



# The BBC's trading activities

## Statement on requirements and guidance

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.

Under the Charter and Agreement, the BBC Public Service is allowed to carry out some specific types of “trading” activity which are ancillary to its core public service activities and are commercial in nature.

On 29 March 2017, we published a consultation on the requirements we proposed to place on the BBC to protect fair and effective competition in how the BBC carries out its trading activities. In this document, we consider our proposed requirements and guidance in the light of the consultation comments and respond to the points raised. The requirements themselves are set out in a separate document entitled “The BBC’s commercial and trading activities: requirements and guidance”.<sup>1</sup>

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<sup>1</sup> See *The BBC's commercial and trading activities: requirements and guidance* at: [https://www.ofcom.org.uk/\\_data/assets/pdf\\_file/0025/99412/bbc-commercial.pdf](https://www.ofcom.org.uk/_data/assets/pdf_file/0025/99412/bbc-commercial.pdf).

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## Section 1

# Introduction

- 1.1 The BBC's role is to act in the public interest and serve all audiences with content which informs, educates and entertains. To do so, it provides impartial news and information, together with high-quality and distinctive output and services.
- 1.2 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 increasing choice, 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. Ofcom has a role to protect fair and effective competition in the markets in which the BBC operates.
- 1.3 In order to deliver the Mission and Public Purposes the BBC uses the licence fee to create programmes and other content for audiences. In carrying out this public service activity the BBC is often left with assets it can use or spare capacity it can sell to raise further revenue, for example the licensing of copyright in programmes, or access to unused studio space.
- 1.4 Under the Charter and Agreement the BBC is allowed to raise revenue from these activities, which are ancillary to the carrying out of the Public Service.<sup>2</sup> These are defined as 'trading activities'.<sup>3</sup> The definition limits the scope of trading activities conducted by the public service part of the BBC, because in general the BBC is required to conduct activities that are commercial in nature through separate commercial subsidiaries.<sup>4</sup> The Charter also specifically requires Ofcom to set requirements to protect fair and effective competition in relation to the way the BBC carries out trading activities.<sup>5</sup>
- 1.5 Trading activities involve the BBC Public Service<sup>6</sup> trading either: (a) with its own commercial subsidiaries (e.g. BBC Worldwide); or (b) with third parties and the general public.
- 1.6 In March 2017 Ofcom consulted on proposed requirements to address potential competition concerns involving trading activities.
- 1.7 We explained that Ofcom had already set requirements which deal with the trading relationship between the BBC Public Service and its commercial subsidiaries. This is because under the Charter Ofcom is also required to look directly at the activities of the commercial subsidiaries and to set requirements "to ensure that commercial activities do not distort the market or gain an unfair competitive advantage due to

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<sup>2</sup> The Charter and the Agreement are available at: <https://www.gov.uk/government/publications/bbc-charter-and-framework-agreement>.

<sup>3</sup> Clause 31 of the Agreement.

<sup>4</sup> Under clause 23(4) of the Agreement, "The BBC as a corporation must not directly undertake any commercial activities and they must be provided through one or more commercial subsidiaries". Under clause 23(2), "commercial activities" are defined as activities which (i) fit with the Mission and Public Purposes; (ii) are not funded by licence fee revenue; and (iii) are undertaken with a view to generating a profit.

<sup>5</sup> Article 46(5) of the Charter.

<sup>6</sup> References to the 'Public Service' or 'BBC Public Service' should be read as references to the BBC's UK Public Services, trading activities and non-service activities.

their relationship with the Public Service".<sup>7</sup> These existing requirements therefore already address trading between the BBC Public Service and its own commercial subsidiaries as they cover:

- 1.7.1 operational separation between the BBC Public Service and its commercial subsidiaries;
  - 1.7.2 supply of goods/services and transfer pricing between the two; and
  - 1.7.3 transparency and monitoring requirements.
- 1.8 Our March 2017 consultation therefore focussed on proposed requirements with respect to how the BBC Public Service trades with third parties and the general public.<sup>8, 9</sup> We proposed requirements and guidance in respect of:
- 1.8.1 supply of goods/services and pricing;
  - 1.8.2 no undue discrimination; and
  - 1.8.3 transparency and record keeping.
- 1.9 We received five responses from stakeholders to our consultation from the BBC, ITV, Sky, Pact and one member of the public.<sup>10</sup> In December 2016 we published four consultations setting out how we intended to regulate the BBC's impact on competition.<sup>11</sup> Where relevant we have also considered comments that were raised in response to that set of consultations.
- 1.10 Broadly, respondents agreed with our regulatory approach. However, some requested additional clarifications on aspects of our proposed requirements, and suggested some amendments. They commented on a range of issues including:
- 1.10.1 clarity on the definition of trading activities and how they differ from commercial activities;
  - 1.10.2 the appropriateness of using excess BBC Public Service capacity for trading activities;
  - 1.10.3 the pricing of the BBC's trading activities and the generation of a profit from such activities; and
  - 1.10.4 the transparency of the BBC's trading activities and its pricing methodologies.

