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# The merger of BBC Studios and BBC Worldwide

The BBC's commitments

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# The merger of BBC Studios and BBC Worldwide

- 1.1 Ofcom's role in relation to the BBC's commercial activities, as determined by the BBC Charter and Agreement, is to regulate competition issues concerning the boundary between the BBC Public Service and its commercial subsidiaries.<sup>1</sup> We have a responsibility to set requirements on the BBC to ensure that the relationship between the BBC's commercial activities and the BBC Public Service does not distort the market or create an unfair competitive advantage.
- 1.2 We have therefore set "trading and separation requirements" which relate to issues such as information flows across the boundary, financial support, reporting and transparency and include the following<sup>2</sup>:
- i) the BBC's commercial activities must be carried out by commercial subsidiaries that are separate from the BBC Public Service;
  - ii) the BBC's commercial subsidiaries are run by boards and executive committees which are distinct and separate from the BBC Board and its executive committees. The BBC's commercial subsidiaries should not have access to information about the BBC Public Service's strategy, priorities or activities that is not available to the wider market;
  - iii) the BBC must provide goods and services to its commercial subsidiaries on equivalent terms and prices to those offered to third parties, and in line with our transfer pricing principles;
  - iv) the BBC's commercial activities must earn a commercial rate of return. Where a line of business is not making a commercial rate of return, the BBC must inform Ofcom; and
  - v) the BBC must report information to enable us to monitor the BBC's compliance with our requirements and publish certain information to provide transparency to the market on its commercial activities.
- 1.3 Under the Agreement there is a process to deal with material changes that the BBC proposes to make to its commercial activities. The Agreement defines a material change to the BBC's commercial activities as:
- the carrying out of a new type of activity as a commercial activity; or

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<sup>1</sup>The "Agreement" refers to the Agreement between the Secretary of State for Culture, Media and Sport, and the BBC, available at <https://www.gov.uk/government/publications/bbc-charter-and-framework-agreement>, Ofcom's role is outlined in the Agreement, Clause 28 (1).

<sup>2</sup> We published our requirements and guidance on the BBC's commercial activities in March 2017 and incorporated our requirements and guidance on the BBC's trading activities into this publication in July 2017. Our requirements and guidance are available at: [https://www.ofcom.org.uk/\\_data/assets/pdf\\_file/0025/99412/bbc-commercial.pdf](https://www.ofcom.org.uk/_data/assets/pdf_file/0025/99412/bbc-commercial.pdf)

- a significant change to the BBC's commercial arm,

where there is a significant risk that the change may, as a result of the relationship of the activity with the BBC Public Service, distort the market or create an unfair competitive advantage.<sup>3</sup>

- 1.4 The BBC must, in the first instance, consider whether a proposed change is material. If the BBC concludes that a proposed change is not material, it is open to Ofcom to disagree. If Ofcom disagrees, we can undertake a formal assessment under the Agreement of the competition risks associated with the proposed change. This process would start with the BBC carrying out and publishing a commercial test.<sup>4</sup>
- 1.5 In November 2017, the BBC announced a proposed change to its commercial activities by merging two of its commercial subsidiaries, BBC Studios and BBC Worldwide, into a single entity, also named BBC Studios. We refer to the merged entity as the "new BBC Studios" below. The proposed merger brings the BBC's commercial production, sales and distribution activities currently carried out by BBC Studios and BBC Worldwide under a shared management and leadership structure. The BBC has said that the merger will bring with it a number of benefits, including securing investment in British content, and explained that the change is aligned with the market norm. The BBC plans to implement this new structure from the beginning of April 2018.
- 1.6 The BBC assessed the materiality of its proposed change and concluded that the merger does not constitute a material change. In these circumstances, as outlined above, it was not required to undertake a commercial test, or to publish its proposal, unless directed to do so by Ofcom.
- 1.7 Since the BBC's announcement, we have been considering the potential materiality of the proposed change. We have therefore been looking at what competition concerns the proposed merger might raise and how these could affect the boundary between the BBC Public Service and the commercial activities.
- 1.8 To help inform this, we have engaged with the BBC to better understand the potential impact of the proposed merger. We have also spoken with stakeholders to understand their perspective on the proposed merger.
- 1.9 We recognise that it may be beneficial and efficient for the BBC to structure its production and distribution activities in a similar way to other large media organisations. Nevertheless, we also consider that there might be some potential concerns arising from bringing the BBC's two largest commercial subsidiaries together. In particular a risk of reducing transparency over the operation of the boundary between the BBC Public Service and the commercial activities.

