



Review of television production sector

Project terms of reference

Issued: 11 May 2005

Contents

Section		Page
1	Introduction	1
2	Background to regulation in the sector	4
3	Reviewing the case for intervention	8
4	Current position of the independent production sector	13
5	Our approach to the review	15
Annex 1	Key questions	18
Annex 2	Issues outside of scope	19

Section 1

Introduction

1. The UK television industry generates annual revenues exceeding £9bn, and spends almost £5bn on programming – of this, over £2.5bn represents spending on original programming by the five main terrestrial broadcasters. This means that UK television viewers enjoy one of the highest levels of domestically originated programming in the world.
2. UK programming is delivered by a production sector comprising programme-making activity both within the main broadcasters (in-house production) and without (independent and external production). This part of the industry has been and remains an integral part of UK television.
3. Ofcom is beginning a review of the television production sector. This document sets out the terms of reference for the review, which will commence in May 2005, and is expected to be completed by April 2006.

Background

4. Ofcom has a number of responsibilities which relate directly, or at least indirectly, to the television production sector. These include:
 - The setting of quotas regarding original production on the main terrestrial channels, designated as public service broadcasters (PSBs) under the terms of the Communications Act
 - Setting out-of-London production quotas for the PSBs
 - Recommending quotas for the commissioning by the PSBs and other channels of programming sourced from independent producers
 - Monitoring the operation of codes of practice for dealing with independent producers
 - In addition to its formal powers, Ofcom needs to take account of the impact on the overall production sector of proposals made in the context of the Review of the BBC's Royal Charter.
5. The last major review of the sector was conducted by the Independent Television Commission (ITC) in 2002. As well as reviewing existing quotas, the ITC's review recommended that new codes of practice should be put in place between independent producers and existing public service broadcasters. These have since been implemented by the broadcasters, based on guidance issued by Ofcom.
6. The sector was also considered as part of Ofcom's recent review of public service television broadcasting (PSB) in 2004. In the PSB Phase 2 report¹, Ofcom suggested that the new codes of practice should be given time to work before any detailed assessment of them could take place. Ofcom therefore

¹ *Ofcom review of public service television broadcasting, Phase 2 – Meeting the digital challenge* ("PSB2"). Published on 30 September 2004.

concluded that it would be sensible to wait for 12 months before conducting a further review of the production sector.

The current review

7. This document describes how Ofcom will review these codes of practice, as well as other fundamental issues relating to the long-term development of the production sector. In subsequent sections, we provide a background to intervention in this sector, summarise the main work programme that will be taken forward over the coming months, and set out the key questions that the review will address.
8. Overall, this review concerns essential aspects of the relationship between television broadcasters and the production sector – focusing in particular on the key production quotas, and the operation of the commissioning system between producers and broadcasters. While the role of in-house production will be considered, the main focus of Ofcom’s analysis will be on the position of the independent production sector.
9. Intervention in the production sector has been an important contributor to the sector’s development. Ofcom will use this review to re-examine the case for this intervention. We will consider whether changes to existing regulations are necessary, and assess the continuing need for intervention in the sector.
10. More specifically, the review will cover:
 - The economic and public policy arguments for intervention in the production sector
 - The effectiveness of existing quotas on origination, independent production, and production outside the M25
 - The extent to which the new codes of practice have helped the market to function more effectively
 - Issues surrounding the exploitation of programming rights on new distribution platforms
 - The transparency of the commissioning process
 - The case for further action or for alternative solutions, which if required may mean investigation of:
 - The appropriate definition of an independent producer, and of qualifying programmes
 - The appropriate level of the independent production quota, and whether it should be defined by volume or value of programming
 - The circumstances that might result in the relaxation or withdrawal of intervention.
11. In examining these issues, the review will address the fact that the available data on the state of the production sector is of insufficient quality and quantity.

We will therefore aim to establish a solid evidence base on the size and status of the production sector.

The timing of this review

12. This review comes at a critical time for the UK television broadcasting sector in general, and for the production sector in particular. For instance, the Government's review of the BBC's Royal Charter is now well underway. The recent Green Paper² indicated that the future of independent production is a key issue, and the Paper also highlighted the need to give detailed consideration to the BBC's plans for the reform of its commissioning system (including the proposed Window of Creative Competition).
13. More generally, the sector is moving ever closer to digital switchover. A firm date is yet to be set, but Ofcom recently published an indicative schedule for a switchover process running from 2008 to 2012. It is sensible to consider what implications this significant shift might have for producers, as well as for the broadcasters they supply. For instance, as the independent production sector evolves in this changing market environment, might it be possible to define the circumstances that might lead to the withdrawal or relaxation of intervention? This will be a key question for the current review.