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<sup>7</sup> Article 46(6) of the Charter.

<sup>8</sup> Our consultation entitled "*The BBC's trading activities*" is available at:

<https://www.ofcom.org.uk/consultations-and-statements/category-2/bbc-trading-activities>.

<sup>9</sup> In our trading activities consultation, we used the terms "third parties" and "the wider market" to refer to third parties and the general public.

<sup>10</sup> We have published all non-confidential responses in full on our website at:

<https://www.ofcom.org.uk/consultations-and-statements/category-2/bbc-trading-activities>.

<sup>11</sup> See our consultations on *Regulating the BBC's impact on competition* at:

<https://www.ofcom.org.uk/consultations-and-statements/ofcom-and-the-bbc/bbc-competition-statement>.

- 1.11 In Section 2 of this statement, we have considered our proposed requirements and guidance in the light of the consultation comments and responded to the points raised. Having considered these comments, we have made one change to the requirements we set out in the consultation.<sup>12</sup> This change relates to the pricing of tickets to BBC Public Service events and is explained in paragraphs 2.37-2.41. We have also clarified certain aspects of the requirements and guidance in this statement in the light of the issues raised in the consultation responses.
- 1.12 As a result, we have set requirements that mean the BBC must price its goods and services at market prices wherever possible, and only use a cost-based approach where market benchmarks are not available. We have also required the BBC not to discriminate unduly against or between third parties, and to maintain records of trading activities.
- 1.13 Now that we have considered appropriate requirements for both commercial and trading activities, we have decided to include them in one document, entitled “The BBC’s commercial and trading activities: requirements and guidance” (the ‘Guidance’)<sup>13</sup> covering:
- 1.13.1 Separation between the BBC Public Service and its commercial subsidiaries;
  - 1.13.2 How the BBC Public Service trades (supply of goods and services and transfer pricing) with its commercial subsidiaries;
  - 1.13.3 How the BBC Public Service trades (supply of goods and services and pricing) with third parties and the general public; and
  - 1.13.4 The BBC’s commercial activities undertaken by the commercial subsidiaries.
- 1.14 In combining the requirements, we have made no changes to the requirements and guidance relating to commercial activities which we published on 29 March 2017.
- 1.15 In paragraphs 3.19-3.20 of the combined requirements and guidance document we outline that the trading activities requirements and guidance are found under the headings of “Supply and pricing of goods and services” and “Monitoring, reporting and transparency”. The requirements under “Supply and pricing of goods and services” are explained in paragraphs 3.37 and 3.40-3.47 of the Guidance, while the requirements under “Monitoring, reporting and transparency” are explained in paragraphs 3.76-3.78.

## Impact assessments

- 1.16 For the reasons set out in this document we have concluded that the requirements and guidance will have a positive impact; they will help to protect competition for the benefit of audiences and take a proportionate approach towards the regulation of the BBC’s activities in this area. We do not consider that the requirements and guidance are likely to have any particular impact on race, disability and gender equality.<sup>14</sup>

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<sup>12</sup> The BBC’s trading activities consultation is available at: <https://www.ofcom.org.uk/consultations-and-statements/category-2/bbc-trading-activities>.

<sup>13</sup> See *The BBC’s commercial and trading activities: requirements and guidance* at: [https://www.ofcom.org.uk/data/assets/pdf\\_file/0025/99412/bbc-commercial.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0025/99412/bbc-commercial.pdf).

<sup>14</sup> In addition to carrying out impact assessments, we are required by statute to assess the potential impact of all our functions, policies, projects and practices on race, disability and gender equality.

Specifically, we do not envisage the impact of any outcome to be to the detriment of any group of society or any group of consumers over another.

## Future Work

- 1.17 We are currently undertaking further work to develop our understanding of the processes and practices around the operation of the BBC's commercial subsidiaries and their relationships with the Public Service. For example, we will look in detail at the BBC's transfer pricing arrangements and the specific nature of the range of different commercial activities that sit within the BBC's commercial subsidiaries, including the BBC's identification of individual lines of business for the purpose of setting a commercial rate of return. We will also undertake further work to understand in more detail the full scope and scale of trading activities, whether they relate to the BBC Public Service trading with the commercial subsidiaries, third parties or the general public.
- 1.18 Following this further work, we will consider whether changes are required to the Operating Framework which may include additional requirements placed on the BBC. In addition, our requirements and procedures will be kept under review and amended as appropriate in the light of any change to our powers and responsibilities. We will provide an explanation where we depart from the approach set out in the Guidance.
- 1.19 Where relevant to responding to stakeholder comments, we have referred to our planned future work in this statement.

