

**Submission to Ofcom's Call for Evidence:  
public service broadcasters and the UK  
production sector**

**pact.**

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**March 2021**

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## Executive summary

The current production sector rules, including the independent production quota and the arrangements that frame the Terms of Trade between independent producers and the PSBs, have been an unparalleled success. Independent production companies (indies) have delivered some of Britain’s best loved shows and sector revenues have grown steadily over the last decade.

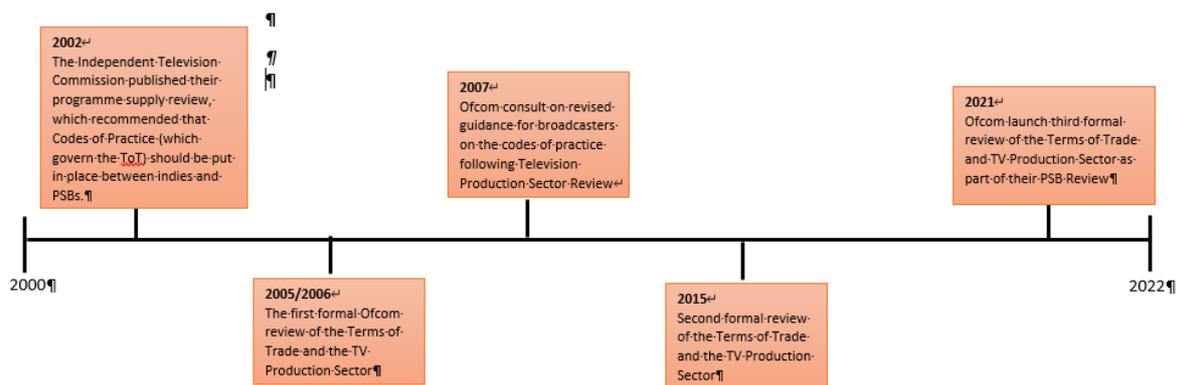
Independent producers need certainty to invest and to take the risks that result in the most innovative programmes. The Terms of Trade provide this certainty by giving producers control over their own IP. The 25% independent production quota requires the UK PSBs to commission content from indie suppliers, the majority of whom are small and medium sized businesses (SMEs). The original rationale for the introduction of the Terms of Trade: to counterbalance the PSBs’ negotiation power against SMEs and vertical integration of broadcaster production arms, and to secure more independent production outside London remains today.

The existing regulatory system has unlocked huge growth across the sector. In 2003 independent production companies were worth just £850 million to our economy. Today, the sector is worth over £3 billion. It has grown by 30% over the last five years<sup>1</sup> and there are now over 500 independent television producers employing tens of thousands of people across the country.

Independent producers work across a wide range of genres making content which is culturally significant, informative, and economically and creatively successful.

Each review of the Terms of Trade (this is the second in a decade) chills the market and freezes investment.

**Figure 1. Terms of Trade timeline**



Pact has three key questions that must be answered by Ofcom to bring clarity to the evidence base used for this review:

<sup>1</sup> Pact Census 2020, Oliver and Ohlbaum

1. What problem is Ofcom trying to fix and what evidence has been used to prove that this is linked to the supply side of the UK domestic programme market?
2. What evidence has been presented to Ofcom by the PSBs? The call for evidence document cites that the relationship has changed between PSBs and UK production sector mainly focusing on the changes to the wider market conditions such as the increase in international revenues. Pact would like to understand how this evidence is material and detrimental to the supply of the UK domestic programme market?
3. Finally, Ofcom should confirm if they have investigated the evidence that has been presented to them by PSBs on whether there is a material cost to them by adhering to the current arrangements that frame the Terms of Trade and the requirements of the Indie quota. If this has not been carried out, we urge Ofcom to complete this immediately.

Pact cannot see the detriment that the current arrangements that frame the Terms of Trade and the indie quota bring to broadcasters.

Pact considers that the supply side of the UK commissioning market is working well because of the interventions of the PSB regime. The supply side is highly competitive: several hundred producers of varying size create content for the UK television market. This means broadcasters can easily switch between different producers offering similar content although there does also continue to be considerable specialisation within genres.

The result of this highly competitive environment is that independent producers fear losing commissions if they insist on specific terms. If a project is lost indies will have to invest more of their own capital into ideas for productions which they must again negotiate on commissions and terms.

The Terms of Trade establishes standard terms which ensures that a specific share of the gains from the project remains with producers. Ownership of the IP is a long-term asset value for the company, critically it can be used to attract capital and investment back into the UK. By attracting external finance by selling or pre-selling their IP, indies can take risks and innovate, recouping on development funding invested by the production company into specific projects. It also helps PSBs to pay less towards their programming and manages to provide audiences with diverse and high-quality programming. Harnessing the global markets through secondary rights and international IP have allowed indies to accept low margins on UK domestic commissions and invest more of their commissioning income into programmes and Research & Development (R&D) for future projects.

