

29.
12.
03

Contents

Section A: Introduction

Chairman's Message	2
Chief Executive's Report	4
Report from the Chairman of the Content Board	8

Section B: Operating and Financial Review

Operating Review	12
Financial Review	16

Section C: Core Areas of Activity

Strategy and Market Developments	28
Competition and Markets	32
Content and Standards	36
External Relations	38
Support Services	40

Section D: Operations

Operations: sharing spectrum, supporting the public	42
Licensing activity	46
Enforcement, monitoring and interference	52
The Ofcom Contact Centre	56

Section E: Statement of Accounts and Corporate Governance

Foreword	62
The Ofcom Board	64
Corporate Governance	66
Board Committees	68
Non-Board Committees	71
Public and Parliamentary Accountability	72
Statement of Responsibilities	74
Statement on Internal Control	75
Remuneration Report	78

Section F: Accounts for the Period April 2003 – March 2004

Certificate and Report of the Comptroller and Auditor General	86
Income and Expenditure Account	88
Statement of Total Recognised Gains and Losses	89
Balance Sheet	90
Cash Flow Statement	91
Notes to the Accounts	92





Chairman's Message

This is our first full Annual Report. It is hybrid in nature, covering two different kinds of activity through the year; firstly, the set-up phase from 1 April to 28 December 2003, then secondly our first three months of operation as the communications regulator once Ofcom assumed its powers on 29 December of that year.

Ofcom's transition from legislative concept to working reality began as Parliament approached the completion of an often intense two and a half year journey.

That journey comprised 17 days of Parliamentary debate, 26 Commons Standing Committee sessions, more than 300 stakeholder submissions and more than 500 Parliamentary amendments. The outcome was the Communications Act 2003 – Ofcom's main rulebook. Mandating 263 separate statutory duties for the new regulator (more than double the total number of duties inherited from the five regulators which we replace), the Act is a legislative heavyweight for the digital era, to be implemented by a regulator whom Parliament has encouraged to be light-touch in its approach.

The establishment of Ofcom comes as the sector we regulate faces major change in the future. The move to universal digital transmission in broadcasting and to internet protocol-based networks in telecommunications will have a profound effect on the sector between now and the end of the decade.

Technological innovation and lower barriers to entry for new competitors will yield new services – some of them radically different to what is available now – as well as greater choice and better value. Such developments are also a prerequisite if the UK is to be seen in future as an innovator and leader in a sector of growing global importance.

However, delivering on those opportunities will depend in large part on investor confidence; the next generation of wireless and wireline networks will not be built without a belief within the capital markets that the business models underpinning them are sustainable for the long-term.

There are early signs that the sector is beginning to emerge from the worst of the investment stasis evident since late 2000. But tentative interest will not become commitments of scale without a strong degree of certainty. For our part, insofar as we have a role to play, it is to apply clear and cohesive forethought to all of our decisions in these important emerging markets.

The Board is actively engaged in these broad strategic issues as well as the detail of Ofcom's many and diverse tasks; decisions on policy and other matters of substance are fully debated by the nine members prior to decision. It greatly values the work of the Content Board – its statutory committee in the content area – and the work of the Consumer Panel and other advisory committees.

Throughout 2003 our immediate priorities were for the most part necessarily inward-looking and practical in nature. The bringing together of five organisations into one against the backdrop of a live, and constantly shifting, Parliamentary debate about the shape of the regulator's remit amounted to a significant operational challenge for all of us at Ofcom.

However, we also used that period of creation to discuss, agree and publish the fundamental regulatory principles which all of us will seek to follow and against which all should expect publicly to be measured.

The seven principles are set out in full on our website at www.ofcom.org.uk. I would like to highlight three in particular:

- that we will operate with a bias against intervention;
- if we do have to intervene, we will strive to ensure our interventions are timely and are based on evidence; and
- that we will always seek the least intrusive means of regulating.

The first three months of operation in 2004 gave all of us at Ofcom an opportunity to use those principles as a filter through which both the routine of day-to-day regulatory operations and the outcome of debates on policy formulation must pass.

Three months is too short a period for a detailed assessment of our success in abiding by our own principles. However – while allowing for the effects of transition and the immediate logistical challenges of bringing together five very different cultures into one – we believe that the direction of travel is correct.

The overall effect of those principles is encapsulated in the term *a bias against intervention*. We will not tread where the functioning of a truly competitive market is already meeting the appropriate needs of citizen-consumers. If we do need to step in, we will, first and always, seek to facilitate a quick outcome with the stakeholders concerned rather than resort to the minutiae of direct regulatory measures.