## Status of this document

- 1.20 This statement sets out our response to stakeholder comments about our The BBC's trading activities consultation. The final requirements and guidance document, published alongside this statement *The BBC's commercial and trading activities*<sup>15</sup>, forms part of the BBC's Operating Framework.<sup>16</sup>
- 1.21 This statement does not itself form part of the Operating Framework. Its content provides background to the operative requirements and guidance set out in the Operating Framework.<sup>17</sup>

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<sup>15</sup> See our finalised guidance: *The BBC's commercial and trading activities* at: [https://www.ofcom.org.uk/\\_data/assets/pdf\\_file/0025/99412/bbc-commercial.pdf](https://www.ofcom.org.uk/_data/assets/pdf_file/0025/99412/bbc-commercial.pdf).

<sup>16</sup> The requirements and guidance are contained in a document entitled "*The BBC's commercial activities: requirements and guidance*" issued on 29 March 2017 and will continue to apply to commercial activities carried out from 3 April 2017 until 26 July 2017. These requirements and guidance are available at: [https://www.ofcom.org.uk/\\_data/assets/pdf\\_file/0018/104760/bbc-commercial290317.pdf](https://www.ofcom.org.uk/_data/assets/pdf_file/0018/104760/bbc-commercial290317.pdf).

<sup>17</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).

## Section 2

# Trading activities requirements

- 2.1 Under the Charter and the Agreement, Ofcom must set out how it will regulate the way the BBC carries out trading activities and the procedures to be followed. This includes such requirements as Ofcom consider appropriate to protect fair and effective competition.
- 2.2 As explained above, trading activities are carried out by, and are ancillary to, the BBC Public Service. These activities are commercial in nature, and involve the BBC Public Service trading with its own commercial subsidiaries, third parties and the general public (we sometimes refer to third parties and the general public as 'the wider market'). As mentioned in paragraph 1.14 of Section 1 of this statement, we published requirements in March 2017 setting out how the BBC Public Service should trade with its commercial subsidiaries.
- 2.3 Our trading activities consultation therefore considered competition concerns that may arise where the BBC Public Service offers goods and services to the wider market. We explained that without appropriate safeguards there was a risk that the BBC's public funding could be used in a way that could harm fair and effective competition in the UK.
- 2.4 We also explained that competition concerns will vary depending on the nature and scope of the trading activity in question, but that they were most likely to stem from the following concerns:
  - where the BBC is trading with its own commercial arm, there is a risk that the relationship between the BBC Public Service and its commercial subsidiaries could confer an unfair competitive advantage on its subsidiaries;<sup>18</sup>
  - when the BBC supplies products or services to the wider market it may do so in a discriminatory manner. This could involve unduly discriminating against or between third parties (either by setting different prices or granting preferential access to services). Trading in this way may put certain parties at a competitive disadvantage; and
  - the BBC could offer goods and services at below market price, due to the advantages that it may enjoy as a large publicly funded body, which could make it difficult for suppliers of similar services to compete.
- 2.5 Our consultation proposed requirements and associated guidance to address the above competition concerns. We proposed requirements that the BBC must:
  - 2.5.1 set prices in line with prevailing market practices where possible and never set prices below incremental cost;
  - 2.5.2 not discriminate unduly against or between third parties; and

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<sup>18</sup> As set out in detail in *The BBC's commercial and trading activities: requirements and guidance*: [https://www.ofcom.org.uk/\\_data/assets/pdf\\_file/0025/99412/bbc-commercial.pdf](https://www.ofcom.org.uk/_data/assets/pdf_file/0025/99412/bbc-commercial.pdf).



- 2.5.3 maintain records of its trading activities with third parties.
- 2.6 Broadly, respondents agreed with our regulatory approach. They included comments on the following themes which we discuss in more detail below:
- Scope of trading activities;
  - Pricing requirements;
  - Access to the BBC's goods and services;
  - Sale of spare capacity;
  - Undue discrimination; and
  - Transparency of the BBC's trading activities.
- 2.7 Some respondents also requested additional clarifications on some aspects of our proposed requirements, and suggested some amendments.
- 2.8 In this section, we summarise the comments made by stakeholders, provide our responses and the conclusions we have reached.

## Scope of trading activities

### Summary of responses

- 2.9 Sky said that trading activities are more akin to public service activities than commercial activities, noting that they must comply with Articles 9 to 17 in the Charter; Sky considered that this meant that they should be subject to more scrutiny than the commercial activities because commercial activities must only comply with Articles 9, 10 and 12.<sup>19</sup>
- 2.10 Sky also stated that the main distinction between a trading and a commercial activity had not been reflected in the consultation and that Ofcom had not explained how it would satisfy its duties in relation to both trading and commercial activities.<sup>20</sup> Sky argued that, in the light of the difference in the way these duties are expressed, it was wrong to assimilate trading activities with commercial activities and impose the same requirements on both types of activity.<sup>21</sup>
- 2.11 In addition, Sky submitted that trading activities are of greater competition concern because the BBC Public Service could directly subsidise the commercial subsidiaries through its sales of goods and services to them.<sup>22</sup> However, Sky did not set out in its response what additional requirements it considered we should apply to trading activities between the Public Service and the commercial subsidiaries.

