requirements. In Sky's experience, the reality is that the Public Service dictates commercial objective setting, strategy and decision-making at the BBC commercial subsidiaries, including the BBCS, and in doing so, the BBC is distorting the market.

Supply of key BBC content to BritBox on an exclusive basis

The BBC's approach to licensing content to BritBox is an example of the distortion of competition that results from the lack of separation and transparency between the BBC Public Service and BBCS. Here, Sky observes that the BBC appears to be pursuing a strategy aimed at favouring BritBox, in which the BBC holds a 10% stake, by directing BBCS to make certain key BBC content exclusively available to BritBox in the primary and secondary windows through the existence and application of the Public Service's Programme Release Policy ("PRP")¹⁷ from which BritBox is the sole beneficiary. Granting BritBox an unfair competitive advantage in an increasingly crowded market distorts competition by putting rival pay TV services that might otherwise license BBC content on a commercial basis at a disadvantage. BritBox is directly exploiting such advantage by advertising its services as being "the biggest box of British boxsets".

The BBC's strategy of favouring BritBox is also exemplified by the unique and priceless promotion of BritBox on BBC1 on 3 March 2020, when the BBC broadcast an advertisement for BritBox immediately after the last episode of Doctor Who by promoting related content acquired and distributed by BritBox. Whilst availability of the current series "on DVD" was called out, no mention was made of its availability via streaming or download on various third-party outlets, such as Amazon or iTunes. The BBC advertised the availability of 'Classic Doctor Who' series exclusively on BritBox.

¹⁴ Ofcom, 'The BBC's commercial and trading activities: requirements and guidance - Statement on modifications to Ofcom's requirements and guidance', 11 February 2019, paragraph 3.19. Available at: https://www.ofcom.org.uk/data/assets/pdf_file/0016/134350/statement-bbc-commercial-trading-activities.pdf.

¹⁵ Ofcom, 'The BBC's commercial and trading activities: requirements and guidance', 11 February 2019, paragraph A.15. Available at: https://www.ofcom.org.uk/data/assets/pdf_file/0018/136071/BBC-commercial-trading-updated-requirements.pdf.

¹⁶ For example, the BBC's Annual Statement on operational separation was to describe high level "measures, internal controls and processes implemented to ensure compliance with the requirements, across the UK". Available at: <http://downloads.bbc.co.uk/aboutthebbc/reports/policies/operational-separation.pdf>. See also, the 'BBC Board Policy - Exchange of Information Protocol'. Available at: <http://downloads.bbc.co.uk/aboutthebbc/whowere/bbcboard/information-sharing-protocol.pdf>.

¹⁷ Available at: <http://downloads.bbc.co.uk/commissioning/site/bbc-programme-release-policy-october-2019.pdf>.

The promotion of BritBox constituted ‘advertising’¹⁸ as the BBC had agreed in the Memorandum of Understanding with ITV that it would ‘cross-promote’ BritBox and received value under the arrangement as a result. Advertising on the BBC’s advertising-free services would be extremely valuable given the significant impact of unique brand references on the UK’s most-watched channel. The BBC therefore infringed the Framework Agreement obligation not to use licence fee funds for advertising-funded services.¹⁹ The fact that the promotion qualified as ‘programme-related material’ does not stop the promotion constituting ‘advertising’; it merely exempts it from the advertising minutage rules, which in any event do not apply to the BBC as it is not supposed to include any advertising.

Ofcom’s materiality assessment noted at the time that “[t]he BBC and ITV have not yet agreed how the BBC will [cross-promote Britbox]”, but that the BBC’s own editorial guidelines provided sufficient protection from distortion of competition given their requirement for editorial justification and non-discrimination.

Ofcom went on to state:

“we are conscious that we do not currently have any regulation in place on the BBC in this area and taking into account stakeholder concerns, we are considering whether regulation on cross-promotion is required to protect fair and effective competition. This work will include looking at what is agreed in relation to cross-promotion in the long-form agreement between ITV and the BBC. In this context we expect the BBC to explain to us the approach it intends to adopt to cross-promotion on BBC iPlayer prior to implementation.”