The injunction to all of us at Ofcom is clear; explore other options before you recommend intervention. However, light-touch regulation is not necessarily easy to achieve and all participants – from regulator and the regulated to the public and Parliament – must have confidence in the process if it is to work.

Under Section 3 of the Communications Act, we are required to identify how we have resolved any conflicts between Ofcom's General Duties in the conduct of important cases. During the period under review, the Board can report that no important cases arose in which such conflicts had to be resolved. That is perhaps a testament to the quality of our rulebook. It is also, we hope, a positive harbinger for the year ahead as Ofcom seeks to secure the right balance between the many competing forces shaping the UK's communications landscape.

David Currie
25 August 2004



Chief Executive's Report

Ofcom's Annual Report 2003-04 covers, by necessity, a great deal more of our work in plumbing than our work in policy.

Throughout 2003 much of the management team's attention was devoted to establishing the fundamental systems and processes without which no regulator could function. The set-up months – from April to December 2003 – presented Ofcom with both a unique opportunity and a complex challenge.

The opportunity lay in the creation of a new organisation which combines the virtues of the public and the private sectors. One that is able to match due process with due pace and with a clear understanding of the commercial realities of the communications sector; and one that is both fewer in number but stronger in expertise than the sum of the five organisations it has replaced.

The challenge lay in doing so in the full glare of public and Parliamentary attention and within an unavoidably compressed timeframe. The Communications Act did not receive Royal Assent until 17 July 2003; leaving a little over five months to complete a five-way organisational merger and associated headcount and property portfolio rationalisation.

Most of the core senior management team were in place by the summer of 2003. The first and most important task was the selection of colleagues from the legacy organisations. The process which followed is set out in the Operating and Financial Review section of this Report.

Our starting intention was to use the transition from five organisations to one to make a range of efficiency savings. We reduced headcount by 25 per cent; we also set ourselves a 2004-05 budget target which was 5 per cent lower, on a like-for-like basis, than the combined budget of the five previous organisations. London-based colleagues then successfully migrated from five organisations in six separate London properties into a single headquarters building. Colleagues in the Nations and Regions followed the same process in the spring of 2004.

Ofcom intends to build on those early operating budget target reductions. We are committed to being an RPI-minus regulator in relation to our own costs. In addition to the 5 per cent budget reduction as a result of the operational merger, Ofcom has committed to a further 5 per cent cost reduction during 2004-05 and we aim to cut another 5 per cent next year.

The transition was put into effect with minimal interruption to the flow of daily business – licensing activity, complaints investigation, casework and all other ongoing work continued to be undertaken throughout the handover from five organisations to Ofcom.

The whole project was completed slightly ahead of time and slightly under the set-up budget allocated to Ofcom in the form of a loan by the Department of Trade and Industry (DTI).

The sector

The sector we regulate matters. Well-run electronic communications networks underpin the workings of modern democracy; they also play an important part in securing industrial competitiveness.

These are activities we do well as a nation. The UK communications sector has developed a global reputation for growth and innovation in a number of areas such as mobile telephony and digital television. It is also a significant source of employment and revenues for the public purse.

However, new challenges lie ahead, principally the need for further investment in infrastructure:

- In broadcasting, to prepare for the transition to fully digital transmission.
- In telecommunications, to prepare for the second generation of mass-market broadband services.
- In wireless communications, to prepare for the delivery of new, high-speed fixed and mobile data services.

If the UK is to remain economically competitive and its people are to benefit from the new services becoming available to their peers in other countries, then these investments are not optional.

Over the next two to three years a large number of companies will face difficult decisions about the timing, scale and source of the investment needed to bring about these changes. Investors are beginning to return to the sector; however, they are looking for clear evidence of sustainable growth before committing.

Our approach to the sector

The communications sector has changed significantly in recent years, to the point where many of the assumptions which had informed approaches to regulation in the past are becoming increasingly less relevant and appropriate. As the organisation took shape it was clear to the Ofcom Board that effective communications regulation in the future would depend on the regulator adding a new mix of skills as well as adopting a new kind of approach.

In the latter part of 2003 and the early part of 2004, Ofcom began to build the appropriate capabilities across a range of professional areas, from technology and research to competition law and economic analysis.