² Review of the BBC's Royal Charter: *A strong BBC, independent of Government*. Published on 2 March 2005.

Section 2

Background to regulation in the sector

14. Intervention in support of the independent production sector dates primarily from the creation in 1982 of Channel 4, the UK's first publisher-broadcaster, and the formal introduction of the independent production quota ten years later. These changes were the key drivers in the opening up of a programme supply market that was previously based on in-house production by the BBC and ITV. Figure 1 below illustrates the history of intervention in the sector, and the rest of this section summarises the key developments since 1982.

Figure 1: Summary of intervention in the production sector

1982	Creation of Channel 4, stimulating growth of independent production
1986	Peacock Committee recommends 40% independent quota
1990	Broadcasting Act introduces statutory 25% independent quota
1993	Statutory independent quota takes effect
1996	Broadcasting Act introduces 10% independent quota on DTT channels
1997	Creation of Channel 5
1998	Channel 4 required to spend 30% out of London
2001	Channel 5 agrees to 10% out of London target
2002	ITC Programme Supply Review published
2003	Communications Act comes into effect

15. The 1986 Peacock Committee on Financing the BBC recommended the introduction of a 40% independent quota on the BBC and ITV. In the following year, ITV entered into a voluntary agreement with the independent sector, aiming to reach 25% by the end of 1992 and the Independent Broadcasting Authority (IBA) began monitoring ITV's independent commissions and transmissions by hours and value. By the end of 1992, 22% of ITV's originated hours were from the independent sector.
16. The 1990 Broadcasting Act³ marked the introduction of the statutory independent quota on the BBC, ITV, Channel 4, S4C and, later, Channel 5. Set at 25% of qualifying programmes and measured in hours the quota took effect on 1 January 1993. On Channels 3, 4 and 5 the quota was monitored by the ITC while on the BBC it was overseen by the Office of Fair Trading (OFT) and applied across BBC One and Two taken together.

³ Broadcasting Act 1990, Sections 16, 25 and 186.

17. The definitions of qualifying programmes (excluding, for example, acquired programmes, repeats and news) and independent production (broadcasters having no more than a 25% share in an independent production company and vice versa) were set out in the Government's Broadcasting (Independent Productions) Order of 1991, which was amended in an order of 1995 to preclude two or more broadcasters having an aggregate shareholding of more than 50% in a qualifying independent.
18. The 1996 Broadcasting Act⁴ introduced a 10% independent production quota for digital terrestrial television channels, using the same definitions of qualifying programmes and independent producers as apply to the 25% quota on the BBC and Channels 3, 4 and 5.
19. ITV has met the quota every year since its introduction, helped by the fact that the licences awarded in the early 1990s included the publisher-broadcasters Meridian and Carlton. The BBC has sometimes struggled to meet the quota in the past, although the quota was exceeded in 2004 and the BBC has said that it is "taking steps to ensure that it will never again fail to meet the quota and that it is viewed as a floor, not a ceiling."⁵ A key reason cited for the shortfall in the past for the BBC has been the loss of qualifying independent status of large independent suppliers. In the past, this has meant that programmes which had qualified at the point of commission no longer qualified at the time of broadcast, and so could not be counted towards the quota.
20. In 2002, the ITC Programme Supply Review made a number of recommendations on the independent quota. These are summarised below:
 - The 25% quota should remain in force and continue to be measured in hours
 - The definitions of qualifying programmes and qualifying independents should remain largely unchanged, although some revisions to the operation of the quota were proposed
 - Specifically, the ITC proposed that there should be some clarification on the application of the quota so that 1) it should apply to BBC One and Two separately rather than across the two as previously, 2) it should apply to all PSB channels, including for example the BBC's licence fee funded digital channels, 3) that independents owned by European broadcasters with no UK presence should not be excluded, and 4) that qualifying independence should be measured at the point of commission rather than transmission
 - Ofcom should review the operation of the quota with regard to range, value, the definition of qualifying independents and regional distribution
 - Ofcom should be able to impose sanctions on broadcasters who fail to meet the quota.
21. The Programme Supply Review also recommended that all PSBs be required to develop and implement new codes of practice setting out principles regarding the commissioning process and a framework for agreeing terms of trade with independent producers.