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<sup>3</sup> The Agreement, clause 25(6).

<sup>4</sup> The commercial test requires the BBC to assess its proposal against the commercial criteria. The four commercial criteria are that a commercial activity must: fit with the BBC's Public Purpose, exhibit commercial efficiency, not jeopardise the good reputation of the BBC or the value of the BBC brand, and must not, as a result of the relationship of the activity with the BBC Public Service, distort the market or create an unfair competitive advantage.

- 1.10 The BBC has provided voluntary commitments in respect of the proposed merger which are set out in the attached annex. The commitments have been agreed by the BBC Board and are intended to give assurance that transparency over the relationship between the BBC Public Service and the new BBC Studios will be preserved. For example, the BBC has committed to set commercial rates of return targets, and to report financial performance, on production activities separately from distribution activities.
- 1.11 The commitments also set out how the BBC will seek to ensure compliance with the trading and separation requirements under its new structure and include additional measures which the BBC will put in place to monitor compliance. For example, they set out the approach the BBC will take to monitoring operational separation and describe the role of the BBC's Fair Trading Committee and external Fair Trading audit.<sup>5</sup>
- 1.12 Taking the characteristics of the BBC's proposed change, our trading and separation requirements and the commitments provided by the BBC together, we do not consider it would be appropriate to conduct a formal assessment under the Agreement of the proposed change.
- 1.13 In addition, following our work to date to better understand the commercial and trading activities and their relationships with the Public Service, we have decided to consult in summer 2018 on revisions to our requirements and guidance, including whether more detailed reporting is required from the BBC to ensure that we have sufficient information about the BBC's commercial and trading activities and their performance to enable us to carry out our regulatory duties. This work covers the new BBC Studios as well as the BBC's other commercial activities. In addition, we expect to issue a call for inputs towards the end of 2018/19 on the BBC's commercial television production activities which would inform our decisions on the scope of our work in this area for early 2019/20.<sup>6</sup>

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<sup>5</sup> Fair Trading is the term used by the BBC in relation to its compliance with Ofcom's trading and separation rules.

<sup>6</sup> A review conducted under clause 30 of the Agreement.

## The BBC's commitments to Ofcom

- A1.1 The BBC announced its decision to bring together two of its commercial subsidiaries, BBC Studios and BBC Worldwide, to trade as a single entity known as BBC Studios on 29 November 2017.
- A1.2 The BBC Board has approved a series of voluntary commitments to be transparent about how these new arrangements will work in practice. The commitments are intended to demonstrate that the BBC has the necessary procedures in place to ensure the proposed merger of BBC Studios and BBC Worldwide will not distort the market or result in BBC Studios gaining an unfair competitive advantage due to its relationship with the licence fee funded BBC Public Service.
- A1.3 The BBC Board will oversee these commitments and the BBC's compliance with them. The BBC's Fair Trading Committee oversees how the BBC complies with Ofcom's trading and separation rules and other relevant provisions in the BBC Charter and Framework Agreement.<sup>7</sup>

## The Commissioning Process

1. With regard to the BBC's commissioning process, the BBC commits to continue to treat all producers and distributors equally, irrespective of their relationship to the BBC, whether they are external companies, BBC in-house public services teams or BBC Studios. The BBC commits to ensuring there is fair competition between new BBC Studios and third party producers. The BBC will continue to commission the best ideas to inform, educate and entertain its audiences.
2. The BBC commits to maintaining its existing Commissioning Process Framework.<sup>8</sup> In particular, the BBC will retain the following mechanisms to ensure it promotes competition and is transparent:
  - a Commissioning Code of Practice, which sets out the principles to be applied when agreeing terms with qualifying independent producers for the supply of TV programmes;<sup>9</sup>
  - a published tariff, setting out the indicative prices the BBC is prepared to pay for the supply of commissioned television programmes, which applies to all producers including qualifying and non-qualifying independents and BBC Studios;<sup>10</sup>