Our intention throughout has been to recruit colleagues who are able to engage effectively with their peers within the companies we regulate. In recruitment terms, in many cases that has meant drawing directly on the sector we regulate; while the majority (85 per cent) of all Ofcom colleagues transferred from the five previous organisations, a majority of senior colleagues have joined Ofcom from the commercial sector.

As those senior colleagues have joined the organisation, we have developed the various internal functions which oversee both policy formulation and day-to-day regulatory operations. These are overseen by the Executive Committee, which comprises the organisation's most senior managers.

Early decisions

Whilst most management focus throughout 2003 lay in the necessary detail of operational transition, Ofcom also began to engage in a number of important policy areas:

- In telecommunications we began to set out our longer-term approach to the UK's broadband market, including:

- Changes to the regulation of the Wholesale Broadband Access market intended to stimulate greater competition.
- Defining a guaranteed margin for wholesale providers using BT's Datastream products.
- Introducing greater flexibility for wholesale providers by cutting the cost of moving their customers between BT's IPStream and Datastream products.
- First steps in our review of local loop unbundling, the process which allows network operators to compete in offering a range of innovative new broadband, media and telephony services between the local telephone exchange and the customer's premises.
- In broadcasting:
 - We played an active role alongside the Independent Television Commission and the Office of Fair Trading (OFT) in response to the merger of Carlton and Granada, and worked closely with the OFT successfully to implement the Contract Rights Renewal Remedy in the statutory undertakings.
 - We approved the broadcasters' Codes of Practice for commissioning work from independent producers.
 - In radio we developed a new process for the licensing of new FM commercial radio stations, with extensive input from industry.
- In wireless communications:
 - We embarked upon our Strategic Review of Spectrum Framework – Ofcom's long-term approach to the management of an important and finite national resource.
 - We undertook a public consultation on proposals to allow Spectrum Trading between wireless communications services providers.

Why consult?

The law requires Ofcom to consult ahead of many of its decisions. This legal obligation is entirely appropriate; even if consultation was not mandated by the statute, our own belief is that our decisions must be informed by the views of people and organisations with an interest in the outcome. Stakeholder consultation is an important aspect of our commitment to transparency.

In light of this, Ofcom has developed a formal consultation strategy. This is led by a consultation champion – Philip Rutnam – whose role is to ensure that the organisation adheres to its stated principles. Our major consultation documents are made available to a broad range of stakeholders; wherever an issue is likely to be of direct interest to citizen-consumers we also produce a summary granted a Crystal Mark by the Plain English Campaign.

There was an unavoidably large number of consultations during the period under review, for two reasons. First, the pace of decision-making in the legacy organisations slowed as decisions were deferred to Ofcom's in-tray – leading to an increase in the amount of work to be completed once Ofcom opened its doors on 29 December 2003. Secondly, the Communications Act also required a large number of changes to be implemented as soon as Ofcom assumed its powers.

During the period under review, of the 37 consultations issued by Ofcom, nine represent the lag effect of the interregnum between the legacy regulators and Ofcom, 23 were required by the Communications Act and only five were initiated by Ofcom.

Of the consultations begun by Ofcom, at least two – the Statutory Review of Public Service Television Broadcasting and the Strategic Telecommunications Review – will by the end of 2004 provide clear regulatory frameworks for much of the communications sector. This will hopefully reduce the number of day-to-day decisions and consultations in which Ofcom will have to engage the industry.

Our bias against intervention

In practice, appropriate light-touch regulation can take many forms. All yield longer-term benefits to citizen-consumers by reducing unnecessary regulatory burdens (and therefore costs) on businesses while continuing to provide the necessary audience and customer protections. For example, if a broadcaster is inadvertently in breach of the Programme Codes but on its own initiative takes immediate and appropriate action to prevent a repetition, then regulatory intervention is not required.

If intervention is required, we are committed to ensuring it is fair, prompt and effective. This may mean the timely and proportionate application of our powers as the regulator. It may also mean an attempt to facilitate a resolution by encouraging greater negotiation between the parties to a complaint or dispute.

Our approach to co-regulation of broadcast advertising is also founded on a commitment to securing the right balance between protection of the citizen-consumer interest and a commitment to securing the least intrusive means of regulation. The creation of a spectrum trading market – replacing a top-down, centralised approach to the management of the airwaves with one defined by an open market among wireless communications service providers – is another example where the regulator can reduce its role in direct regulation.