⁴ Broadcasting Act 1996, Section 19.

⁵ BBC's submission to DCMS Charter Review public consultation.

22. The 2003 Communications Act⁶ set the 25% independent quota for all public service channels, including the BBC's digital channels, to be measured by hours but with the provision to measure by spend as well. It also gave Ofcom the power to require broadcasters to carry forward any shortfall into the following year. As of April 2005, the quota applies to BBC One and Two separately rather than taken together. While the BBC's other channels are taken together it should be noted that BBC Three has a separate commitment to a 25% quota. The Communications Act also required the introduction of the new codes of practice for broadcasters and independents and continued the 10% independent quota for digital terrestrial channels.
23. The Television Without Frontiers directive (1989, 1997) says that European independent production should account for at least 10% of transmitted hours where practicable on all channels, including digital satellite and digital cable, although the definitions are slightly different from those that apply to the 25% and 10% independent quotas in the Communications Act and Ofcom has the power to assess the extent to which compliance is or is not practicable.
24. In addition to the application of quotas for independent production, regulatory intervention in the wider broadcast market has also had an impact on the sector. In 1955, ITV was created as a federal, regionally based organisation, partly in order to provide a counterbalance to a largely London-centric BBC. Licences were awarded periodically based on a 'beauty parade' system which emphasised the programme making achievements and aspirations of the applicants. While the IBA measured how much network programming was provided by each ITV region, formal regional production quotas did not arrive until 1998 when, as part of its licence renewal, Channel 4 was required to spend at least 30% outside London. Five agreed to a 10% Out of London target in 2001 and in 2002 the ITV Charter committed ITV to an Out of London spend of at least 50% including both regional and network programmes.
25. The 2003 Communications Act⁷ requires that a suitable proportion of programmes are made outside the M25, that these constitute a suitable range of programmes and that a suitable proportion of money is spent in a suitable range of production centres. The BBC's Out of London quota is measured across all BBC channels and is 25% by hours and 30% by spend. Channel 4 and Five's commitments are 30% and 10% respectively, measured by hours and spend, while ITV is committed to 50% by both hours and spend. The definitions of Out of London production used by the broadcasters will be consistent by 2006, with 2005 being a transitional year.
26. Figure 2 below summarises the regulatory environment as it exists today – setting out the production quotas for the main terrestrial channels.

⁶ Communications Act 2003, Sections 277, 309 and Schedule 12.

⁷ Communications Act 2003, Sections 286, 288 and the BBC Agreement.

Figure 2: Production quotas per calendar year for terrestrial analogue channels as at 2004

Quotas (% of hours)	BBC One	BBC Two	Channel 3	Channel 4	Channel 5
Independent production⁸	25% ⁹	25%	25%	25%	25%
Original production¹⁰	70%	70%	65%	60%	53%
Original production broadcast in peak	90%	80%	85%	70%	42%
Regional production¹¹ (% of hours)	25% across all BBC channels	See BBC1	50%	30%	10%
Regional production (% of spend)	30% across all BBC channels	See BBC1	50%	30%	10%
Regional programmes made in and for the region	95% BBC1 & 2 together	See BBC1	90%		
European original production¹²	50%	50%	50%	50%	50%
European independent production¹³	10%	10%	10%	10%	10%

⁸ DTT channels are also required to fulfil an independent production quota of 10%. The definition of 'independent production' excludes repeats, news and acquired programmes.

⁹ BBC One, BBC Two and BBC Three each have to achieve 25% independent production separately, and all BBC channels need to achieve the 25% quota collectively.

¹⁰ Original production, by this definition, includes repeats.

¹¹ Regional production consists of network programmes made outside the M25, including repeats.

¹² The Television Without Frontiers Directive excludes news, sport and game shows from the quota for European programmes.

¹³ The same quota applies to all digital channels, where practicable.