Take these interventions away and the diversified supply and working capital to drive SME growth to help maintain and drive innovation within the UK content market will fall away and impact the content choices of PSB commissioners and audiences alike.

Pact understands that the future of PSM delivery is also being considered by Ofcom and that Ofcom is seeking ways to ensure sustainability of the PSBs going into the next ten years; this includes:

- Reiterating their recommendation to Government to introduce legislation to ensure that existing PSBs' on-demand services and content – as well as their existing broadcast TV channels – are given prominence across connected TVs PSBs.
- Setting out the emerging view on how a flexible service neutral approach will deliver the future Public Service Media framework.

Pact recommends that a key part of this future must be continuing the corresponding PSB obligations of which the Terms of Trade and the indie and Nations and Regions' quotas are an intrinsic part under the current PSB compact. Ofcom must carry out a thorough impact analysis of the perceived benefits and risks of any new system for audiences, PSBs and producers.

The success of Terms of Trade and Indie quota is indisputable. The light touch framework of principles of the Terms of Trade enables commercial agreements to be continually updated as technologies evolve and viewing habits change. This is an extremely effective piece of legislation, in part because it is flexible and therefore enables PSBs and independent producers to renegotiate terms as required in order to allow for the sector to adapt to changing consumer demands and technological needs. As a means of illustrating this, the tables in Annex 1 to our response (which is confidential to Ofcom) highlight the key changes in the Terms of Trade between Pact and each of the PSBs, noting how they have evolved over time.

The Indie quota continues to ensure there is a wide supply in the market and the protected status encourages more start-ups as key talent can spin out of bigger groups to start their own companies. The number of SME businesses in the UK commissioning market remains high with at least 50 new start-ups entering the market every year.<sup>2</sup>

There has never been a formal complaint to Ofcom - by any party - about the operation of the legislation for both the Terms of Trade and Indie quota, which is underscored by the fact that two reviews since 2004 have found them to be fit for purpose.

The system fosters entrepreneurialism and enables anyone to monetise their own creativity. Barriers to entry in the indie sector are incredibly low: with one good idea, even the smallest companies can create hits that are exported across the world.

This has created a flourishing, thriving British industry comprised of hundreds of small, innovative businesses. 83% of indies are SMEs – and the greatest growth in the industry is coming from the smallest companies.

The economic success stories of UK indies have ripple effects in local economies across the whole of the UK. Other industries, from catering to post-production services, are dependent on a buoyant, healthy indie sector and benefit from its success.

The market share of the big four public service broadcasters has barely changed since 2003, still representing 77% of demand in the market. The BBC and Channel 4 are the dominant players.

Given the benefits which the Terms of Trade and Indie quota have brought to the UK creative economy over the years, we question the rationale for Ofcom's call for evidence into these rules.

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<sup>2</sup> O&O strengthening UK Culture and Creativity, 2020

Pact considers that seeking any potential changes to the rules could have a significant impact on the UK production sector including for audiences, the financial sustainability of producers and commissioners and to the diversity and attractiveness of the sector.

Changes to specific features of the regulation could have significant negative effects, for example, if Ofcom decided to limit the qualifying status of indies for the Indie quota to company turnover thresholds, this would disproportionately affect SMEs. The report by O&O in Annex 2 outlines this in more detail. It found that if the PSBs were required to honour the Terms of Trade when commissioning content from smaller producers, but that larger producers (regardless of ownership) were excluded, then this would incentivise the broadcasters to use their market power in order to secure more favourable terms with the producers who fell outside of the scope of the regulations. Rather than aiding the growth of SMEs, limiting the size of company who can qualify for the regulatory benefits is likely to work against them.

Amending the Terms of Trade guidance and Indie quota would not only jeopardise all the gains of the last eighteen years, and risk destroying the independent sector, but it would also push up the cost of commissioning high-quality PSB content, which surely is not in the broadcasters' interests.

In this submission, we outline the key arguments as to why we believe that the regulation governing the UK independent TV production sector – primarily the arrangements that frame the Terms of Trade, and the 25% independent production quota – are working well and should be maintained. We also include a commissioned piece of research by Oliver & Ohlbaum as an annex to this submission in order to support our findings:

## Introduction

- 1) Pact is the UK trade association which represents and promotes the commercial interests of independent feature film, television, digital, children's and animation media companies.
- 2) The UK independent television sector is one of the biggest in the world. Despite the difficult economic climate, independent television sector revenues have grown from £1.3 billion in 2005 to approximately £3.3 billion in 2019.<sup>3</sup>
- 3) The success of the UK independent sector is underpinned by an effective light-touch regulatory regime. The requirement in the 2003 Communications Act for Ofcom to produce Codes of Practice, which underpin commercial negotiations between Pact, on behalf of independent producers, and each of the PSBs affords protections for indies against the market power of the PSBs, and it enables the PSBs to seek agreement from rights holders when they wish to use additional rights to launch new services.
- 4) The fact that the Terms of Trade have evolved over time, and that there has never been a formal complaint about them brought to Ofcom by any party, shows that they continue to operate well.
- 5) Pact welcomes the opportunity to input into this call for evidence. We see it as an opportunity for Ofcom to examine the sector in greater detail, which can then enable a period of certainty for the sector, without any further regulatory reviews.
- 6) For further information, please contact Pact's Head of Policy, Emily Oyama, at [emily@pact.co.uk](mailto:emily@pact.co.uk).

