

Submission to Ofcom's BritBox Materiality
Assessment

pact.

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Introduction

1) Pact is the UK trade association representing and promoting the commercial interests of independent feature film, television, digital, children's and animation media companies.

2) Pact is a strong supporter of the UK Public Service Broadcasting (PSB) system, which provides high quality UK content to UK audiences. The PSB system is founded on open competition for ideas which drive creativity and innovation in the UK production and broadcasting ecosystem.

3) In 2017, the BBC was the largest PSB commissioner of the independent production sector at £453 million. However, the BBC external commissioning spend has declined from 2013 when it stood at £476 million. This fall in external spend has resulted in a growing financial gap between the BBC's programme tariff (budget contribution) and the actual cost of the programme. A large proportion of this decline has been mitigated by an increase in third-party funding, such as co-production, tax credits and deficit funding from production companies.

4) This deficit financing model applies to all the PSBs (BBC, ITV, Channel 4 and Channel 5) as producers accept risk as part of the financing process of UK PSB content. In order to secure the necessary UK and international sales to bridge the financing, and/or enable the producer to make a profit from the series (IP), producers are incentivised to make the series as high quality as possible to maximise its potential exploitation in order to secure revenues as production margins are low. The Terms of Trade system, in which producers own the IP of programmes, therefore benefits both the PSBs and the UK audience alike.

5) IP ownership and access to the UK and international markets has transformed the UK independent television sector to from a cottage industry in 2003 to one of the biggest in the world. In 2018, UK independent television sector revenues has risen to over £3 billion.¹

6) These revenues are generated by the independent production sector having access to the UK and world market. The PSBs have enjoyed a percentage share of these international and UK revenue streams without imposing any restrictive criteria on the producer.² The BBC's criteria for the proposed new programme release policy appears to give the BBC the right to approve the buyer during the 12-18 months

¹ Pact Census 2019

² Note – The UK PSBs bar the selling of their commissioned programmes and series to other UK PSBs and their wholly owned subsidiaries in the UK market

holdback window at the point of commission. It is Pact's view that the criteria do not comply with the guidance issued by Ofcom in their guidance documents on the 'Distribution of BBC public services' and the 'BBC's commercial and trading activities'.

7) Pact welcomes the opportunity to submit evidence to Ofcom's BritBox materiality assessment. Pact supports competition in the SVOD marketplace and has welcomed the formation of the UK content focused SVOD BritBox. This is because the commercial company will be another buyer and commissioner of UK content. However, Pact is concerned about the trading separation that will exist between BritBox and the BBC Public Service due to the proposed changes to the BBC's programme release policy, and the introduction of qualifying criteria procedure that distort this competition.

8) The BBC's proposed criteria for the programme release policy have been framed by the BBC to ensure that BritBox effectively becomes the only buyer for BBC content during the 12-18 months BBC holdback window. This confers an unfair competitive advantage onto BritBox, in which the BBC has a commercial interest and investment. It will also potentially stop new UK content focused SVOD entrants from buying BBC content which will lead to a reduction of public choice, innovation and investment in the market.

9) The BBC Public Service has proposed to Pact, changes in the Terms of Trade which are designed specifically to benefit BritBox in our analysis. This proposal would seem to be in contravention of paragraph 2.3 of Ofcom's most recent BBC Commercial and Trading Activities guidance which states that "Competition concerns may arise if third parties are less able to compete effectively because of the relationship between the Public Services and the commercial subsidiaries ... Alternatively, if they had access to information about the Public Service's strategy and priorities that was not available to third parties, they may be in a better competitive position than their rivals. This may distort competition by giving the commercial subsidiaries an unfair competitive advantage compared to their rivals" and paragraph 3.9 states that "Ofcom must set out trading and separation requirements on the BBC to ensure that commercial activities do not distort the market or gain an unfair competitive advantage as a result of their relationship with the Public Service. These may include requirements to ensure one or more of the following: (i) relationships between the Public Service and the commercial subsidiaries operates at arm's length on commercial terms; (ii) commercial activities are carried out in accordance with normal market principles; and (iii) the relationship between the Public Service and the commercial subsidiaries is appropriately transparent".