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<sup>19</sup> Sky response, paragraph 1.7.

<sup>20</sup> Sky response, paragraph 1.9.

<sup>21</sup> Sky response, paragraph 1.3.

<sup>22</sup> Sky response, paragraph 1.11.

- 2.12 The BBC noted that some of its trading activities are likely to involve content and technology rights and suggested that our references to “goods and services” should be extended to include rights.<sup>23</sup>
- 2.13 ITV said that Ofcom should recognise explicitly that trading activities are a tangential outcome of the BBC Public Service and should not be standalone commercial businesses managed by the BBC Public Service.

### Ofcom's response

- 2.14 Sky's concerns with respect to the risk of direct subsidy of the commercial subsidiaries via the BBC Public Service are dealt with directly by our requirements that we imposed in March 2017, including those requiring the BBC to set market based transfer prices for any goods and services provided to the commercial subsidiaries by the BBC Public Service.<sup>24</sup>
- 2.15 To provide greater clarity on Ofcom's requirements we have combined our requirements on the BBC's trading activities into our commercial activities requirements and guidance. In doing so, we have set out which of our requirements apply to a commercial activity, trading activity or both.<sup>25</sup>
- 2.16 In response to Sky's broader point concerning the difference between trading activities and commercial activities, we recognise that the Charter imposes more general duties on the BBC in relation to its trading activities than those imposed on the BBC in respect of its commercial activities.
- 2.17 Whilst we must have regard (among other things) to the requirement for the BBC to comply with its duties under the Charter (including its general duties)<sup>26</sup>, our principal role is as follows:
- 2.17.1 in relation to trading activities, to set requirements to protect fair and effective competition; and
  - 2.17.2 in relation to commercial activities, to set requirements to ensure that commercial activities do not distort the market or gain an unfair competitive advantage due to their relationship with the BBC Public Service.
- 2.18 Although these competition duties are not the same, we do not consider that it necessarily follows that we must impose different requirements for trading and commercial activities. We think that the key question is whether the requirements address the competition concerns in relation to each kind of activity.
- 2.19 We explained in paragraph 3.14 of the trading activities consultation that the commercial activities requirements already in place address our competition concerns in respect of the BBC Public Service trading with its commercial subsidiaries. Those requirements are designed to ensure that the commercial subsidiaries do not receive an unfair competitive advantage or distort the market through their relationship with the BBC Public Service (for example by ensuring an appropriate transfer price is paid for goods and services). We consider that these

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<sup>23</sup> BBC response, paragraph 2.2.

<sup>24</sup> The Guidance, paragraphs 3.38-3.47.

<sup>25</sup> As set out in *The BBC's commercial and trading activities: requirements and guidance*: [https://www.ofcom.org.uk/\\_data/assets/pdf\\_file/0025/99412/bbc-commercial.pdf](https://www.ofcom.org.uk/_data/assets/pdf_file/0025/99412/bbc-commercial.pdf).

<sup>26</sup> Charter, Article 45(2)(c).

requirements are appropriate for addressing our competition concerns in relation to the BBC Public Service trading with its commercial subsidiaries.

- 2.20 As a result, our consultation on trading activities set proposed requirements to address our competition concerns in respect of the BBC Public Service trading with third parties and the general public. In our view, these competition concerns can be addressed by imposing similar requirements to those set out for how the BBC Public Service trades with its commercial activities (e.g. market based pricing for the supply of goods and services).
- 2.21 We therefore consider that in accordance with our duties in the Charter and Agreement we have set appropriate requirements to address our competition concerns in relation to each kind of activity.
- 2.22 In response to the BBC's comment regarding the term "goods and services", we recognise that trading activities may include intellectual property rights. We consider that intellectual property rights are captured within the broad term "goods and services". We also note that the same term has been used in the context of the requirements relating to commercial activities. We do not therefore consider that it is necessary to amend the definition of "goods and services" to refer to intellectual property rights specifically.
- 2.23 In respect of ITV's concerns that trading activities could become commercial businesses managed by the BBC Public Service, we note that this is prohibited in the Agreement<sup>27</sup>, and the scope of trading activities is restricted to those listed in clause 31(2) and replicated in paragraph 3.2 of the BBC's trading activities consultation and Annex 1 of the Guidance. The BBC has recognised in its response that the scope of its trading activities is "severely constrained from the outset" due to the provisions in the Agreement.<sup>28</sup> We also require the BBC to undertake all commercial activities through commercial subsidiaries.<sup>29</sup> It is the BBC's duty to ensure that it complies with the requirements set out in the Charter and Agreement, and in our Guidance.

## Pricing requirements

### Summary of responses

- 2.24 Stakeholders broadly agreed with our proposed set of pricing requirements. ITV, Pact and Sky agreed that, in the absence of an open market process, a market benchmarking approach should be used to set prices.<sup>30</sup>
- 2.25 However, ITV suggested that it could be made clearer that open, competitive tendering should be the default approach.<sup>31</sup> ITV also argued that Ofcom should have more oversight in cases where a market benchmarking approach is used.<sup>32</sup>
- 2.26 Sky expressed concern that as long as the BBC retains discretion over which goods it supplies to the wider market, the availability of market benchmarks may be limited if the BBC chooses to strike agreements exclusively with its commercial subsidiaries.