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<sup>3</sup> Pact Census Independent Production Sector Financial Census and Survey 2020, by Oliver & Ohlbaum Associates Ltd (2020)

## Overview

1. Terms of Trade and the independent production (Indie) quota benefits all sizes of indies and is one of the main catalysts for talent and producers to work with the PSBs over and above any other provider. The fact that the sector is succeeding year-on-year through increased international revenues does not dilute the continued need for the carefully balanced regime to continue. The increase in originated content being commissioned from UK indies by platforms and international channels has benefited audiences, PSBs and indies of all sizes.
  - **Audiences:** have enjoyed higher quality content as platforms operating on scale are spending for global purposes. As a result, UK audiences get to benefit from any scale enterprises either as a subscriber or as a licence fee payer. Licence fee payers also benefit from these scale enterprises as often productions commissioned by PSBs rely on third party investment (which could involve platforms and international channels). In total, the PSBs received third party contributions of £455m in 2018. For PSBs excluding ITV, third party investment more than doubled from £150 million to £364 million over the period from 2008 to 2017, an annual growth rate of almost 10 per cent.<sup>4</sup>
  - **PSBs:** PSB spend has been boosted by third party investment which includes co-production agreements and deficit funding from independent producers both of which involve working with platforms or international channels either via secondary sales or through co-funding productions.
  - **Indies:** through secondary sales and exploiting their own IP can invest in development and build businesses of scale; the system continues to allow growth. The ability to exploit IP allows indies to ensure they maintain profit margins which in turn builds their businesses. This allows all companies to benefit from the system. For example, smaller indies tend to invest 4.5% of their revenues (which includes secondary exploitation revenues) into research and development.<sup>5</sup>
2. If we moved to a world where any adjustments of the Codes of Practice were put in place it could have a chilling effect on the market particularly at such a precarious time within our industry – where shoots of recovery are only just beginning. Indies need certainty to invest, and to take the risks that result in the most innovative programmes.
3. Ofcom evidence and rationale behind a review between the PSBs and UK production sector is unsatisfactory and fails to thoroughly acknowledge and consider the original features of the intervention:
  - a. To counterbalance the negotiating strength of the broadcasters;
  - b. To reduce the detrimental effects of the vertical integration of programme production by PSBs;
  - c. To secure more independent production outside London.
4. Furthermore, it overlooks the overarching objectives of the regime<sup>6</sup> which are to:

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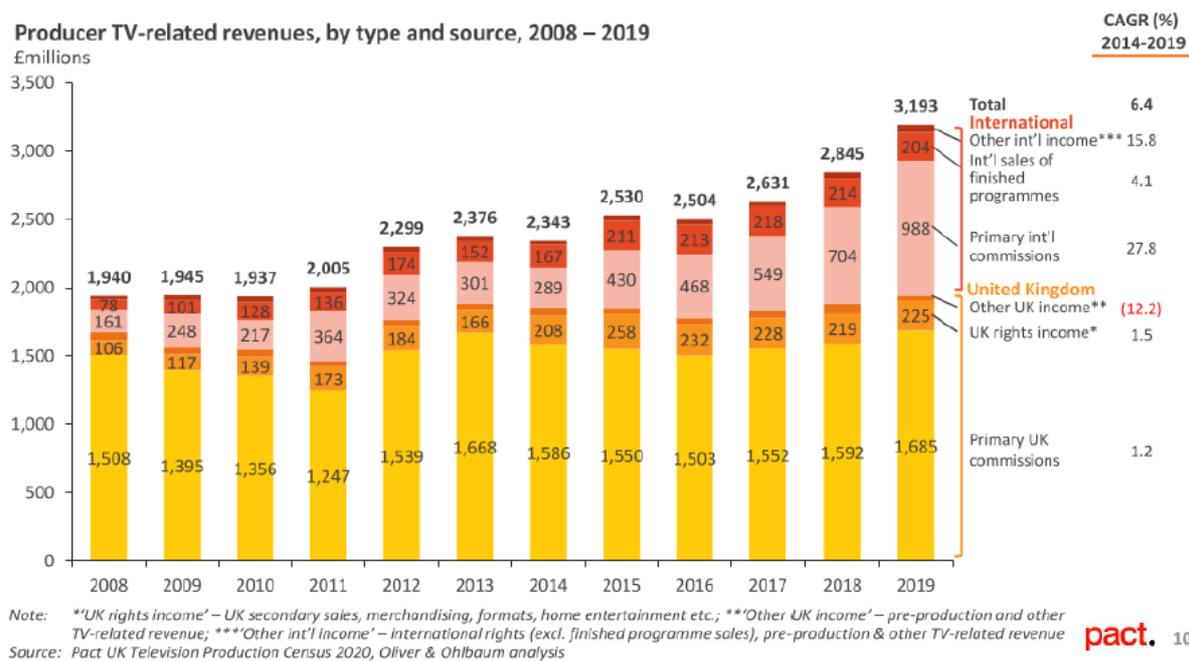
<sup>4</sup> Oliver and Ohlbaum report, Call for Evidence: Public Service Broadcasters and the UK production sector, 2020

