

## ITV plc response to Ofcom's consultation on the BBC's trading activities

### **Introduction**

We welcome the opportunity to respond to this consultation. In principle, it clearly makes sense that the principles and rules relevant to the operation of the BBC's commercial activities generally should apply to the BBC's trading activities too.

One high level point that was missing from the proposed Ofcom regime around the trading activities was some recognition that the trading activities ought to be a tangential outcome of core public service activity and not stand alone commercial businesses in their own right. In this context, Ofcom should be clear in the regulatory framework that the BBC should not conduct more of these activities than is necessary to dispose of excess capacity or of inevitable by products of PS activity. In particular, the BBC should never take decisions in the public service to enhance the position of the BBC in its trading activities, nor should it maintain excess capacity beyond the short term where it is possible to dispose of/hand back publicly owned/funded assets rather than trade with them.

In addition to this, one fundamental point that is very relevant both to the licensing of rights by BBC PS but also to securing up-front investment in exchange for distribution rights (which can amount to much the same thing) is around the rate of return of relevant business lines at BBC WW. We remain very concerned that unless there is effective rate of return regulation at BBC WW, it will be able to act on strong incentives to overpay for rights and secondary distribution opportunities, squeezing out third party distributors. Even worse than this, if such overpayment is linked to tenders by BBC Studios, third party producers may also lose out on original programme commissions from the BBC.

The reason for this is that without effective rate of return regulation on BBC WW at an appropriately granular level, the BBC overall has an incentive for BBCWW to overpay for investment/distribution rights since by doing so the BBC receives additional funding for PS content but at the same time the advances reduce BBCWW's taxable profit and enhance the market positions of BBC WW and BBC Studios.

### **The BBC's trading with commercial subsidiaries**

We strongly agree with Ofcom's assessment that:

*'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 give the subsidiaries an unfair commercial advantage', which*

*'may lead to less innovation and investment, and ultimately worse outcomes for UK consumers in terms of their access to quality services.'<sup>1</sup>*

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<sup>1</sup> Ofcom 'The BBC's Trading Activities' consultation, 2017

We note Ofcom's comment that its requirements and guidance for these types of trading activities was set out in its consultation and statement on the BBC's commercial activities.

We were disappointed that Ofcom chose not to require the BBC to publish actual transfer prices or price ranges, which we believe would be able to maximise transparency without affecting commercial confidentiality. As we said in our previous response, the reports by both John Fingleton and EY have illustrated real issues around transparency, and publication of actual prices is the best possible way to ensure prices are fair, since the market would be able to identify and flag any clear discrepancies. Given that the BBC's content is funded by a mandatory fee collected by law, the BBC is in a very different position to the commercial market and should be more transparent, if only to reassure licence fee payers that it is achieving a justifiable and competitive price from its commercial subsidiaries.

In the absence of that mechanism we agree with Ofcom's focus on a market benchmark approach and would urge Ofcom to ensure that the level of detail published by the BBC around transfer pricing methodologies is meaningful. As we set out previously, simply listing the type of approach and the sorts of factors that were taken into account is not sufficient to provide meaningful transparency: the BBC should publish specifics such as what dataset was used, from which source, how the final transfer price may differ from the market data, etc. Such an approach would help to illustrate where irregular approaches have been used.

Ultimately, we believe that the Ofcom guidance should be clear that any approach other than a market price based one, arrived at through a tender, should be a last resort and there should be compelling justifications for such an approach. In cases where the BBC has used its discretion in setting the transfer price, there should be a requirement to flag to Ofcom that it has done so. This is not to suggest that Ofcom should be in any way continually involved in the day-to-day operations of the BBC, but simply to ensure that Ofcom is made aware when the BBC has departed from its guidance (such as to use a market benchmark approach whenever possible, and to only use an alternative approach when justified).

We welcome Ofcom's plan to undertake further work on the BBC's transfer pricing arrangements, and look forward to engaging with Ofcom on this matter.

### **The BBC's trading with third parties**

Ofcom's proposals for requirements around the BBC's trading with third parties in many way mirrors its requirements around the BBC's trading with its commercial subsidiaries, and therefore our comments also broadly mirror our previous comments.

We agree with Ofcom that the primary methodology that should be used by the BBC in setting prices when trading with third parties is that of an open, competitive tender. This is in fact the only methodology that can ensure a truly fair market price is secured. There is therefore a strong reason to ensure that the BBC sets prices based on a competitive tender wherever this is possible; the wording in the Ofcom consultation says that it should happen 'where appropriate', and we suggest that the guidance could be made clearer that this

should be the default in all cases except where there are compelling reasons for an alternative approach.

We agree with Ofcom's proposal that, in the absence of an open market process, the BBC should adopt a market benchmarking approach to pricing, and only in the absence of any evidence around market practices should they adopt a cost-based approach (and that the latter must accurately incorporate all relevant direct costs and an appropriate contribution to overheads). However, we believe that Ofcom should have more oversight of circumstances where such an approach is adopted, whether the BBC is trading with itself or with third parties.

### **Record Keeping around Transfer Pricing and other trading activity**

We continue to be concerned that, given the findings of the Fingleton report and the EY audit, Ofcom's provisions around record keeping and oversight may not be sufficient. Although those reports dealt with transfer pricing and not dealing with third parties, they highlighted issues that are highly relevant to both.

The EY report indicated there were very poor levels record-keeping and monitoring within the BBC (for example, it identified the fact that the BBC does not have a list of all transfer pricing relationships, as the BBC's Fair Trading team does not track information in this way. As such, there is no one even within the BBC who was able to state how many transfer pricing arrangements there are, or review a complete list of their details. It further noted that there is no annual monitoring report on the agreements between the BBC and its commercial subsidiaries, such that third parties can identify any key changes or review the BBC's assessment of how they are in line with the fair trading guidelines. And in one of the case studies, a brand agreement between BBC PS and BBC S&PP, neither party was able to locate a copy of the brand licence agreement nor any of the underlying data that went into the method for determining the fee.)

The Fingleton report highlighted a lack of transparency as a key concern around the current system:

*"In general, the Executive appears to publish the minimum amount of information required by law. It is not clear to us that this level of information is sufficient to demonstrate publicly that the Executive meets the Trust's requirements on separation, and our interviews with third parties suggest this level of information is not sufficient to ensure they are confident the relationships between the BBC's Public Service divisions and its commercial subsidiaries are compliant with State Aid law.*

*Given the widespread lack of trust in the arrangements between the BBC and its commercial subsidiaries expressed to us by third parties, we consider the Executive could do more to demonstrate these relationships are compliant with the Fair Trading Obligation."*<sup>2</sup>

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<sup>2</sup> Fingleton report, p.39

Given the seriousness of these issues around record-keeping and transparency, we are concerned that Ofcom's consultation only sets the BBC a requirement to *'maintain records of its trading activities with third parties'*, but does not specify that, for example, the BBC must make a detailed note of the pricing methodology used for each trading activity whether with a third party **or internally** with supporting data where appropriate (such as market benchmarks). Given the historical concerns around poor record-keeping, we feel it would be appropriate for Ofcom to state the level of detail that must be recorded in order to ensure those records are meaningful.

Furthermore, we note Ofcom's comment that *"We expect to engage with the BBC periodically to ensure that its records are sufficient for our purposes"*. We would suggest that greater clarity around the level of oversight would be beneficial in ensuring the BBC is compliant in its record keeping. For example, an annual review would be an appropriate mechanism to ensure that the requirements and guidance are being followed.