Section 3

Reviewing the case for intervention

Considering the rationale for intervention

27. This review will consider carefully the rationale for intervention, and will assess whether there remains a case for continued intervention in the production sector. In examining the rationale for intervention, it is useful to start by summarising the key arguments that are often put forward to support intervention in the production sector.
28. Intervention is often justified with recourse to the perceived benefits that the independent production sector delivers to both end consumers of television and UK citizens more generally. These include:
 - Promoting innovation, creativity and risk taking
 - Increasing competition, raising quality and reducing costs
 - Increasing range and diversity, in terms of programme genres and geography
 - Providing an alternative source of new on- and off-screen talent as well as helping to develop a skilled workforce
 - Making it easier for new channels to enter the market, thereby contributing to viewer choice
 - Increasing employment in different parts of the UK, and in places which lack a major in-house production presence, thereby contributing to dispersal of production around the UK
 - Creating a base for international success.
29. It is an open question how many of the above characteristics are intrinsic to the independent sector. While some have argued that in-house producers are unlikely to generate all these benefits for consumer citizens, others have been robust in questioning whether the independent sector is any better placed than in-house producers to deliver these outcomes.
30. In *Building Public Value*¹⁴, the BBC argues that there are powerful reasons why in-house production is important, such as security of supply and quality, critical mass, training and development and greater efficiency. Ofcom's review will consider this argument, and the benefits arising from publicly-funded television production.
31. The BBC also recognises, however, the importance of the independent production sector in ensuring that licence fee is invested in the best ideas and the best talent. Hence, it recognises the role of independent producers in injecting fresh ideas and contributing to quality and innovation. Consequently,

¹⁴ *Building Public Value*, BBC, July 2004.

in its internal review of content supply¹⁵, the BBC announced the plan to extend the range of contestable funding to independent producers. Under these proposals, the 25% independent quota would be maintained, a 50% in-house production guarantee would be introduced, and the remaining 25% would form a “window of creative competition” (WOCC) for bids from in-house, external and independent producers. Additionally, the BBC has proposed reducing its internal production capability from 70% to 60%, with the 10% capability above the 50% in-house guarantee to enable it to compete in the WOCC. The in-house production capability could be further reduced in the future.

32. In the Green Paper on BBC Charter Review, the Government has called for a full and public debate around how the BBC’s proposals could work in practice. An additional question to be addressed is whether the BBC has a special remit in relation to the independent sector or whether the arguments for increasing the amount of independent production may apply to other broadcasters, such as ITV1.
33. The Green Paper states that “the licence fee should constitute venture capital for creative production and should support a strong independent sector. The BBC needs to make sure it broadcasts the best, most innovative programmes, and that means giving independent and external producers a fair chance to compete.”¹⁶ While it is still open to question as to exactly what venture capital for creative production means in practice, the government’s support for continued intervention is clear.

The role of economic analysis and public policy aims

34. It is important to distinguish between different arguments that could be used to justify intervention in the independent production sector. The main distinction is between economic and public policy arguments and it is important to be clear about their differences and respective merits. Ofcom’s review will consider both sets of arguments in detail.
35. From an economic perspective, intervention would be justified in the following instances:
 - If it were shown that there are positive externalities arising from the activities carried out in the production sector, and that the market would not seek to capture these if left to its own devices. Intervention could hence be justified to correct this market failure.
 - If competition issues existed in the sector, and it were shown that these had a material detrimental impact on consumers. For example, if the position of larger vertically integrated broadcaster-producers led to competition to supply programming being restricted – and so reducing output, quality and raising costs. The question would then become whether ex-ante intervention was required, or if ex-post competition law powers would be sufficient to deal with the problem.
36. Even if the economic justification for intervention were absent, intervention could be considered if there were overriding public policy objectives; for

¹⁵ The initial results of this review were announced by Mark Thompson, Director General of the BBC, in the New Statesman lecture of 7 December 2004.

¹⁶ See Charter Review Green Paper, p. 7.

example, policy-makers may consider that a strong independent production sector would help create a platform for international success; and the independent sector may be seen as important in helping the UK achieve international recognition in production.