<sup>5</sup> IBID

<sup>6</sup> Review of the operation of the television production sector, Ofcom 2015

- promote cultural diversity and open up the system to new energies and voices: where the best programme ideas originate from across the whole market and external producers often cater for a wider mix of genres;
  - stimulate SME growth, promoting creativity and fostering new talent: where reducing barriers to entry enables indies to establish themselves as SMEs, promote British intellectual property, and attract overseas investment to a strong domestic sector;
  - balance vertical integration trends: the vertical integration of broadcasters and producers in the supply market can lead to a lack of diversity of supply and therefore not deliver a broad range of genres or value for money.
5. Ofcom’s market analysis of production revenue between the UK broadcasters and the indie sector is overestimated and unclear. Notwithstanding that the majority of money spent on UK commissioned programmes is with the independent sector Ofcom assumes this to be £1.5bn more than UK broadcasters when in fact the figure is around £500m.<sup>7</sup> Ofcom has included the international revenues of the production sector but not compared this with the UK broadcasters’ international revenues. When international revenues of the UK broadcasters are included the difference narrows to £200m in favour of the independent production companies.<sup>8</sup>
6. Pact considers that the regulatory interventions, the Terms of Trade and the Indie quota, that have helped the sector grow to an over £3bn a year industry (as seen below), should not be brought into question. The regulations have been flexible enough to respond to the new demands of audiences and creates the environment needed for high quality, innovative and diverse content that audiences want to see.

**Figure 2: independent producer TV related revenues, 2008-2019**



<sup>7</sup> Annex 7 role of PSBs in the UK TV production sector, A7.26, Ofcom 2020

<sup>8</sup> Based on BBC Annual report, ITV annual report on BBC Studios and ITV studios 2020 respectively.

Source: *Pact Census 2020*

7. Despite the increase in revenues, demand is still driven by the buyers and the balance of power i.e., which underpins the rationale for the Terms of Trade, remains unchanged. 77% of the UK production revenues continue to be controlled by the top four PSBs.<sup>9</sup>
8. Section 285 of the 2003 Communications Act enables qualifying independent producers to share in the risk of programme production in a manner which would not be possible if they did not own their intellectual property rights.
9. The legislation requires Ofcom to issue guidance, in the form of Codes of Practice, which stipulate that there should be clarity in which rights are purchased by a broadcaster as part of a commission deal. The Codes of Practice form the basis on which Pact and each of the PSBs negotiate the Terms of Trade.
10. Without the regulatory protection which indies receive under the Terms of Trade, many thriving television production companies would quite simply have to close. Without the Terms of Trade, companies would revert back to being solely work-for-hire service companies who operate by charging a production fee on commissions. It would hinder producers' ability to develop ideas and retain staff. UK producers are key contributors to not only the UK economy but also the wider creative economy and job creation.
11. Work-for-hire entities are not attractive to creative talent either, so the impact of removing the Terms of Trade protections will likely lead to significant talent moving to global streamers, where they can see better income opportunities. One of the determining factors in attracting and engaging creative talent is the incentive for them to invest in and nurture their own ideas and businesses, with the potential earn-outs that enables in the long-term. That market growth of UK talent will be stymied by a reversal of the current regulatory framework.
12. If indies aren't able to trade on their intellectual property (IP) rights in its current form, then they won't be able to continue to invest in their businesses. This would have a detrimental effect on the UK creative economy, and would be felt both on-screen, with a reduction in competition and therefore diversity of ideas and efficiencies keeping costs down; and off-screen, given that the sector is a major employer.
13. The UK TV production sector is a delicate ecosystem of regulation which underpins entrepreneurial investment. Because indies are operating at maximum efficiency, sharing risks in production with the commissioning broadcasters by investing their own money into R&D and programme production, the market is very efficient.
14. We therefore see no evidence presented that there is a structural issue with the market as it currently stands.

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<sup>9</sup> Pact Census 2020, Oliver and Ohlbaum

15. As noted in the Executive Summary, we have supported our submission with a detailed report from Oliver and Ohlbaum, which is attached as an annex.