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<sup>27</sup> Agreement, clause 23(4).

<sup>28</sup> BBC response, paragraph 1.2.

<sup>29</sup> The Guidance, paragraphs 3.22-3.24.

<sup>30</sup> ITV response, page 2-3; Pact response, paragraph 1.3; Sky response, paragraph 1.4.

<sup>31</sup> ITV response, page 3.

<sup>32</sup> Ibid.

Sky considered that this raises a clear risk of adversely impacting fair and effective competition, and emphasised the importance of ensuring that a market based approach is adopted instead.<sup>33</sup>

- 2.27 The BBC said that BBC Group assets and services “do not lend themselves to meaningful market comparison” and that, in such cases, it “is essential only that the cost (including direct costs and an appropriate share of overheads) is passed on to the subsidiaries based on their use.”<sup>34</sup>
- 2.28 Sky and the BBC both commented on the extent to which the BBC’s trading activities should be expected to generate a profit. Sky noted that our proposed guidance states that the BBC may make profits incidentally without identifying when this might be the case.<sup>35</sup> Sky expressed concern that this suggests “some acceptance of supply at less than market rates (and therefore implying some subsidy from the licence fee funded service)” and argued that this gives rise to legal uncertainty.<sup>36</sup>
- 2.29 The BBC argued that there is a “clear tension” between the characterisation of trading activities in paragraph 3.6 of our consultation as “not expressly designed to make a profit” and our requirement that the BBC does not price below market norms.<sup>37</sup> The BBC also argued that it is explicitly permitted to charge for trading activities described in clause 31(2)(b) of the Agreement (e.g. tickets for BBC Public Service events) on a cost recovery basis and suggested that paragraph 3.6 in our consultation document should be amended to reflect this.<sup>38</sup>
- 2.30 ITV expressed concern that, “unless there is effective rate of return regulation at BBC [Worldwide], it will be able to act on strong incentives to overpay for rights and secondary distribution opportunities, squeezing out third party distributors”.<sup>39</sup> It argued that overpaying for rights would mean that “the BBC receives additional funding for Public Service content but at the same time advances reduce BBC Worldwide’s taxable profit and enhance the market positions of BBC Worldwide and BBC Studios”.<sup>40</sup>
- 2.31 Pact called on Ofcom to undertake an early review of the BBC’s transfer pricing arrangements and ITV welcomed our plan to undertake further work in this area.<sup>41</sup>

## Ofcom’s response

- 2.32 Regarding ITV’s suggestion that it should be made clearer that open market pricing should be the default approach, we consider that our proposed pricing requirements already set out a clear hierarchy for the approach that the BBC should adopt when setting prices:
- 2.32.1 the BBC should use open market processes to set prices where appropriate;

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<sup>33</sup> Sky response, paragraph 1.16.

<sup>34</sup> BBC response, paragraph 3.3.2.

<sup>35</sup> Sky response, paragraph 1.10.

<sup>36</sup> Sky response, paragraph 1.12.

<sup>37</sup> BBC response, paragraph 3.1.

<sup>38</sup> Ibid.

<sup>39</sup> ITV response, page 1.

<sup>40</sup> Ibid.

<sup>41</sup> Pact response, paragraph 1.8, ITV response, page 2.

- 2.32.2 absent an open market process the BBC Public Service should carry out market benchmarking; and
- 2.32.3 only when the BBC can demonstrate that an open market process is not appropriate and no relevant market benchmarks exist may a cost-based approach be used.<sup>42</sup>
- 2.33 In relation to ITV's suggestion that we provide more oversight in circumstances where market benchmarking is adopted, we note that our proposed requirements specify that the BBC must publish the methodologies it uses to establish transfer prices for each type of good or service that the BBC Public Service supplies to commercial subsidiaries.<sup>43</sup> Furthermore, in line with our duties in this area, we will consider any complaints raised by stakeholders in relation to the pricing methodologies and may also carry out investigations we consider appropriate to determine the BBC's compliance with the pricing requirements.
- 2.34 In response to Sky's concern about market benchmarking for goods and services that are supplied solely to its commercial subsidiaries, we do not consider that the availability of relevant market benchmarks (e.g. prices charged for similar goods and services offered by other suppliers) would necessarily be limited in these cases. Furthermore, as set out in our statement *Regulating the BBC's impact on competition: Statement on requirements and guidelines*<sup>44</sup> ("Competition Statement"), even for goods and services that are only supplied to commercial subsidiaries, the BBC is required to explore whether prices for goods and services can be set with reference to market benchmarks before adopting a cost-based approach.
- 2.35 Whilst we accept the BBC's point that relevant benchmarks may be limited for certain trading activities, the above hierarchy requires the BBC to show that those assets and services which it deems to be "BBC-specific" cannot be benchmarked.
- 2.36 In response to concerns relating to the profitability of the BBC's trading activities, we would like to clarify that we are not proposing to impose any explicit requirements regarding the profitability of these activities. Rather, we have proposed a set of pricing requirements that are intended to ensure that, as far as possible, the BBC's pricing is in line with market norms to ensure that it does not distort fair and effective competition. We consider these requirements to be sufficient to address Sky's concerns relating to pricing below market rates.
- 2.37 In response to the BBC's concern that our proposed pricing requirements do not adequately take account of clause 31(2)(b) of the Agreement: we recognise that, in relation to ticketing specifically, clause 49(4)(h) of the Agreement envisages that the BBC may receive a contribution to the costs of certain events from the proceeds of ticket sales. Those events are "The Proms, Proms in the Park, Cardiff Singer of the Year, Young Musician of the Year and other similar events which contribute to the BBC's Mission and Public Purposes". However, the BBC may only do so in line with a statement of policy agreed with the Secretary of State.