10) Pact is concerned that if these changes were agreed, the BBC would retain full discretion over which programmes will be granted the 12 months early holdback

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release. This will raise valid questions of which particular programmes will be selected by the BBC for an early 12 months holdback release and why. Will these programmes be selected – at the point of commission – following a request by BritBox? Alternatively, will the BBC Public Service seek to consult with BritBox on which programmes should be released early in order to meet BritBox’s commercial requirements. Both these scenarios, which will be made possible by the BBC’s new criteria, will be collusive, anti-competitive and appears contrary to the codes of practice which were established under Section 285 of the 2003 Communications Act.

11) For further information, please contact Pact’s Interim Head of Policy, Niall Stewart, at [✂] or on [✂].

Materiality Assessment

1.1 Pact notes that Ofcom's guidance on the BBC's commercial and trading activities and distribution of BBC Public Services state the following regarding the BBC:

1.2 Ofcom 'The BBC's Commercial and Trading Activities: requirements and guidance' - February 2019

1.3 Paragraph 2.15 states that "Competition concerns may arise if third parties are less able to compete effectively because the relationship between the Public Service and the commercial subsidiaries gives the subsidiaries an unfair competitive advantage."

1.4 Paragraph 2.17 states that "if the commercial subsidiaries receive an unfair competitive advantage, suppliers who compete with them may be less able to attract customers and may be unable to expand or may be forced to exit the market entirely. This may lead to less innovation and investment, and ultimately worse outcomes for UK consumers in terms of their access to quality services".

1.5 Paragraph 2.19 states that "Competition concerns will vary depending on the nature and scope of the trading activity in question. However, they are likely to stem from one of the following concerns:

a) Discriminatory pricing/access: when the BBC supplies products or services to third parties, it may do so in an unduly discriminatory manner. This could include charging different prices to different third parties for the same service, granting preferential access or refusing to supply to certain third parties. Trading in this way may put some parties at a competitive disadvantage.

b) Pricing below market norms: there is a risk that the Public Service offers goods and services to third parties at below market price, due to advantages that it may enjoy as a large publicly funded body, which could make it difficult for suppliers of similar services to compete."

1.6 Ofcom 'Distribution of BBC Public Services' - March 2017

1.7 Pact notes that paragraph 3.9 of this document states that "the absence of BBC content from a platform is likely to place it at a competitive disadvantage".

Section entitled 'Potential competition concerns':

1.8 Paragraph 3.18 states that "there is the risk that the BBC supplies its public services in a discriminatory fashion".

1.9 Paragraph 3.19 states that if the "BBC supplies its public services on overly restrictive terms ... then this may limit the ability of platform operators to compete".

This may limit their ability to innovate and invest in their services so reducing the quality and range of services on offer to the public.

1.10 Paragraph 3.20 states that there is the possibility that the “BBC offers terms which the platform cannot reasonably be expected to accept”.³

The BBC Criteria

1.11 Pact has reviewed the BBC’s criteria in the light of Ofcom’s the BBC’s commercial and trading activities and distribution guidelines and whether they meet the key tests of fairness, reasonableness and non-discrimination.

1.12 Criterion a) states that the SVOD must “operate under a corporate strategy designed specifically to invest in and support the UK creative industries and PSB ecology as a whole, and its core editorial strategy will be aimed at providing UK focused multi-genre content from UK content providers”.

1.13 Pact has assessed this criterion on whether it meets Ofcom’s BBC’s commercial and trading activities and distribution guidelines in being fair, reasonable and non-discriminatory. This criterion is not fair or reasonable because it relies on a subjective judgement from the BBC on whether the SVOD is supporting the UK creative industries and the PSB ecology. It is also discriminatory because the last phrase of this criterion is clearly designed to discriminate against SVODs whose core editorial strategy is not to provide “UK focused multi-genre content from UK content providers” but provide a premium subscription service of global content to UK subscribers. This general term means that, regardless of its investment into British content or studios, commercial SVODs like Netflix or new UK entrants will never be able to qualify as they will never operate under a “strategy designed specifically to invest in and support the [UK] PSB ecology as a whole”.

1.14 Pact believes that this criterion is in contravention of paragraph 3.19 and 3.20 of Ofcom’s guidance document on the distribution of BBC Public Services.