Externalities and market failure

37. Some of the perceived benefits of the independent sector noted in paragraph 28 could be considered to fall under the umbrella of the market failure rationale – in other words, were it not for intervention, such gains (to the extent that they exist) would not be fully realised.
38. The market failure argument will need to be interrogated in detail. Here, the key questions will concern the extent to which perceived positive externalities actually arise; and crucially whether the sector would ever realise particular benefits from these if it were left to its own devices.
39. In addition, there is the specific issue surrounding the distribution of production across the UK – whether there is detriment from production being concentrated within London, and a demonstrable economic benefit from production being distributed more widely across the UK.
40. The basis for previous interventions in this sector would appear to be based on the premise that external benefits do indeed arise and that the sector, absent intervention, would not capture these. As we have already seen in the previous section, prior interventions have taken the view that the solution to the problem is to support the development of an independent production sector – from the creation of Channel 4, to the independent quota and the more recent codes of practice. This review proposes to consider the evidence on market failure in the sector and the appropriateness of the existing and/or new measures.

Competition issues

41. An assessment of the economic rationale for intervention cannot focus solely on the question of market failure. Benefits may also be left unrealised if there are problems with regard to competition in the market.
42. On this issue, we should once again start by referring to the earlier work that has been carried out. The ITC's programme supply review sought to investigate the scope of competition issues arising in the sector. Its emphasis was on the relationship between broadcasters and producers and whether broadcasters were in a position to exercise buyer power to the detriment of independent producers.
43. The outcome of the ITC's review identified the need to level the playing field between in-house and independent producers when competing for commissions, as well as ensuring that independents were able to negotiate freely the commercial terms of their secondary rights. Both these matters may have arisen owing to the concentrated nature of the broadcast market. Ofcom's review will revisit this issue, and attempt to carry out a full assessment of this and other potential competition issues that may be surfaced as part of a detailed analysis of the market structure.

Key questions

44. A key underlying question for this review is whether there might be any tensions between public policy in the production sector on the one hand, and the underlying economic characteristics of the relevant markets – and therefore the need for regulatory intervention – on the other.
45. The ITC’s review recognised the potential for tension in this area, warning against the perpetuation of a “welfare culture” whereby producers rely on the quota rather than their own competitive strength. The long-term goal was therefore seen as the creation of an independent production sector that is viable and sustainable in its own right.
46. Ofcom’s review will assess the extent to which the long-term goal of sustainability has been achieved to date. While there are a number of aspects to this analysis, our general approach will be to consider what the sector would look like going forward in the absence of intervention. We will use this analysis to seek to define the circumstances that might lead to the withdrawal or relaxation of intervention.
47. The analysis will need to consider current market conditions as well as future market developments. In particular it will be important to understand whether:
 - The size of the market for programme commissioning is increasing
 - Independent producers are facing increased competition from acquisitions and imported programmes
 - The increase of digital channels will result in more commissions for independent producers
 - The growth of new distribution platforms constitutes an important source of value for programme makers.
48. The analysis will also need to consider the independent producers themselves, and their different roles and business structures:
 - The codes of practice aimed to level the market between in-house and independents, and we will consider whether there is any evidence of subsequent structural change in the sector
 - The implications for the sector of the development of “super indies” capturing horizontal synergies. This will involve further investigation of the benefits of scale to an independent producer, the implications for the geographic dispersion of production, and also what this might mean for the definition of qualifying and non-qualifying independents
 - Whether there is an existing pattern to the types (genre or scale) of commissions that independents win compared to in-house producers and the impact this may have on the value of secondary rights to independents
 - Whether incremental value has been created by the fact that producers now retain the option to exploit secondary rights, or whether the extent of value creation in the sector is unchanged from that which was realised under the

earlier arrangements (i.e. effectively a straight transfer from broadcasters to producers)

- Whether independent producers have the capabilities to exploit secondary rights fully, or whether there are changes that could support their wider distribution.
49. In addition, the review will need to consider the key issues with respect to the vertically integrated broadcasters. For instance, it will be useful to:
- Assess the benefits to viewers arising from in-house production – whether financed commercially or via public funding
 - Understand the benefits and costs to the broadcaster and to the broader sector of integration – including any anti-competitive or unattractive consequences.