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<sup>42</sup> The Guidance, paragraphs 3.1-3.10.

<sup>43</sup> The Guidance, page 18.

<sup>44</sup> *Regulating the BBC's impact on competition: statement and requirements and guidelines*, paragraph 4.20:

[https://www.ofcom.org.uk/\\_data/assets/pdf\\_file/0037/99577/BBCCompetitionStatement.pdf](https://www.ofcom.org.uk/_data/assets/pdf_file/0037/99577/BBCCompetitionStatement.pdf)

- 2.38 We understand that this reflects a historical practice – the BBC's editorial guidelines say that, "Proceeds from ticket sales may only be used to pay for events or for a series of events costs and should not be designed to generate further income", and that "money from ticket sales must not be used for broadcast costs".<sup>45</sup> Respondents to our consultation did not raise competition concerns in relation to this historical practice.
- 2.39 We also understand that the BBC and the Secretary of State are currently discussing a statement of policy dealing with the recovery of the costs of the events listed above from the proceeds of ticket sales (as required by clause 49(4)(h) of the Agreement).
- 2.40 In the light of these factors, we consider that it is appropriate for our pricing requirements not to apply to pricing of the events referred to in clause 49(4)(h) so that the BBC may continue to price tickets for these events, in accordance with a statement of policy that is agreed with the Secretary of State pursuant to clause 49(4)(h). We recognise that the BBC can seek to recover a contribution to the costs of staging these events from the proceeds of ticket sales without seeking to recover the full costs (which would include the costs of broadcasting these events). We have therefore amended our proposed requirements by inserting an exemption in respect of tickets for the events referred to in clause 49(4)(h) and this is explained in paragraph 3.47 in the Guidance. If in future there are competition concerns in relation to the pricing of tickets for these events, we will assess whether the exemption remains appropriate.
- 2.41 In relation to other activities falling within the scope of clause 31(2)(b) of the Agreement, the Agreement does not envisage a particular pricing regime (as it does for the events referred to in clause 49(4)(h)). The BBC has provided us with some examples of other activities which it considers fall within this category (e.g. tours of BBC sites, small scale BBC branded merchandising). We will continue to engage with the BBC in order to understand the full range and scale of activities covered by this clause.
- 2.42 ITV's concern that the BBC's commercial subsidiaries may have incentives to overpay for content rights, is addressed by our requirements relating to regulation of the rate of return of the BBC's commercial activities.<sup>46</sup> In particular, we set out that the BBC must establish a commercial rate of return for each of the lines of business within its commercial subsidiaries and ensure that the activity is undertaken in such a way that it delivers this rate of return. A key aspect of the return earned will be the price subsidiaries have paid for inputs, including content rights. Whilst we would not necessarily expect the BBC to carry out such an analysis at the level of individual titles, our rate of return requirements should protect against the systematic overpayment for rights, as we would expect this to give rise to a return that is below the typical commercial rates for the relevant line of business.<sup>47</sup> We will continue to engage with the BBC with respect to how it calculates and benchmarks its rates of return for each line of business to ensure that they are in line with market norms.

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<sup>45</sup> See the BBC's editorial guidelines on ticketing for BBC events and programmes at: <http://www.bbc.co.uk/editorialguidelines/guidance/ticketing>.

<sup>46</sup> The Guidance, pages 22-24.

<sup>47</sup> It is important to note however that there are a range of factors, aside from overpayment of rights, that could give rise to a low rate of return e.g. we might expect to see lower returns in the early years of an investment, which are offset by higher returns later on. Hence a low rate of return would not necessarily imply overpayment and we would have to consider this alongside a range of evidence (e.g. relevant market benchmarks).

- 2.43 In relation to reviewing the BBC's transfer pricing, as set out in our Competition Statement<sup>48</sup> and at paragraph 1.17, we have begun additional fact-finding work to understand in more detail the transfer pricing arrangements between the BBC Public Service and its commercial subsidiaries. We will engage with stakeholders in this area as appropriate as we progress with this work.