1.15 Issues of PSB ecology would seem to be a matter of public policy, and not materiality assessments that focus more questions on competition and the functioning of the marketplace.

1.16 Criterion b) states that the SVOD must “carry prominent and approved BBC branding at a service and content level delivering the BBC greater attribution and control of its brand”.

1.17 This criterion also fails to meet the principles of fairness, reasonableness and non-discrimination. It is unlikely that any commercial company, that is not in part or

³ Ofcom, ‘Distribution of BBC public services: Ofcom’s requirements and guidance’, 29 March 2017

fully owned by the BBC, would allow BBC branding at the service level. This would be contrary to the interests of the independent commercial company in promoting its own brand and so the criterion is unreasonable. The criterion also excludes any possibility of any new UK focused SVOD being able to purchase BBC content as this criterion would damage the creation of their own brand in the UK market.

1.18 After reviewing this criterion, Pact believes that this term is in contravention of both the Ofcom guidance document on the BBC's Commercial and Trading Activities and the guidance on Distribution of BBC Public Services. In terms of competition, this is a clear breach of paragraphs 2.15 and 2.19 in the guidance on the BBC's Commercial and Trading Activities. With regards to the distribution guidance, the BBC's criteria contravene paragraphs 3.19 and 3.20.

1.19 Criterion c) states that the SVOD must “provide the BBC with data-based insight into the performance of BBC content on its service”.

1.20 This criterion means that commercial companies are being asked to provide commercially sensitive data to the BBC Public Service, which is a major investor in a competitor company. Pact believes that this raises the question of what meaningful undertaking could the BBC Public Service provide to guarantee that such information won't be shared with BritBox. The only SVOD which will be able to provide the BBC with such data is BritBox due to the BBC Public Service's share ownership in the company. This criterion is unfair, unreasonable and discriminatory as only BritBox will be able to comply with this term in order to secure the necessary qualification.

1.21 Pact holds the view that this criterion is in contravention of paragraphs 2.15 and 2.17 of the Ofcom guidance on the BBC's Commercial and Trading Activities. In terms of Ofcom's guidance on the Distribution of BBC Public Services, Pact considers that this is in contravention of paragraphs 3.9, 3.19 and 3.20.

1.22 Criterion d) states that the SVOD must “provide the BBC with a material degree of oversight in relation to the prominence, attribution, windowing and scheduling of BBC content on its service”.

1.23 This criterion is unfair for it will provide the BBC Public Service with a considerable degree of control over a commercial company which is in competition with BritBox. This is both unfair and unreasonable. It is also discriminatory for only BritBox will be willing to provide the BBC Public Service with this material degree of oversight.

1.24 Pact considers that this criterion contravenes paragraphs 2.15 and 2.17 of Ofcom's guidance on the BBC's commercial and trading activities and paragraphs 3.9, 3.19 and 3.20 of Ofcom's guidance on the Distribution of the BBC Public Services.

1.25 The BBC Public Service is seeking to offer criteria which no platform can reasonably accept. This will deny BBC content to independent and commercial

platform operators which will limit their ability to compete, innovate and invest in their services. In turn, this will reduce the quality and range of services on offer to the public.

1.26 The BBC has stated that all the criteria must be met before a buyer is approved under the programme release policy. As only BritBox can agree to all of these terms, it is likely to become the only qualified buyer during the 12-18 months holdback window. This means that BritBox will have the unfair competitive advantage of having sole qualifying buyer access to BBC content during the 12-18 months window. BritBox could therefore offer to buy secondary rights at prices below likely market value as there won't be any other buyers who would be eligible to bid for those rights at the 12 months point. This creates a monopoly buyer for this window and removes the producers' ability to achieve a true market value.

1.27 This means that the BBC criteria are in contravention of Ofcom's guidance document on the BBC's Commercial and Trading Activities in terms of paragraphs 2.15, 2.17 and 2.19. With regards to Ofcom's guidance document on the Distribution of BBC Public Services, Pact believes that it is in contravention of paragraphs 3.18, 3.19 and 3.20.

Market Impact

Indies

1.28 Pact understands from the market that the 18 months holdback is already reduced for a large proportion of the BBC's content where the BBC does not provide the full financing for much of its external commissions. Independent production companies are required to find financing from the market in order to complete the series, or programme budget needed for the BBC commission. The production company cannot go into production – under the terms of its contract with the BBC – until the budget is fully financed.