In some areas we have a specific statutory duty to work towards a public policy goal which markets alone cannot achieve. Our work on maintaining and strengthening the quality of Public Service Broadcasting in an increasingly competitive market is a good example of this. Viewers, Parliament, broadcasters and regulator all value public service broadcasting and recognise the contribution it makes to a greater social good. However, if left to itself, the market is unlikely to deliver the range and quality of programmes currently on offer. Targeted and proportionate intervention is therefore appropriate and necessary.

Evidence-based regulation

We seek to ensure all our decisions are founded on evidence, and we research markets constantly. For example, our actions to release 5.8 Ghz Band C spectrum for broadband applications of particular benefit to remote rural communities was driven by technological research as well as by clear indications from users of the need for a low-cost licensing solution.

Ofcom is committed to an assessment of the impact of any proposed change in regulation prior to the implementation of that change. Regulatory Impact Assessments (RIAs) explicitly present different policy options and the advantages and disadvantages of each. The evidence presented may be costed (as in a cost-benefit analysis) or not. RIAs play an important role in informing regulatory policy.

The reviews and consultations inherited from the legacy organisations were consistent with the RIA processes of those organisations. No Ofcom decisions to which the RIAs relate were taken during the period under review.

The full list of RIAs undertaken is set out in the Operating Review section of this Report.

Measuring our effectiveness

An early priority for 2004-05 is the development of an evaluation framework which assesses Ofcom's performance for the purposes of both external accountability and internal management efficiency. Ofcom will publish key performance targets in future Annual Reports.

This evaluation framework will include a range of indicators measuring the degree to which Ofcom has achieved its regulatory objectives and principles. Those indicators will include promptness standards. To that end, Ofcom is already capturing data on:

- Time taken to conclude competition cases.
- Time taken to resolve fairness and privacy complaints.
- Response times in operational areas such as Licensing and the Ofcom Contact Centre.

Lessons learned

During the transition to Ofcom in late 2003 and the early part of the operational phase from 29 December 2003 to 31 March 2004, there were a number of areas where in either process or policy, shortcomings emerged:

- Whilst we opened Ofcom's doors on time and slightly under budget, in retrospect we still underestimated the internal logistical burden arising from the transition.
- As a consequence of the effects of transition in our early weeks we were obliged to publish a relatively large number of consultations which placed a short-term but unforewarned regulatory burden on our stakeholders.
- In our consultation on access to television services for disabled people we accepted too readily the arguments against stepped targets. The consultation process was effective in helping us reach a better outcome.
- We did not sufficiently seek the views of key stakeholders, particularly those in the newspaper industry, prior to the announcement of our consultation process on the media mergers public interest test.

The year ahead

Ofcom's Annual Report for 2003-04 provides only a brief snapshot of Ofcom's longer-term approach.

The year ahead will bring the completion of work in significant commercial areas:

- In television with the conclusion of the Review of Public Service Broadcasting.
- In telecommunications with the conclusion of the Telecommunications Strategic Review.
- In wireless communications services with the further development of the Strategic Review of Spectrum Framework and the implementation of Spectrum Trading.
- In television, the implementation of the planning framework identified in our report to the Secretary of State for Culture, Media and Sport, entitled *Driving Digital Switchover*.

We will also seek to refine still further our many hundreds of day-to-day operational services and systems, whilst increasing efficiency and reducing unnecessary costs.

We expect that our principles will continue to be tested against the daily reality of regulating one of the UK's most dynamic and constantly-changing sectors; we will also expect to be measured against our delivery of the Ofcom Annual Plan for 2004-05. That document will form the basis for next year's Annual Report, when we will report publicly on the extent to which we have achieved the objectives expected of us.

In conclusion I would like to take this opportunity to thank all my colleagues within Ofcom, and the senior team in particular. The communications sector is vital to the competitiveness of any modern economy, and its products and services provide choice, information and entertainment to millions of people on a daily basis. In approaching our task we have tried to get the balance right between the citizen interest and the consumer interest. Whether we have achieved this or not is for others to judge. What I know to be incontestable is the hard work and effort that has been put into delivering the responsibilities laid on us by Parliament, and rightly expected of us by the companies we regulate.

Stephen A. Carter
25 August 2004

Report from the Chairman of the Content Board

The Ofcom Content Board was set up in accordance with Section 13 of the Communications Act 2003. A committee of the Board of Ofcom, it has two key functions – broadcast content regulation and media literacy.