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<sup>7</sup> BBC Fair Trading Committee Terms of Reference

([http://downloads.bbc.co.uk/aboutthebbc/insidethebbc/managementstructure/seniormanagement/subcommittee/pdf/bc\\_sub\\_committee\\_fairtrading.pdf](http://downloads.bbc.co.uk/aboutthebbc/insidethebbc/managementstructure/seniormanagement/subcommittee/pdf/bc_sub_committee_fairtrading.pdf))

<sup>8</sup> <http://downloads.bbc.co.uk/commissioning/site/bbc-commissioning-process-framework.pdf>

<sup>9</sup> [http://downloads.bbc.co.uk/commissioning/site/code\\_of\\_practice.pdf](http://downloads.bbc.co.uk/commissioning/site/code_of_practice.pdf)

<sup>10</sup> [http://downloads.bbc.co.uk/commissioning/site/tariff\\_prices\\_for\\_independents.pdf](http://downloads.bbc.co.uk/commissioning/site/tariff_prices_for_independents.pdf)

- guidance on the BBC website on how the BBC works with suppliers, including compliance with the Business Affairs Charter which governs business dealings with independent production companies;<sup>11</sup>
  - the well-established external facing BBC Commissioning website which announces upcoming commissions to the market, sets out the common processes for independent production companies, BBC Studios and in-house and relevant mechanisms for submitting programme ideas such as BBC Pitch;<sup>12</sup>
  - a system for managing complaints about TV commissions through which third parties can raise concerns;<sup>13</sup> and
  - a separate process for managing competitive tenders for returning series.
3. The BBC will publish details of the BBC network television hours<sup>14</sup> produced by both new BBC Studios and external suppliers in the BBC Annual Report and Accounts which is approved by the BBC Board. This will include information for different genres. The BBC will publish this information in the upcoming 2017/18 BBC Annual Report and Accounts and will continue to do so in subsequent years following the proposed change.
  4. The BBC will maintain rigorous operational separation between its Public Service commissioning teams and new BBC Studios pitching into the UK Public Services. The BBC Board and the BBC Fair Trading Committee will monitor operational separation, as part of their respective remits to review on an ongoing basis the BBC's compliance with the four commercial criteria set out in the Framework Agreement.<sup>15</sup> The external annual Fair Trading Audit will consider the effectiveness of the BBC's controls including operation separation between the UK Public Service and new BBC Studios. The BBC will publish the Auditor's opinion in the BBC Annual Report and Accounts.

## Financial Support

5. There will continue to be no cross subsidy between the BBC Public Service and the BBC's commercial arm. The BBC will not use any licence fee revenue to fund any of the costs of making this change.
6. The BBC Board will set commercial rates of return (informed by market norms) for all lines of business within the new BBC Studios. The BBC Board will review the performance of new BBC Studios against these targets and report to Ofcom in accordance with the requirements set out in Ofcom's trading and separation rules. The lines of business in new BBC Studios will be consistent with the current lines of business in BBC Studios and BBC Worldwide. For the

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<sup>11</sup> [http://downloads.bbc.co.uk/commissioning/site/Business\\_affairs\\_charter.pdf](http://downloads.bbc.co.uk/commissioning/site/Business_affairs_charter.pdf)

<sup>12</sup> <http://bbc.co.uk/commissioning>

<sup>13</sup> [http://downloads.bbc.co.uk/commissioning/site/complaints\\_about\\_commissioning.pdf](http://downloads.bbc.co.uk/commissioning/site/complaints_about_commissioning.pdf)

<sup>14</sup> Programmes made for viewing on any of the UK Public Television Services, other than programmes made for viewing only on a variation of such a service that relates to one of the Nations or Regions of England.