1.29 For production companies to access this essential market finance, the BBC often reduces its 18-month holdback period for a much shorter window. This allows the producers to seek to secure the necessary financing agreements, and the BBC then secures a programme or series with a full production budget, but at a reduced cost to the Corporation.

1.30 Many small and medium sized companies, in particular, will be required to accept the BritBox offer as there will be too much uncertainty regarding the content's value at 18 months. Small and medium sized companies, which do not enjoy the same access that larger companies have to corporate finance, equity or bank loans, tend to produce genres which have limited international potential and rely on UK secondary rights sales to complete the financing and achieve a reasonable margin. The only credible strategy for these companies is to realise the UK secondary rights value as soon as possible. This means that these smaller companies may be forced

to sell the content at a price dictated by BritBox, and not the full value achieved in an open market.

1.31 Any reduction in secondary sales could impact on the production company's ability to raise deficit financing, which could affect their margins. This coupled with the impact of the extended iPlayer windows could result in smaller and medium sized companies operating on slimmer margins. This would, in turn, lead to less investment in the development of new ideas. This would impact on competitiveness, innovation and damage the diversity of the programme supply market across the UK. If this were to occur, then this would ultimately be to the detriment of the UK's PSB ecology. Larger suppliers and companies owned by the PSB broadcasters may be better placed to amortise risk and maintain margins. This will not be the case for small and medium sized suppliers who operate on low production margins, especially in those genres which are central to the purposes of the PSBs. Pact would urge Ofcom to consider carefully the medium to long term consequences of increased integration in the UK PSB broadcasting, distribution and production ecosystem.

1.32 This is why Pact believes that the BBC criteria will contravene paragraphs 2.15, 2.17 and 2.19 of Ofcom's guidance on the BBC's Commercial and Trading Activities. In terms of the distribution of BBC Public Services guidance document, the BBC's proposed criteria will contravene paragraphs 3.19 and 3.20.

Competition

1.33 In paragraph 1.31 of the Materiality Assessment document, Ofcom states that they "consider supporting British content-focused SVODs will help to support the creative economy across the UK, particularly given the increase in SVOD revenues in recent years". The BBC's criteria will inhibit any new UK-focused SVOD entrants from entering the market as no entrant UK SVOD service, with considerable start-up costs, will accept the terms of the BBC qualifying criteria in the revised programme release policy. The importance of BBC content to any new UK-focused SVODs was noted in Ofcom's the BBC's Commercial and Trading Activities guidance document which states in paragraph 1.7 that in relation to distribution that there is a risk that competitors may not be able to develop "compelling consumer offering if they are unable to include BBC content in their services, or are given access to it on unfair or discriminatory terms". The BBC criteria bar competitors from purchasing BBC content in the 12-18 months window, as the terms are discriminatory against rival commercial companies. This is a clear contravention of Ofcom's guidance on Distribution of BBC public services of paragraph 3.19 and 3.20.

1.34 If competition is to be effective in driving innovation and investment in the market, then the barriers to entry should not be such that they require substantial investment and/or compliance costs. Nor, should incumbent companies have the

power to set the terms or criteria for entry into a particular market which could have the effect of distorting or limiting effective competition.

1.35 Under the proposed changes to their programme release policy, the BBC will be the body that not only sets the entry criteria but also adjudicates on the suitability of potential applicants under their own criteria. This means that it is unlikely that any other commercial service will be able to launch in competition to the BBC's own commercial interest.

Criteria Procedure

1.36 Pact would query Ofcom's use of the term "expected" in paragraph 1.24 of the Ofcom materiality assessment document. There is no question that BritBox will qualify for early access to the BBC commissioned content. Pact would suggest that the imposition of this qualifying criteria is to ensure that only BritBox will be able to qualify.

1.37 In paragraph 1.27 of the Materiality Assessment document, Ofcom states that the BBC has said that it wants to be satisfied that early release at 12 months will enhance public value beyond that provided by the market. Pact believes that this particular criterion has been established to provide the BBC "specific team" with a 'catch all' reason to reserve the 12-18 months early access privilege to BritBox. This is not about adding 'public value' to the market, but instead distorting it by closing off BBC content from fair and competitive price competition between BritBox and other secondary rights buyers.