Section 4

Current position of the independent production sector

Overview

50. Ofcom's review will contain a detailed analysis of the current position of the independent production sector, and will attempt to address the evidence gaps that currently exist in this area. This is a diverse and fast changing sector, comprising over 600 independent companies producing for a far smaller number of broadcast customers. There is considerable variation in the output produced and the turnover achieved by companies, both between different companies and for the same company from year to year. However, in recent years and in total, the UK independent production sector appears to have increased significantly in scale and stature.
51. The ITC's Programme Supply Review identified expenditure by the terrestrial channels (BBC1, BBC2, ITV1, Channel 4 and Five) at network level on qualifying independent productions as £530m for 2001. In addition, other sources of revenue include sales to UK digital channels and international customers and the exploitation of secondary rights. These latter sources are likely to be growing in importance, and a recent estimate has suggested that the combined turnover to UK independent production companies may now be significantly in excess of £1bn.
52. There are also signs that the volume of output from the UK independent sector is increasing. The ITC review identified qualifying independent programme hours broadcast by the terrestrial channels at network level as 6700 hours for 2001. More recent estimates tentatively suggest that demand for output from independent producers has grown due to the increasing penetration and viewing share of digital channels, and subsequent demand for more new productions, more hours of ongoing commissions and more repeats of archive programmes.
53. Despite these new openings, the main terrestrial broadcasters (the BBC, ITV, Channel 4 and Five) remain the primary customers for the output of independent producers. The BBC and ITV account for just under half of the broadcast hours of programming produced by UK independent producers, and significantly more in terms of value of expenditure.
54. Channel 4 and Five commission over two-thirds of their original productions from independent production companies, but at budgets that reflect their comparative share of audience and NAR. Commissions from multichannels are increasing in frequency and scale, but tend to be lower in value than commissions by the terrestrial broadcasters.
55. There is also some evidence of change in the structure of the supply of independent programming. Many argue that the introduction of the new codes of practice and the growth in the international market for secondary rights has changed the financial model for independent producers and has increased interest from investors.

56. As a result, the last three years have seen an increase in consolidation and flotation of companies. For instance, the former can be found in All3media, the holding company established in 2003 for 9 separate production houses; and the flotation of Shed Productions in March 2005 is an example of the latter.
57. The evolution of the sector has arguably tended to favour the growth of industry heavyweights or 'super-indies'. These are typically diversified companies working across multiple genres for almost all of the major broadcasters, and exploiting key rights and brands in the global market – a prime example being Endemol. It is estimated that in 2004 the top 10 production companies by turnover accounted for close to half of the entire turnover and hours of output of the sector.
58. The remaining 600+ companies in the sector tend to be more focused on either the genres they produce in or the broadcasters they produce for. The majority are located in London – indeed, only four of the top 30 independent production companies by turnover are located outside London.

Data availability

59. The information currently available on the independent production sector reflects its past more than it provides a clear picture of the present, or indeed suggests its future. This review will therefore aim to fill the gap, and develop a comprehensive fact-base relating to UK content production.
60. The quantitative data available on the number of commissions and financial performance of independent producers, while a useful benchmark in sum, has been focused on the headline figures of revenue and profit growth for companies rather than the structural changes underpinning such growth. Ofcom proposes to conduct quantitative research into the volume and value of commissions to independent producers from different sources, and the impact of the exploitation of content rights – both in the UK and abroad – on a company's financial performance. This research will be conducted in conjunction with Pact, the trade association that represents and promotes the commercial interests of the independent producers, and its membership.
61. Under the operation of the statutory quotas, the volume, value, genre and region of origin of broadcast hours made by independents are collected from the terrestrial PSBs. Ofcom will attempt to extend this analysis to information from multichannel broadcasters, these being the most significant new source of demand for the output of independent producers in recent years.
62. To date, the internal workings and external impact of 'in-house' production and programme distribution have been less understood. Ofcom will therefore attempt to gain a better understanding of the volume and value of output from 'in-house' producers, and assess where this is complementary or competitive to the independent sector. The focus of our data analysis will, however, remain on the position of independent producers.

Section 5

Our approach to the review

Overall approach

63. The key building blocks of our proposed approach will be
- **Research and analysis:** The review will take an evidence-based approach, aiming to build a comprehensive fact-base regarding the UK production sector, in order to help drive thinking on the future of public policy in this arena
 - **Expert advice:** The review will benefit from specialist advice from experts both within Ofcom and from elsewhere. Specifically, Ofcom's main Board and Content Board will guide the project; and, where appropriate, external expert advisers will be invited to provide specialist advice
 - **Consultation and workshops:** Ofcom will make use of the public consultation process, to allow all interested parties to submit views and help guide the Ofcom work. In addition, we expect to hold seminars and discussion groups on the key issues and topics during the course of the review – the output of which will inform our final outputs.