**Question 1: Given changes to audience consumption patterns and wider market developments, is there any aspect of Ofcom's Guidance on commissioning of independent productions which Ofcom should update to ensure it remains fit-for purpose?**

- 1.1 Ofcom must answer key questions on what evidence they have that shows the current system needs updating. The Codes of Practice that PSBs use to negotiate with indies are flexible and high level enough for both PSBs and indies to negotiate adapting to audience consumption patterns and technology changes. Most recently new Terms of Trade were concluded with the BBC which extended the initial rights window to 12 months on all content it commissions with initial payment and new Terms were also agreed with Channel 4 which applies to all productions commissioned.
- 1.2 The wider market developments do not underpin a fundamental change in the relationship between indies and PSBs. UK PSBs still represent 77% of the UK commissioning market.<sup>10</sup>

*Wider market developments: how both PSBs and indies can harness global markets*

- 1.3 Pact agrees that the wider market is changing with new service providers investing in content – Netflix, Amazon etc. Independent producers are embracing these new markets. Greater competition and investment in the sector is a good thing. In fact, this is a sign of the regime working, as attracting international investment in order to grow the domestic market helps to stimulate SME growth. PSBs are also benefiting from these changes and the Terms of Trade enables them to accommodate changes within the current rights or enables opportunities for further negotiation.
- 1.4 PSBs benefit from the current system because when they commission a programme from an indie an opportunity to lower costs will be built into the system, especially if the producer is able to attract extra financing to meet the costs of a production budget. This enables PSBs to continue to provide high quality programming for their audiences for a fraction of the price in particular high cost genres but increasingly this is happening across a range of programming. For example, premium dramas from major SVOD services such as Netflix and Amazon Prime range in the £10m GDP per episode range, while a prime PSB drama is more likely to sit in the £2-£3m GDP range.<sup>11</sup> All indie productions rely on secondary sales to monetise international rights and to grow their own companies. UK VOD rights often are disproportionately valuable and a key component of any global or multi-market deal when negotiating with the likes of Netflix or Amazon. In research we commissioned O&O to complete in 2019 it found that 'UK secondary sales form an important part of the producer's assessment of whether a project is viable. 'and that 'The importance of secondary sales has been exacerbated in recent years as producers are increasingly required to deficit finance productions. In

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<sup>10</sup> Pact Census O&O, 2020

<sup>11</sup> Oliver and Ohlbaum report, Call for Evidence: Public Service Broadcasters and the UK production sector, 2020

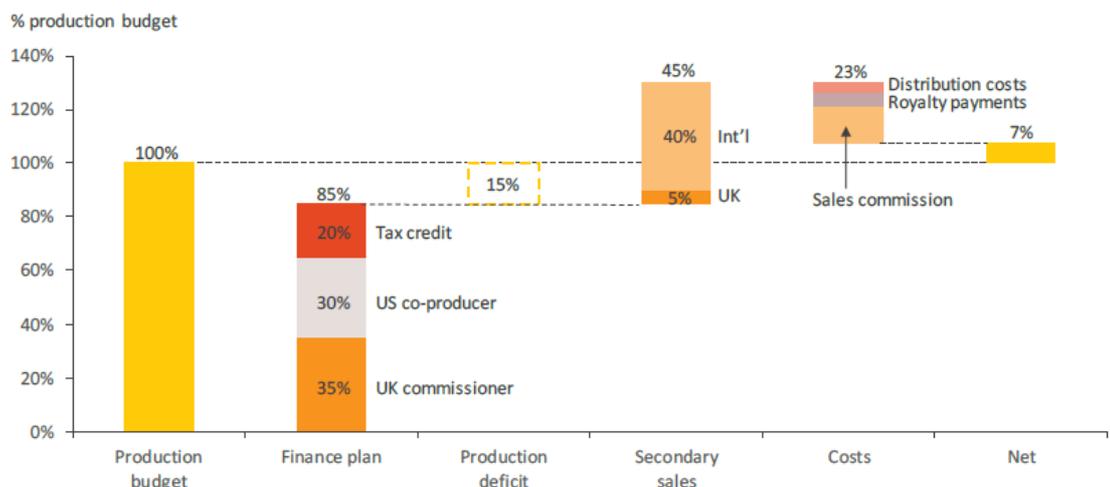
some cases, this means taking no production fee and thus relying solely on secondary rights to make the project a financial success.’<sup>12</sup>

- 1.5 If any element of the Codes of Practice were to stipulate different terms for different genres there would be significant impacts on the incentives for SMEs to grow and invest in their company. Narrow or change the arrangements that frame the Terms of Trade to suit a particular genre and the diversified supply may dwindle. There would also be fewer incentives for companies to build on their creative successes and limit the opportunity to grow their business.

**High End Drama finance modal**

Below is an illustrative example of how a finance model for high-end drama could be put together. In this case it is with an international broadcaster as the co-producer. Note that there remains a 15% gap in the finance for the production budget. This gap is filled by advances from distributors, who decide whether to cover this deficit based on the likelihood of secondary sales, either in the UK or internationally. Expected revenue from UK secondary sales might be around five per cent of the programme budget, making it an important consideration when assessing the financial viability of a project.