Clearly, such regulation is required as the BBC has demonstrated that it is unable to apply editorial rules to protect fair and effective competition. Sky notes that were Ofcom to apply the current Ofcom Cross-promotion Code to the BBC, it would not be permitted to cross-promote BritBox due to its limited shareholding and the fact that the programmes were no longer editorially controlled by the BBC. In any event, where the BBC restricts access to its content such that it can promote BritBox as the exclusive outlet, a non-discrimination obligation provides no protection for fair and effective competition. Any new rules would need to address such issues.

Accordingly, it can be seen that the BBC’s restriction of access to its content supports its intention to promote BritBox over other BBC outlets. (The BBC has never cross-promoted UKTV channels or content despite its 50% interest in the broadcaster until recently acquiring 100%.) In this way, the arrangements also raise fundamental questions over the extent to which the BBC’s arrangements with BritBox can be said to be at ‘arm’s length’ in accordance with the Requirements.

Sky cannot comment on the extent to which the joint venture agreement between the BBC and ITV is relevant to the BBC’s strategy of favouring BritBox. However, Sky would expect Ofcom to review those arrangements to satisfy itself that there is no link between the two, particularly in circumstances where there is an expectation that the BBC will increase its stake in the joint venture in due course.

¹⁸ Defined by Ofcom as “any form of announcement broadcast whether in return for payment or for similar consideration or broadcast for self-promotional purposes by a public or private undertaking or natural person in connection with a trade, business, craft or profession in order to promote the supply of goods or services, including immovable property rights and obligations, in return for payment”. Ofcom Code on the Scheduling of Television Advertising. Available at: https://www.ofcom.org.uk/_data/assets/pdf_file/0014/32162/costa-april-2016.pdf#:~:text=1%20Code%20on%20the%20Scheduling%20of%20Television%20Advertising%20Communications%20Act%2C%20the%20Audiovisual%20Media%20Services%20%28AVMS%29%20Directive.

¹⁹ Framework Agreement, Clause 49(2).

Sky's concerns regarding the BBC's strategy aimed at favouring BritBox are further detailed in Annex 2.

Commercial rate of return earned by BBCS

The BBC is required to earn a commercial rate of return over an appropriate period of time for each commercial subsidiary and line of business in order to prevent them from gaining an unfair competitive advantage or distorting the market due to their relationship with the Public Service.

In the short to medium term, however, the BBC's strategy concerning the supply of key content to BritBox (discussed above) is likely to have the effect of reducing BBCS' revenues from licensing content to third parties, thereby reducing the return paid by BBCS to the Public Service, as well as the share of revenues to any third party production companies that have contributed to content that is distributed by BBCS. Sky understands that the BBC's strategy is similarly of concern to PACT. It may therefore also affect the BBC's incentives to use independent production companies when commissioning content going forward.

Sky considers that greater transparency is needed in this area, particularly in the light of BBCS' decision to combine its production and distribution activities into one line of business and Ofcom's provisional conclusion that this is appropriate. Sky therefore welcomes Ofcom's plan to evaluate and provide guidance to stakeholders on what it considers represents a commercial rate of return and the appropriate period of time over which BBCS should earn such rate.

Sky also welcomes Ofcom's proposal, as set out in its consultation on BBCS' lines of business,²⁰ to amend the Requirements by imposing additional reporting obligations on the BBC (in order to enable Ofcom to monitor and assess whether the production and distribution line of business is earning a commercial rate of return), and requiring the BBC to give Ofcom three months' notice of any future changes to the composition of the commercial subsidiaries or lines of business.

Lack of transparency in the supply of goods and services from the Public Service to BBCS

As noted above, the goods and services which BBCS receives from the Public Service must be provided at 'arm's length' and any sharing of services must be carried out on commercial terms. These obligations exist to safeguard against the distortion of fair and effective competition. Sky is concerned about the possible impact of the lack of separation (discussed above) on the terms on which goods and services are provided by the Public Service to BBCS.

Such concern is reinforced by the current lack of separation and transparency around the supply of goods and services to BBCS. For instance, Sky is aware that the Public Service and BBCS have shared support functions including important strategic staff such as the legal and regulatory services. In Sky's experience, it can be unclear in what capacity various individuals in these divisions are acting. This is concerning not least because there should be strict separation in these areas in order for them to operate independently and objectively.