A review in two phases

64. The project will be conducted over 12 months, including a round of significant consultation. We expect to complete the review by Easter 2006, and will publish two separate reports:
- Phase 1 interim report: Understanding the television production sector, and proposals for the future
 - Phase 2 final report: Conclusions and recommendations.
65. The rest of this section sets out the issues that will be considered in each phase. Annex 1 provides a summary of the key questions that the review will aim to answer, and Annex 2 notes some issues that are considered to be outside the scope of this review.

Phase 1 – understanding the television production sector, and proposals for the future

66. In the first phase, Ofcom will take forward further work on the key questions raised in this scoping document. An important part of this will involve an analysis of the current position of the television production sector. Ofcom will:
- Review the case for intervention in the sector, interrogating both the public policy and economic arguments for intervention
 - Review the current industry structure, alongside recent and continuing developments
 - Analyse the history of demand for programme commissions (overall and independent), and the main trends in demand

- Review the geography of the content production sector
 - Analyse the financial performance of the key players in the production sector
 - Carry out an economic analysis of the sector, focusing on sector structure, the operation of the relevant markets, and competition issues raised.
67. We will also consider how intervention in the production sector might need to change as the market environment continues to evolve. In this area of the work programme, Ofcom will:
- Analyse the impact of regulation in the sector, including the operation to date of the new codes of practice put in place in 2004
 - Review the issues surrounding the exploitation of programming rights on new distribution platforms, including a consideration of whether the codes of practice might need to evolve in order to reflect the growing importance of new media delivery
 - Seek to identify the desired characteristics of the sector, the barriers to their achievement, and the circumstances that might allow for a relaxation of intervention
 - Consider scenarios for the future development of the sector under the impact of differing changes to the regulation of the sector (quota levels and definitions). Here the key questions will concern what the impact of regulatory change could be on the different groups of producer – whether in-house or external
 - Make proposals for any changes that might be needed to existing regulations.
68. This work programme will feed into the Phase 1 report and consultation document covering the structure and operation of the production sector, and Ofcom's proposals for the future of regulation in the sector.
69. This report is expected to be published in late 2005, following which the formal consultation period will continue until the start of 2006.

Phase 2 – conclusions and recommendations

70. Having considered the outputs of the above work programme, and the responses to the consultation, Ofcom will produce a comprehensive final report, setting out:
- Our conclusions
 - A recommended package of regulatory changes (if any are needed), and an implementation plan for the timing of any required change to quotas
 - Any changes to the codes of practice that are deemed by Ofcom to be necessary.
71. We currently envisage publishing our final report by April 2006.

Next steps

72. The review process begins in May with a series of initial discussions with producers and broadcasters to clarify the approach and to discuss Ofcom's data requirements in more detail.
73. The first formal consultation will begin in late 2005, following the publication of Ofcom's Phase 1 report.

Ofcom team leaders

74. The Ofcom senior team with responsibility for delivery of this review are:
 - **Kate Stross** – Director of Content, Content and Standards
 - **Jim Egan** – Head of Strategy Development

Point of Contact

75. For points of clarification or further information, please email Khalid Hayat (Manager, Strategy Development) on khalid.hayat@ofcom.org.uk

Annex 1

Key questions

Do the public policy arguments for a strong independent production sector – such as the promotion of innovation and diversity – stand up to economic scrutiny? Is there any necessary link between innovation and an independent production sector?

What market failures and / or competition issues (if any) justify intervention – whether at the national level or in promoting a wider geography of production?

Should intervention remain for public policy reasons – whatever the economic case – in the interests of sustaining a healthy independent sector?

What would the television production sector look like without intervention, and is it possible to define the circumstances that might lead to the withdrawal or relaxation of intervention?

What are the benefits of vertically integrated production to viewers and broadcasters, and might they be outweighed by any competition issues created by the existence of such vertically integrated producers?

Is the BBC a special case? How will the proposed 25% window of creative competition work and should a similar idea be applied to other broadcasters? These issues will be considered in conjunction with DCMS, as an input into the Charter Review process.

Is there a tension between interventions that might support large independents (mainly in London) and smaller companies, based in London and across the UK?