**Fig 3 Illustrative Finance model for high-end drama**



Note: To protect commercially sensitive information, the programme titles used in the text are not necessary those provided to us by producers and may not be accurately represented by these finance model illustrations. This chart is illustrative of a UK/international broadcaster co-production; global SVoD shares of co-production budgets are likely to be higher.  
Source: O&O analysis and estimates

- 1.6 Ofcom must bear in mind that at the point of commission the likelihood of success and therefore recoupment is driven by whether a programme will be a hit. This is always an unknown and therefore any arrangements of the terms that frame the Terms of Trade should not be constrained by perceived levels of deficit financing that any programme

<sup>12</sup> IBID

genre could bring. This would constrain and punish indies who in turn would be hampered in how they could reward talent if a programme was to be a success.

- 1.7 PSBs may not realise quite how beneficial the Terms of Trade arrangement may be for them in terms of attracting high quality producers and ideas to fill their schedules and platforms. One way that has differentiated PSBs against others in the market is the opportunity for producers to exploit the intellectual property after the initial licence period. This incentivises the producer to make the programme with the PSB rather than an SVoD which as Ofcom identifies most often holds all the rights upfront 'through global deals for all rights in all windows'<sup>13</sup>
- 1.8 International co-production of programmes with the PSBs by SVODs and other non-UK broadcasters creates a symbiotic relationship, enabling original programme commissions, which the PSBs may not otherwise be able to finance. PSBs can harness the global TV sector to fund an increasing share of their schedule/content.
- 1.9 We disagree with Ofcom's assumptions that UK TV market is markedly different from 2015, the last time a review took place, and that international platforms like Netflix are now part of the domestic UK commissioning market. SVoDs commission ultimately with a global audience in mind.
- 1.10 In research we commissioned Oliver & Ohlbaum to carry out, they noted that as SVoDs have 'matured, they have begun to focus on commissioning their own programming and have helped drive the demand for global commissions, with Netflix's multi market footprint in particular leading it to commission programmes such as *House of Cards*, *Orange Is the New Black*, and *The Crown*, for a global audience.'<sup>14</sup> Furthermore in interviews carried out by O&O they found that SVoD content buyers were drawn to working with UK based producers and the production sector because of the ecosystem that exists here which is differentiated by its 'creative diversity' and that ultimately the highly valued British approaches bring 'real global appeal'.
- 1.11 SVoDs form a very small part of the indie sector's commissioning opportunity. In research we commissioned Oliver and Ohlbaum to carry out they found that compared to £2.6 billion of PSB investment, SVODs spent £0.4 billion on UK originations in 2019.<sup>15</sup> The PSBs delivered over 32,000 hours of UK original content in 2018, compared to 221 hours of SVOD original productions made in the UK.<sup>16</sup> To illustrate this further if we take a look at drama commissioning of 190 original TV dramas released by Netflix in 2018/19, twelve were 'UK'. For Amazon Prime this was three out of 45.<sup>17</sup>

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<sup>13</sup> Ofcom, Small Screen:Big Debate consultation -The Future of PSM, Dec 2020

<sup>14</sup> Oliver & Ohlbaum: Strengthening UK Culture and Creativity in a globalising TV marketplace, 2020

<sup>15</sup> Oliver and Ohlbaum report, Call for Evidence: Public Service Broadcasters and the UK production sector, 2020

<sup>16</sup> IBID

<sup>17</sup> IBID

**Figure 4 Number of SVoDs original TV dramas**

NUMBER OF 2018-2019 ORIGINAL TV DRAMAS						
	Released in total	UK	UK producer	Filmed in the UK	Featuring UK talent	2019 titles
<b>NETFLIX</b>	190	13	12	12	12	<ul style="list-style-type: none"> <li>Sex Education</li> <li>Criminal: UK</li> <li>After Life</li> <li>Black Mirror</li> <li>The Crown</li> <li>Top Boy</li> </ul>
<b>amazon</b> Prime Video	45	3	2	2	3	<ul style="list-style-type: none"> <li>Good Omens</li> <li>Ripper Street</li> <li>The Collection</li> </ul>

*Note:* Does not include co-productions with a broadcaster where the show was not released on SVoD before appearing on linear TV. 'Talent' refers to actors and/or directors. 'UK producer' means that a UK production company was involved.

*Source:* IMDB, ScreenDaily, Netflix, Amazon, Oliver & Ohlbaum analysis

PSBs continue to account for most of the UK TV revenues for producers - 77% of programme spend and PSB in-house and owned production companies continue to make just under half of the programmes commissioned in the UK.<sup>18</sup> The independent production sector continues to make just over half of all UK PSB content – again this is relatively unchanged to 2015.