## Access to the BBC's goods and services

### Summary of responses

- 2.44 The BBC considered that Ofcom should make it clear that the BBC is not expected to make all goods and services available to the wider market and that some goods and services are permitted to be supplied solely to BBC commercial subsidiaries (e.g. for reasons of operational efficiency).<sup>49</sup>
- 2.45 Sky questioned whether the requirements meant that the BBC would be permitted to never supply a good or service to the wider market as long as its commercial subsidiary is conducted on an arm's length basis.<sup>50</sup>

### Ofcom's response

- 2.46 We addressed the above concerns within the context of our commercial activities guidance and requirements. Our guidance sets out that the BBC Public Service may supply goods and services solely to the BBC commercial subsidiaries only if there is a clear reason for exclusivity or where the goods and services are being shared for reasons of operational efficiency (such as business support services). For instance, we do not expect the BBC to supply 'business support' shared BBC group functions (e.g. finance, HR, IT, legal) to the wider market.<sup>51</sup>

## Sale of spare capacity

### Summary of responses

- 2.47 ITV and Pact both argued that the BBC should not maintain spare capacity beyond the short term to enable it to carry out trading activities. ITV said that Ofcom should make it clear that the BBC should not conduct more trading activities than are necessary to dispose of excess capacity or of the inevitable by products of public service activity. Pact also questioned why capacity should be maintained by the BBC Public Service to provide professional functions such as HR services to its commercial subsidiaries.
- 2.48 The BBC said that it would be helpful for Ofcom to recognise that in the context of any spare capacity deal "it may occasionally be reasonable for the BBC to charge a spot rate that is below market rates for short term use where the asset would otherwise be under-utilised."<sup>52</sup>

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<sup>48</sup> The Competition Statement, paragraph 4.78

<sup>49</sup> BBC paragraph, 2.1.

<sup>50</sup> Sky response to our Competition Statement, paragraph 4.23.

<sup>51</sup> The Guidance, paragraph 3.34.

<sup>52</sup> BBC response, paragraph 3.3.1.

## Ofcom's response

- 2.49 We consider that our requirements relating to pricing and undue discrimination address the potential sources of distortion to fair and effective competition that could arise from the sale of spare capacity – namely, the risk of market distortion due to pricing below market norms or discriminating unduly between different parties.<sup>53</sup> We recognise that there may be other concerns, aside from the potential impact on competition, why the BBC should not be maintaining excess capacity solely for the purposes of trading. However, concerns that do not relate directly to protecting fair and effective competition would fall outside the scope of Ofcom's regulatory duties in this area. We therefore do not believe that any additional guidance or requirements, relating specifically to the sale of spare capacity, are necessary in the context of these requirements and guidance.
- 2.50 Regarding the BBC's point about the pricing of spare capacity, we acknowledge in the footnote to paragraph 3.11 of our consultation that the relevant market rates will vary depending on the nature of the arrangement in question. In particular, we note that for occasional sales that are being made on an ad hoc basis, prices that cover short-run incremental costs may be appropriate. This may be below typical market rates for longer term arrangements, where we would expect an appropriate contribution to fixed costs, on top of the relevant incremental costs. This is reflected in paragraph 3.44 of the Guidance.
- 2.51 Having considered the consultation responses, we have concluded that it is appropriate to require the BBC Public Service, when it trades with third parties, to make goods and services available on equivalent terms and prices to those offered to its commercial subsidiaries. When the BBC Public Service trades with either commercial subsidiaries or third parties, the BBC must comply with our pricing hierarchy which prioritises the setting of market prices (in respect of tickets for certain BBC Public Service events).

## Undue discrimination

### Summary of responses

- 2.52 In its response to our proposed requirement not to unduly discriminate, the BBC argued that there may be times when there is fair and objective justification for the BBC to charge different prices for the same service (e.g. reflecting seasonality) or for refusing to trade with a particular third-party (e.g. poor credit record of the third party). It argued that it would be helpful to amend the language around undue discrimination to clarify this.<sup>54</sup>

## Ofcom's response

- 2.53 We recognise that in some cases there may be a fair and objective justification for offering different prices to different parties or refusing to supply to certain parties. For example, as noted in paragraph 2.50 above in the context of the supply of spare capacity, the relevant market rate for a given good or service may vary depending on the exact circumstances of the arrangement in question. There may also be cases where supplying to certain third-parties could conflict with the BBC's Mission and Public Purposes. It is for this reason that our requirement refers to undue discrimination and we would consider any objective justification provided by the BBC

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<sup>53</sup> The Guidance, paragraph 3.37.

<sup>54</sup> BBC response, paragraph 2.1.



when assessing whether undue discrimination has taken place. We have added additional clarification on this point in paragraph 3.37 of the Guidance.