What is the relationship between the independent quota and the Out of London quota? Would changes to the independent production quota damage regional production, or could it give regional production a boost?

What are the key trends in output, demand and financial performance in the independent production sector?

How might the position of the sector evolve over time, as digital channels and alternative new distribution platforms become of increasing importance?

What implications does the development of ‘super-indies’ have for the production sector as a whole?

What impact are the codes of practice – put in place in 2004 – having on the relationship between broadcasters and independent producers? Would the operation of the commissioning process be improved by application of the codes of practice to all external producers?

Do the answers to the above questions suggest the need for any changes to regulation in the production sector?

For instance, should there be changes to quota levels, or to the definitions of qualifying programmes or independent production? What benefits might any changes bring?

Annex 2

Issues outside of scope

The main body of this document has considered the scope of Ofcom's review of the production sector. The purpose of this annex is to note some issues that we consider to be outside the scope of the review.

Underlying rights holders

As noted in the main text of this document, Ofcom's review concerns the essential aspects of the relationship between television broadcasters and the production sector – focusing in particular on the key production quotas, and the operation of the wider commissioning system.

As such, we do not propose to consider the position of underlying rights holders – such as writers, actors, and musicians. Issues might arise in this area due, for instance, to the relationships between programme producers and underlying rights holders.

While Ofcom recognises that issues may arise in this area, we believe that any problems are most appropriately dealt with by having recourse to competition law. We do not aim to develop policy in this area, and so will not consider this issue in the current review.

Film production

In responses to previous Ofcom consultations, some have argued that the relationship between television broadcasters (most notably the BBC) and UK film producers needs to be addressed. This argument was, for instance, made by Pact in its response to Phase 2 of the PSB Review.

Ofcom does not propose to give specific attention to film production in this review, since Ofcom does not have the powers to intervene in this area. Specifically, Ofcom's powers in relation to production derive from section 285 of the Communications Act, and the ambit of the codes of practice. Section 285 covers terms for the commissioning of independent productions. Independent productions in turn are defined by reference to the ownership of the companies who make them – and not by genre (e.g. feature films). In addition, and importantly, co-productions were placed outside the scope of the codes of practice. It should be noted that section 264(6)(b) of the Act places upon the PSBs the obligation to include feature films in their service. There is, however, no obligation on the PSBs to commission feature films.

In addition, where concerns have been raised on this issue, they have related to the relationship between the BBC and film producers. The Government has already set out clear proposals on this issue in the Charter Review Green Paper¹⁷

Radio production

As part of its Content Supply Review, the BBC has also been looking at the issue of its commissioning of content for its radio stations. In this regard, the BBC has a self-imposed quota, and has developed new Terms of Trade for radio production.

¹⁷ See, for instance, the box on page 38 of the Charter Review Green Paper, *A strong BBC, independent of government*.

This is not, however, an issue for Ofcom to consider as part of the current review. Ofcom has no powers to intervene in this sphere: Section 285 of the Act only covers public service television broadcasters, not radio. In addition, the BBC's independent quota for radio is voluntary, and is not enforced by Ofcom or another external body.

Other issues

In addition to the above, a number of other issues sit outside the scope of the review and / or are being considered separately:

- **Post-production and ancillary services** – Ofcom does not have any regulatory powers in this area, and so such services will not be considered as part of the review.
- **New media rights** – as noted in the main body of this document, we will consider new media issues in the context of the exploitation over alternative platforms of programming originally commissioned for television broadcast. We do not propose to make policy recommendations regarding the commissioning of content specifically for new distribution platforms, since we have not seen any evidence to suggest that there is a current need for intervention in this space.
- **Local TV** – this is a relevant issue, but is the subject of a separate major project within Ofcom. As such, local TV services will not be considered specifically in the production sector review.
- **Training** – the ITC Programme Supply Review addressed the need to define and monitor investment in training and skills development to freelance workers and small independent producers. These requirements are within the wider remit of the proposed co-regulatory body for training and development of skills.¹⁸ Additionally, extensive research into investment in training in the independent production sector has recently been completed for PACT.¹⁹

¹⁸ Ofcom consultation on 'Proposals for a co-regulatory system for training and the development of skills in television and radio', 07.09.2004.

¹⁹ Spectrum, Quantifying training and investment in the independent production sector, July 2004.