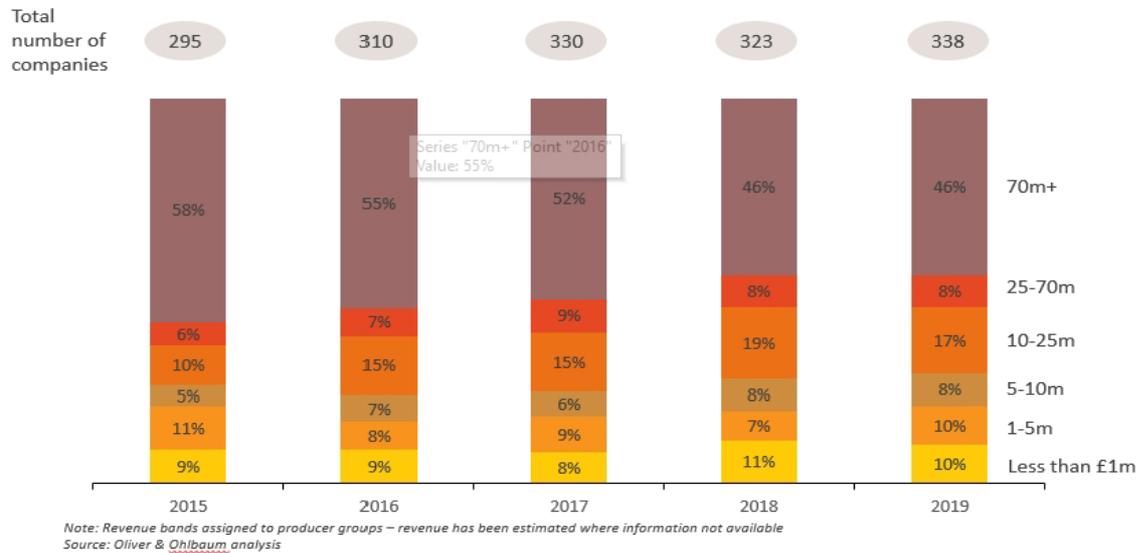
- 1.12 What has changed is that the spread of SMEs being commissioned by all PSB channels has increased whilst in 2014 there was a spread of between 19%-36% of SMEs being commissioned by the PSBs<sup>19</sup> this has now increased to between 31.9% to 50.5%.<sup>20</sup> This again shows that the system is helping to increase the opportunities for all sizes of companies.

<sup>18</sup> Oliver & Ohlbaum: Strengthening UK Culture and Creativity in a globalising TV marketplace, 2020

<sup>19</sup> Oliver and Ohlbaum, UK Independent TV production – Engine of Growth and Renewal, 2015

<sup>20</sup> Oliver and Ohlbaum report, Call for Evidence: Public Service Broadcasters and the UK production sector, 2020

**Figure 5 Share of UK first-run originated hours split by producer revenue band**



*PSBs reaction to wider market developments: Distribution Strategies*

1.13 The wider market developments and audience consumption patterns has pushed PSBs in recent years to strategically push for an extension to its prominence regime. This focuses on using distribution as the primary way to attract and maintain audiences. Pact considers that distribution-led strategies on their own are not going to attract and retain audiences that have grown up with access to global streamers. Ofcom must also acknowledge that PSB commissioners play a part in choosing what content they put on their platforms and schedules and this could play a part in audience migration; suppliers cannot be punished for the editorial choices of the PSBs. No matter how much content is available to audiences it must continue to be high-quality and relevant to audiences particularly to stem the migration of younger audiences. Creating a protectionist broadcasting sector is not the solution. Increased innovation, with different cultural voices and more diversity in our industry is key.

1.14 Ofcom’s own research into PSB viewership found that ‘younger audiences would like to see more of the high-quality, original content that is relevant and appealing to them.’<sup>21</sup> It also found that ‘Gen Z audiences feel that the PSBs should make more of the high-quality content that is relevant for their age cohort. Almost all this audience feel that there is not enough of this type of content at present to keep them coming back without prompting from their peers or through something they see.’ Indies are a key part of catering to this younger audience and the very system that Ofcom is calling into question has done much to keep up with the demands of audiences.

<sup>21</sup> An exploration of people’s relationship with PSB, with a particular focus on the views of young people, Jigsaw/Ofcom – July 2020

## Terms of Trade nurtures the diversity of UK programming

Independent production companies produce a range of high quality programming for the PSBs that helps the PSBs not only meet their PSB obligations, but also draw in big audiences.

*First Dates* produced by TwentyTwenty for Channel 4 remains of the channels most popular factual entertainment series. The programme is now in its thirteenth series and production has now moved to Manchester.

*It's a Sin* a drama mini series for Channel 4 set in the 1980s and depicts the lives of a group of gay men and their friends during the HIV/AIDS crisis in the UK. The programme, produced by Red Production Company, was filmed in various locations across the North West of England and has so far amassed over 6 million viewers in the UK.

*People Just Do Nothing* a BAFTA and RTS award winning mockumentary series for the BBC and produced by Roughcut follows the lives of a group of friends who run a pirate radio station in West London.

*Murder Case*, a documentary series on BBC, follows Scottish police as they investigate some of the country's most complex crimes. The second series of the BAFTA and RTS Scotland winning programme was filmed across a number of years by Firecrest Films, a small but fast-growing indie based in Glasgow.

