



SKY'S RESPONSE TO OFCOM'S CONSULTATION ON PROPOSED REQUIREMENTS ON BBC TRADING ACTIVITIES

EXECUTIVE SUMMARY

- 1.1 The BBC remains a significant intervention by the state in the UK media sector. Its vast scale funding and remit means it has an inevitable impact on competition in the wider market, at all levels of the value chain. Without appropriate safeguards, the BBC's trading activities have the potential to harm the ability of others to compete effectively.
- 1.2 As rightly pointed out at paragraph 1.7 of the consultation document, competition concerns amounting to State aid could arise where the BBC is granting its subsidiaries an unfair competitive advantage, unfairly discriminating against or between third parties and offering goods and services at below market rate. Trading activities present a material risk of distorting competition given the direct link between the BBC and its BBC subsidiaries.
- 1.3 Sky UK Limited ("**Sky**") supports most of Ofcom's suggested requirements. However, Sky has some observations on the manner Ofcom has embraced the concept of 'trading activities', i.e. by wrongly assimilating trading and commercial activities (and hence imposing the same requirements on both categories). Sky also notes that the requirements on transparency (i.e. that the BBC must maintain records of its trading activities) are insufficient to overcome the lack of information and to allow third parties to participate in the market.
- 1.4 Finally, Sky supports Ofcom's expectation that the BBC will use market benchmark, which is the most effective way for an organisation to gauge an appropriate transfer price.¹

COMPETITION CONCERNS

- 1.5 We refer to Ofcom's consultation on proposed requirements on BBC trading activities ("**the Consultation**").

The notion of 'trading activities'
- 1.6 We understand that 'trading activities', which are commercial in nature but are not to be treated as commercial activities, are defined as encompassing transactions between the BBC Public service and (i) its commercial subsidiaries; (ii) third parties; and (iii) the general public through direct provision of good and services.
- 1.7 Sky firstly notes that the main distinction – as set out in the Royal Charter for the continuance of the British Broadcasting Corporation ("**the Charter**") – is not reflected in the Consultation. Trading activities, as dealt with in the Charter, are more similar to Public Services activities rather than to commercial activities. Trading activities are subject to a

¹ See paragraph 3.18 of the Consultation.

higher level of scrutiny as they must comply with all of the general duties set out in articles 9 to 17 of the Charter as opposed to commercial activities which are only subject to the duties laid down in article 9 (acting in the public interest), article 10 (engagement with the public) and article 12 (openness and transparency) of the Charter.

- 1.8 For example, trading activities are subject to the obligations relating to the 'stewardship of public money' (article 16 of the Charter). The competition obligation also differs from one category of activity to another. Trading activities, on the one hand, are subject to a wider obligation (article 11 of the Charter): they must have particular regard to their effects on competition in the United Kingdom, in seeking to avoid adverse impacts on competition which are not necessary for the effective fulfilment of the Mission and the promotion of the Public Purposes and in having regard to promoting positive impacts on the wider market. Commercial activities, on the other hand, must 'simply' not, as a result of their relationship with the UK Public Services, non-service activities or trading activities, distort the market or gain an unfair competitive advantage (article 18(b) of the Charter).
- 1.9 Ofcom should reflect this distinction in the Operating Framework as required in the Charter at article 46 (2): *"Ofcom must prepare and publish an Operating Framework which must contain the provisions Ofcom consider appropriate to secure the effective regulation of the activities of the BBC **as set out in this Charter and the Framework Agreement**".* However, Ofcom has not made any distinction between the two regimes and has failed to explain how its proposed framework satisfies its duty.
- 1.10 Moreover, Sky considers that the Consultation is confusing, suggesting that there is a grey area between commercial activities and trading activities. While trading activities *"are characterised as commercial in nature", "they are not to be treated as commercial activities"*. The ambiguity goes further as *"in practice, they are not expressly designed to make a profit, but may do so incidentally"*, without Ofcom defining or identifying when this might be the case.²
- 1.11 Sky also understands from the Consultation and recent exchanges with Ofcom³ that the sale of the licensing rights by the Public Service to the commercial subsidiary qualifies as a "trading activity" on the part of the Public Service; but the commercial activity is the exploitation of those rights by the commercial subsidiary. In other words, a trading activity is a 'commercial' sale by the BBC Public Service, and a commercial activity is one carried out by a commercial subsidiary. Trading activities therefore carry a risk of direct subsidy supporting the commercial subsidiary via the Public Service and are hence of greater competition concern.
- 1.12 In particular, Sky is concerned that Ofcom appears to accept that the BBC's trading activities, although not designed to do so, may incidentally make a profit or "generate an income"⁴, suggesting some acceptance of supply at less than market rates (and therefore implying some subsidy from the licence fee funded service). Such a legal uncertainty is worrying and could facilitate instances where the subsidiaries or third parties are given an unfair competitive advantage, in particular where there is a lack of transparency facilitating external engagement.
- 1.13 Ofcom's regulatory framework for the BBC's trading services will play a critical role in ensuring that its impact on the wider market is effectively scrutinised and controlled. It is therefore essential that Ofcom's guidance in relation to such assessments is clear and robust. This is even more necessary given Ofcom's significant duties in relation to the BBC

² See paragraph 1.4 of the Consultation.

³ Email exchange with Caroline Chandan-Roels dated 11 May.

⁴ See paragraph 3.6 of the Consultation.

as described in our response to Ofcom's consultations on competition regulation of the BBC.⁵

Transfer pricing requirements

- 1.14 Sky supports benchmarking, which is the most effective way for a vertically integrated public body to gauge an appropriate transfer price. This is particularly true in the broadcasting sector since the value of rights may differ significantly by rights and by purchaser.
- 1.15 Implementing a transparent market-based approach as standard, which provides competitors with the opportunity to participate in the market, would also be an important step in ensuring that the BBC's commercial trading processes (whether defined as trading activities or commercial services) are adequate to protect fair and effective competition. This would give more certainty that the BBC has complied with its obligations, and in particular, to:
- Avoid adverse impacts on competition and promote positive impacts;
 - Observe high standards of openness and seek to maximise transparency and accountability (noting that 'trading activities' are excluded from Article 12 (1)(b));
 - Ensure appropriate partnerships with other organisations including commercial and non-commercial organisations and organisations of all sizes, throughout the nations and regions of the United Kingdom, covering television, radio and online services; and
 - Exercise rigorous stewardship of public money.
- 1.16 Sky finally notes that under Ofcom's proposals, the BBC is required to adopt a cost-based approach only where it can demonstrate that no market benchmarks are available. As long as the BBC retains discretion over which of its Public Service goods and services are made available on the open market, this could become something of a self-fulfilling prophecy – no benchmarks would be available (and therefore a cost-based approach is permitted) precisely because the BBC opts to strike an agreement with its commercial subsidiaries without inviting other offers. This raises a clear risk of adversely impacting fair and effective competition, and emphasises the importance in ensuring that a market based approach is adopted instead.

Transparency and monitoring

- 1.17 In the event that transfer pricing isn't implemented, greater transparency will be required for the BBC to be fully accountable for its obligations.
- 1.18 Appropriate transparency could include the publication of annual reports into trading activities and BBC's compliance with its obligations in that regard. Another way to do this could be by working with the National Audit Office ('**NAO**'), requiring them to audit the accounts of the BBC and the relevant subsidiaries as permitted by the Agreement under clause 55. Ofcom should specify the scope and frequency of those examinations as part of the Operating Framework.

⁵ Sections 1.12 and 1.13 of Sky's response to Ofcom's consultations on competition regulation of the BBC dated February 2017.