The Content Board's primary task within Ofcom is to champion the interests of viewers, listeners and citizens across the United Kingdom relating to:

- the provision of broadcast services of high quality and appealing to a variety of tastes and interests;
- adequate protection from the inclusion of offensive and harmful material in broadcast services; and,
- adequate protection from unfair treatment at the hands of broadcasters and from unwarranted infringements of privacy.

The Ofcom Board delegates to the Content Board all matters that are purely content-related. Where issues have both content and economic dimensions, for example the Public Service Television Broadcasting Review, final decisions are taken at the Ofcom Board following full scrutiny by the Content Board.

Whilst Ofcom has no statutory remit over the content of non-broadcast electronic communications networks such as the internet and 3G, the Ofcom Content Board also has a role in encouraging the appropriate self-regulation of content made available on those networks.

Regulating broadcast content

The Content Board spends the majority of its time on content regulation of broadcasting over terrestrial, satellite and cable platforms. This can be divided into three types or tiers:

Tier One – protecting audiences

Tier One regulation for all radio and television broadcasters (including the BBC, with one exception noted below) is concerned with so-called "negative content regulation" – what broadcasters should not do. This relates to harm and offence, accuracy and impartiality, fairness and privacy. The BBC Governors, not Ofcom, regulate accuracy and impartiality complaints against the BBC.

Further details of Ofcom's approach to content regulation are set out later in this Report.

Tier Two – ensuring creative diversity

Tier Two regulation concerns the establishment and monitoring of quotas for all public service television broadcasters (ITV, Channel Four, Five and BBC television) in relation to independent production quotas, regional production quotas, and original (UK/EU) production quotas. Here the aim is to secure a healthy production industry and strong local content.

Tier Three – broadcasting as a public service

In television, Tier Three regulation involves monitoring the requirement for commercial public service television broadcasters (ITV, Channel Four and Five) to meet their public service obligations via an annual system of statements of programme policy.

Under Tier Three regulation, the BBC is required to consider guidance given by Ofcom about the preparation of the BBC's statements of programme policy. The BBC is also required to consider any reports published by Ofcom such as those produced in the course of the Public Service Television Broadcasting Review.

In radio, there is also a Tier Three equivalent which requires commercial radio stations to adhere to their agreed formats and to the new localness guidance set out in the Communications Act 2003.



Work during the period under review

During the period under review the Content Board either itself or through recommendation to the Ofcom Board:

- Approved the continuation of the relationship between Ofcom and the Central Religious Advisory Committee and approved the appointment of a new Chairman of the Committee.
- Appointed the Chairman and members of the Gaelic Media Service.
- Approved the consultation document on Electronic Programme Guides.
- Approved proposals for procedures to consider statutory sanctions against broadcast licensees.
- Approved the proposal by Five to enhance its peak-time news updates at 8, 9 and 10pm by removing the commitment to produce a late evening news bulletin at 11pm.
- Reviewed the ITC decision in the 118118 case and found that the advertisements did caricature David Bedford.
- Approved interim programme quotas for 2004 for public service broadcasters (including the BBC) pending the outcome of Ofcom's Public Service Broadcasting Review later in 2004.
- Approved procedures for handling fairness and privacy complaints and standards complaints including the format of hearings of the Fairness Committee and the Content Sanctions Committee.
- Endorsed revised guidelines on determining the eligibility of religious bodies to hold certain broadcasting licences.
- Approved for publication the consultation document on the future of broadcast advertising co-regulation.
- Approved an approach to defining regional production and regional programmes.
- Approved for consultation a draft Television Access Services code giving guidance to television channel providers on the provision of subtitling, signing and audio description.
- Approved interim guidance for consultation on localness in commercial radio.
- Approved the approach to be taken to local radio licences in the event of a change in control under the Communications Act.
- Provided input into Phase 1 of the Public Service Broadcasting Review.

Content Board Members

The Content Board comprises 13 Members – two full-time executive Members and 11 part-time non-executive Members. Three of the 13 Members of the Content Board – myself, my deputy chairman Sara Nathan and Kip Meek, Senior Partner Competition and Markets – are also on the Ofcom Board. This further ensures close working between the two Boards.

I would like to thank all my colleagues on the Content Board and all those who work within Ofcom and service its needs. I am fortunate to have great support from many hard-working and creative people in an area of Ofcom which, if handled poorly, could swamp the Ofcom agenda. I feel that the Content Board is now, as we come to the end of the second quarter of 2004-05, fully operational and fully engaged in its new tasks.

Richard Hooper
25 August 2004