## Transparency of the BBC's trading activities

### Summary of responses

- 2.54 Several respondents argued that our proposed requirements would provide insufficient transparency of the BBC's trading activities. Sky said that the requirements on transparency are "insufficient to overcome the lack of information and to allow third parties to participate in the market".<sup>55</sup> ITV called on Ofcom to require the BBC to publish detailed transfer pricing methodologies and said that Ofcom should require the BBC to maintain detailed notes of pricing for trading activities internally and with third parties.<sup>56</sup>
- 2.55 ITV and Pact referred to the findings of a review commissioned by the BBC Trust by Ernst and Young ('EY') into transfer pricing between the BBC Public Service and the commercial subsidiaries.<sup>57</sup> They referred to EY's conclusions on record keeping and were concerned that Ofcom had not set out the level of detail of recording it requires from the BBC. ITV asked for additional clarity on the level of oversight we would have and both ITV and Sky suggested that Ofcom undertake an annual review of trading activities to ensure the requirements and guidance are being followed by the BBC.<sup>58</sup>
- 2.56 Sky referred to the National Audit Office's ('NAO') duties set out in clause 55 of the Agreement and said Ofcom should specify the scope and frequency of their examinations of the BBC and the relevant subsidiaries in relation to trading activities.<sup>59</sup>

### Ofcom's response

- 2.57 We recognise the importance of transparency in providing confidence to the market that the BBC is complying with our requirements. However, we also understand the need for balance between transparency and ensuring the BBC and its commercial subsidiaries can compete effectively in the market. Caution should be taken where information is commercially sensitive as sharing it publicly could damage the competitiveness of both the BBC and the third parties it trades with. For this reason, it would not be appropriate for Ofcom to require the BBC to publish all details of its trading activities with third parties.
- 2.58 Our requirements on the BBC's commercial activities oblige the BBC to provide sufficient reporting to us. We set out in our Competition Statement how we intend to develop our reporting requirements.<sup>60</sup> We also set out requirements for the BBC to publish its transfer pricing methodologies where it trades with, and provides goods and services to, its commercial subsidiaries. At present, we believe that these requirements are sufficient to address concerns with respect to transactions within the BBC Group.

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<sup>55</sup> Sky response, paragraph 1.3.

<sup>56</sup> ITV response, pages 2 and 4.

<sup>57</sup> Pact response, paragraphs 1.7-1.8, ITV response, page 3.

<sup>58</sup> ITV response, page 4, Sky response, paragraph 1.18.

<sup>59</sup> Sky response, paragraph 1.18.

<sup>60</sup> The Competition Statement, paragraphs 4.42-4.45.

- 2.59 The purpose of the proposed requirement to maintain records of trading activities with third parties and the general public is to provide sufficient information to allow us to investigate complaints and to ensure the BBC is complying with our requirements.
- 2.60 At this stage, while we are undertaking further work to determine appropriate reporting requirements, we do not think that it is proportionate to require an annual report specifically on trading activities. However, as we continue our engagement with the BBC regarding the commercial activities, we will consider whether it is appropriate to extend any reporting requirements to trading activities with third parties and the general public and to what extent that should be publicly available. Further, under our powers in the Charter, we can require the BBC to provide further information as necessary to ensure that we meet our regulatory duties.<sup>61</sup>
- 2.61 We responded to the concerns raised in relation to the findings in EY's report in our previous Competition Statement.<sup>62</sup> We said that we would be undertaking further work to consider the BBC's transfer pricing arrangements and as part of this, consider the finding of EY's review and the BBC's response to it. We will also consider the findings of the EY review in ensuring that the records of trading activities with third parties are sufficient for our needs.
- 2.62 With respect to the NAO's duties, we note that it is for the NAO to determine the scope of its audit work in relation to the BBC and its commercial subsidiaries.
- 2.63 Therefore, we consider it appropriate to require the BBC to maintain records of its trading activities with third parties, and will continue to engage with the BBC in this area as we have explained in paragraphs 1.17 and 1.18 above. In addition, the BBC must comply with our requirements relating to commercial activities, which amongst other things, require the BBC to publish its transfer pricing methodologies.

## Our requirements

- 2.64 As mentioned above, the requirements that we are setting in relation to trading activities are contained in the Guidance.<sup>63</sup> That document forms part of the BBC's Operating Framework. It combines the requirements we set in March 2017 in relation to commercial activities with additional requirements governing trading activities. The requirements we have set in relation to trading activities are substantially the same as those we proposed in our trading activities consultation, subject to one exception: we have made one change relating to the pricing of tickets to BBC Public Service events, explained in paragraph 2.40 above.

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<sup>61</sup> Charter, Article 47.

<sup>62</sup> The Competition Statement, paragraph 4.17.

<sup>63</sup> *The BBC's commercial and trading activities: requirements and guidance* is available at: [https://www.ofcom.org.uk/\\_data/assets/pdf\\_file/0025/99412/bbc-commercial.pdf](https://www.ofcom.org.uk/_data/assets/pdf_file/0025/99412/bbc-commercial.pdf).