<sup>15</sup> The Board has the function under the Article 20(8) BBC Charter to ensure compliance with the BBC's obligation Charter, Framework Agreement and Ofcom's Operating Framework. The remit of the Fair Trading Committee is to assist the Board in complying with Ofcom's trading and separation regulatory requirements in its Operating Framework.

avoidance of doubt, the BBC will therefore set targets for the following lines of business with the new BBC Studios:

- UK television production;
  - International production and formats;
  - Content sales;
  - Branded services; and
  - Consumer products.
7. The BBC commits that following the creation of new BBC Studios, it will only alter the internal allocation of revenues and costs between the production (i.e. making new content) and distribution (i.e. content sales and operating commercial television channels) divisions of the new BBC Studios in order to align new BBC Studios with market norms. The BBC will inform Ofcom of any such changes to the allocation of revenues and costs between new BBC Studios' production and distribution divisions.

## Information flows

8. The BBC commits to maintaining its rigorous conflict of interest procedures to ensure that any potential conflicts of interest are identified, recorded and mitigated where necessary. This includes ensuring that directors do not receive information, or participate in discussions, on issues where conflicts may arise, or a perception of a conflict exists. Where a conflict is identified it is recorded in the minutes of the Board meetings, which are published on the BBC's website. In particular, where executives of the BBC's commercial subsidiaries are also directors of the Corporation's main Board or Executive Committee, the BBC will ensure that they do not participate in discussions or decisions about individual programme commissions or tendering decisions for the BBC's public service television or relevant radio output at the Board or Executive Committee. The BBC keeps its conflict of interest procedures under review. In light of this change the BBC reviewed the procedures in place and considers they remain robust and support the BBC Board in discharging its functions under the BBC Charter.
9. New BBC Studios will implement conflict of interest procedures to ensure that any potential conflicts of interest between its production division and its stakes in independent production companies are identified, recorded and managed. The BBC will inform Ofcom and relevant parties of these procedures.

## Transparency and reporting

10. The BBC commits to no lessening of transparency in financial reporting by the BBC's commercial subsidiaries as a result of this change:
- The lines of business in new BBC Studios will be consistent with the existing lines of business in BBC Studios and BBC Worldwide (see paragraph 6 above).
  - The BBC will report to Ofcom in line with Ofcom's trading and separation rules on both the forward looking target commercial rates of return and financial performance for each line of business in new BBC Studios.

- Annually, and no later than by 1 April each year, the BBC will provide to Ofcom an explanation of how the BBC has set its commercial rate of return targets for each line of business, including an explanation of how market norms have informed the targets set by the BBC. The BBC will provide Ofcom all relevant evidence.
  - The BBC will also provide more detailed information as necessary when formally requested by Ofcom and required to carry out Ofcom's regulatory functions.
  - The BBC will also publish each year at the same time as the BBC's Annual Report and Accounts financial and performance information for new BBC Studios, including details of the performance of each line of business approved by the BBC Board.
  - The BBC commits to publishing by 30 April 2018 a structure chart of the new BBC Studios, including the divisional structure and all lines of business comprised within it.
11. The BBC commits to not changing its transfer pricing methodologies as a result of this change. The BBC will ensure these comply with Ofcom's trading and separation rules and will apply methodologies consistently across all of the BBC's commercial subsidiaries and lines of business within its commercial arm. The BBC commits to publishing updated transfer pricing methodologies for new BBC Studios by 30 April 2018.
12. The BBC commits to not changing its brand valuation methodologies as a result of this change. The BBC will ensure these methodologies comply with Ofcom's trading and separation rules. The BBC will set out in its published documents how payment for use of the BBC brand applies to different commercial activities (e.g. to highlight any differences between production and distribution activities). The BBC commits to publishing updated brand valuation methodologies for new BBC Studios by 30 April 2018.
13. In addition, the BBC commits that new BBC Studios' production and distribution divisions will continue to work with third parties outside of the BBC. There will be no exclusivity between new BBC Studios' production and distribution divisions.