1.38 In paragraph 1.34, it is stated by Ofcom that it is important that the BBC is open to releasing content early to any service which can deliver against the policy's broader objectives. Ofcom asserts that the policy should make it clear that the criteria are not a rigid set of rules and the BBC should consider releasing content to an SVOD which does not have service-level BBC branding. The BBC must also have in place a fair, reasonable and non-discriminatory process for assessing applications. Ofcom goes on to state in paragraph 1.35 that if this process is applied in a fair and reasonable way with clear complaint procedures, then there will be no unfair competitive advantage of the relationship between BBC Public Service and BritBox.

1.39 Pact would query the assurances provided by Ofcom in paragraph 1.36 as Pact does not have any confidence in the BBC's process in terms of fairness, reasonableness or non-discrimination because the criteria are not fair, reasonable or non-discriminatory. Pact believes that the criteria are intended to ensure that only BritBox can meet the BBC's set of rules which will bar any competitor from qualification.

1.40 In paragraph 1.25, it is stated by Ofcom that the BBC expects that all the criteria will need to be met. Pact notes that the BBC tries to qualify the requirements needed

to “qualify for access” with such terms as “compliance may a matter of degree” or “certain elements of the overall Programme Release Policy may be more or less important”. These vague terms are intended to fulfil the Ofcom requirement that the rules should not be rigid and open to all SVODs. Pact believes that these vague terms grant BBC’s executives the freedom to make subjective qualification decisions that cannot be challenged on any objective criteria. The establishment of a “clear complaint procedure” to oversee the BBC’s implementation of the policy and the criteria is of little practical value to any potential SVOD entrant or IP rights holder, as there will be no grounds to make a successful appeal or recover the cost of seeking approval in the first instance. This combination of the criteria and BBC oversight will ensure that, due to the uncertainty of success, no other competing service will emerge to challenge BritBox. Regardless of the BBC’s assurances and complaint procedures, the criteria’s guaranteed outcome will remain the same. It will provide BritBox an exclusive right to buy BBC content in the 12-18 months holdback window.

Outcome of Materiality Assessment

1.41 Pact believes that, as stated above, the criteria contravene many of the key terms of Ofcom’s the BBC’s commercial and trading activities and distribution of BBC services guidance documents. Pact believes that Ofcom should re-consider their materiality assessment of the BBC’s proposed changes to the Programme Release Policy. The BBC programme release policy should not impose criteria that are designed to exclude all but BritBox from qualifying for the 12-18 months BBC holdback waiver. All buyers should have equal opportunity in the market to buy BBC content at 12 months if the BBC should choose to make the content available. This will avoid the criteria leading to the creation of a BritBox buyer monopoly.

1.42 Competition is not a theoretical exercise for Pact member production companies. It is about how to survive and grow their businesses. This means having the right under Section 285 of the 2003 Communications Act to control their IP and maximise the revenues from their programmes. These BBC programme release policy criteria will take away part of that control. It will create a monopoly market for BritBox which will lead to artificially low prices as there will be no competition amongst buyers to establish a programmes true market value. This reduced revenue will make it harder for small and medium sized companies, which primarily rely on UK focused content, to grow and invest in IP. This IP investment, in turn, enables smaller companies to diversify, build up their turnover and export their programmes internationally.

1.43 Pact notes that the BBC has the right to release content during the holdback period, which can be at the 12 months stage. However, this content must be available to a greater number of buyers. This means that the content could achieve a proper market price as buyers compete to buy the content’s secondary UK rights. In achieving this, this market price will benefit both the producer and the BBC Public Service as both share in the secondary UK rights revenues.

1.44 Pact is concerned that if this Materiality Assessment is given the go-ahead by Ofcom, it will create a dangerous precedent. This is because it will grant the BBC the right to effectively set its own competition rules and how such rules should be applied in practice. Pact is also concerned that it will blur the essential “arms-length” separation between the BBC Public Service, and its commercial activities which was laid down in paragraph 3.9 of Ofcom’s latest guidance on the BBC’s Commercial and Trading Activities.