²⁰ Ofcom Consultation, 'BBC Studio's lines of business - Assessment of BBC Studios' changes to its lines of business'. Available at: https://www.ofcom.org.uk/data/assets/pdf_file/0019/204490/consultation-bbc-lines-of-business.pdf. Sky has not provided a separate response to this consultation as it does not have sufficient information on the operation of BBCS to comment meaningfully. Sky considers the arm's length separation of BBCS from the Public Service to be a pre-requisite of ensuring that BBCS does not distort competition and has accordingly focused its attention on this call for evidence.

Sky therefore welcomes Ofcom's decision to assess a sample of transfer pricing methodologies to ensure they are consistent with the principles set out in the Requirements. In addition to this, however, Ofcom should clarify how transparency will be improved from a stakeholder perspective.

Conclusion

Sky's concerns go to the heart of the relationship between the Public Service and the BBC's commercial activities, and therefore have a broader impact than Sky's dealings with the BBC. Sky is aware that the independent production sector shares Sky's concerns. Nor do these concerns fall neatly into the regulatory framework applied to the Public Service or commercial activities. Ofcom has a responsibility to ensure that the relationship between the Public Service and the BBC's commercial activities does not distort the market or create an unfair competitive advantage. However, the current lack of separation between BBCS and the Public Service, combined with the lack of transparency around how these two entities interact, demonstrate the inadequacy of the current framework and Ofcom's ability to hold the BBC to account. As a result, the BBC has been able to game the system and enter into intra-group arrangements which risk distorting the market in breach of the BBC's regulatory obligations, to the ultimate detriment of end consumers. Meanwhile, other stakeholders have limited ability to engage meaningfully with the BBC or assess its behaviour against the Requirements. To safeguard against these adverse outcomes, Ofcom should seek to ensure that measures are put in place to secure greater separation and transparency between BBCS and the Public Service going forward.

Sky

December 2020

Annex 1

BBC Boards and Committees Cross-Memberships

BBC Board	BBC Executive Committee	BBC Commercial Holdings Board	BBC Fair Trading Committee
David Clementi (Chairman)			
Tim Davie (Director-General)	Tim Davie (Director-General)	Tim Davie (Director-General)	
	Kerris Bright (Chief Customer Officer)		
	Tom Fussell* (CEO, BBC Studios)	Tom Fussell (CEO, BBC Studios)	
	Glyn Isherwood (CCO)	Glyn Isherwood (CCO)	
Ken MacQuarrie (Dir, Nations & Regions)	Ken MacQuarrie (Dir, Nations & Regions)		
Charlotte Moore (Chief Content Officer)	Charlotte Moore (Chief Content Officer)		
Ian Hargreaves (Non-exec Director)			Ian Hargreaves (Non-exec Director)
Tom Ilube (Non-exec Director)			Tom Ilube (Non-exec Director)
Steve Morrison (Member for Scotland)		Steve Morrison (Member for Scotland)	Steve Morrison (Member for Scotland)
Francesca Unsworth (Dir, News & Current Affairs)	Francesca Unsworth (Dir, News & Current Affairs)		
Elan Closs Stephens (Member for Wales)		Elan Closs Stephens (Member for Wales)	
Shirley Garrood (Non-exec Director)			Shirley Garrood (Non-exec Director)
		Mark Linsey† (Chief Creative Officer)	
	Gautam Rangarajan (Group Dir of Strategy & Performance)		
	June Sarpong (Dir, Creative Diversity)		
	Bob Shennan (Managing Director)		
Tanni Grey-Thompson (Non-exec Director)			

* Tom Fussell is also a member of the BBC Studios Board and the BBC Studios Executive Committee.

† Mark Linsey is also a member of the BBC Studios Board, the BBC Studios Executive Committee and the board of BBC Studios Distribution Limited.

BBC Board	BBC Executive Committee	BBC Commercial Holdings Board	BBC Fair Trading Committee
Nicholas Serota (Senior Independent Director)			
Ashley Steel (Member for England)			
		Mai Fyfield (Non-exec Director)	
		Sarah Jones (Group General Counsel)	
		Dharmash Mistry (Non-exec Director)	
		Bal Samra (BBC Group Commercial Director)	