*A&E After Dark* is a documentary series which follows the A&E team on the nightshift in Hull. The programme was produced for Channel 5 by Crackit Productions, who have offices in Manchester and London.

*Waffle the Wonderdog* is a live action children's series produced by Darrall Macqueen for CBeebies. Each episode is based around everyday issues that affect young children. The series is hugely popular and has been viewed on iPlayer 24 million times.

*Keeping Faith/ Un Bore mercher*, produced by small Welsh indie Vox Pictures for S4C, is a thriller series filmed in both Welsh and English across a variety of locations in Wales. The programme was not only extremely popular in Wales but was also a hit after airing on the BBC in England.

*Only Connect* a quiz show for the BBC produced by Parasol Media, a small indie based in Cardiff, has been dubbed Britain's hardest quiz show and has remained a key part of the BBC's schedule since 2008.

1.15 The Terms of Trade and the related guidance on commissioning indies is important for audiences, indies and PSBs for the following reasons:

- **Audiences:** The guidance sets out the principles to be applied when PSBs negotiate terms with indies which includes how IP rights might be exploited. Exploitation of IP rights have played a key part in maintaining high-quality content and the creative diversity of ideas that the public can benefit from.,
- **Indies:** Through the flexible legislation and the success of UK creative entrepreneurs, indies have been able to grow hugely successful global businesses by exploiting rights for content made originally for UK PSBs.

- **PSBs:** This revenue also benefits PSBs who are able to continue to provide high quality content for a reduced price. The flexibility of the legislation in Section 285 of the 2003 Communications Act and corresponding guidance from Ofcom has enabled PSBs to utilise content in longer windows – most recently this applies to the new terms agreed between the BBC and Pact on iPlayer which gives the BBC the opportunity to exploit third-party content for longer whilst at the same time remunerating producers for a bigger share of the back end.

### *The indie development and production cycle*

1.16 Through owning their intellectual property (IP) rights, indies are able to invest in the development and production cycle at several key stages. Any changes in the guidance on commissioning indies could have unintended impacts throughout the development and production cycle as exploitation of IP forms a vital component at each stage. Alongside investment in R&D, producers also invest in the training and recruitment of new and existing employees as their businesses scale-up and grow. This also benefits broadcasters as these employees often go on to work for them and bring in the skills and expertise learned at production companies. Ensuring the sector has a suitable supply of highly skilled workers in a range of genres to meet demand is vital for the whole broadcasting ecology in the UK. Which is why producers, and the broadcasters, contribute to training schemes such as the high-end TV skills fund, animation skills fund, children's TV skills fund, and the TV skills fund all run by ScreenSkills.<sup>22</sup> The high-end TV skills fund, for example, has raised over £17 million since it was established in 2013, and productions such as *The Crown*, *Killing Eve*, and *Sex Education* have all paid into the fund.

### *Development*

- 1.17 The first stage of the production cycle is in research and development (often referred to as R&D). It is extremely expensive and time consuming to invent, research and develop programme ideas to a stage at which they might be commissioned. For example, high-end drama, which requires scripts and talent attachments to the project can cost an estimated £297,000. Whereas comedy, which often requires a pilot script or episode outline, can cost an estimated £223,000.<sup>23</sup> Independent producers invest millions of pounds in R&D each year, which brings considerable benefit to the UK PSB ecology. Very little of this is ever recouped, with many projects developed and never commissioned.
- 1.18 If a broadcaster is interested in a project, it might put some money towards the cost of funding development. This in effect locks the producer out of the market in terms of preventing the idea being taken elsewhere while the original broadcaster is considering it.

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<sup>22</sup> Further information on ScreenSkills funds and training can be found here: <https://www.screenskills.com/industry/>

<sup>23</sup> From Pact discussions with distributors

1.19 If a producer accepts development funding from a broadcaster before it receives a commission, this opens the door to further dialogue with the commissioner, which is valuable to the production company. However, pilots and other forms of development are often expensive and it is extremely rare for the producer only to use the broadcaster's money in development. In order to try to win a commission in this highly competitive industry, the producer will often add their own investment into funding further development. If the project is commissioned, it is likely that they will be able to recoup. However, if the idea is not commissioned, the producer is liable for the full costs of the development and must also repay the broadcaster who originally put in the development funding if their idea is commissioned at a later date by a different broadcaster. It is unlikely that the new broadcaster would pay the full cost of the earlier development, thereby leaving the producer out of pocket for the money which they invested, even if the programme is eventually commissioned.

#### *Production*

1.20 Moving from development to the production process, it is becoming increasingly rare for a UK PSB to pay for the whole cost of producing a television programme. For example, in a commissioned piece of research O&O found that 'Industry estimates suggest that today only 55 per cent of BBC commissions are fully funded, with the remaining 45 per cent depending on co-production or deficit finance.'<sup>24</sup>

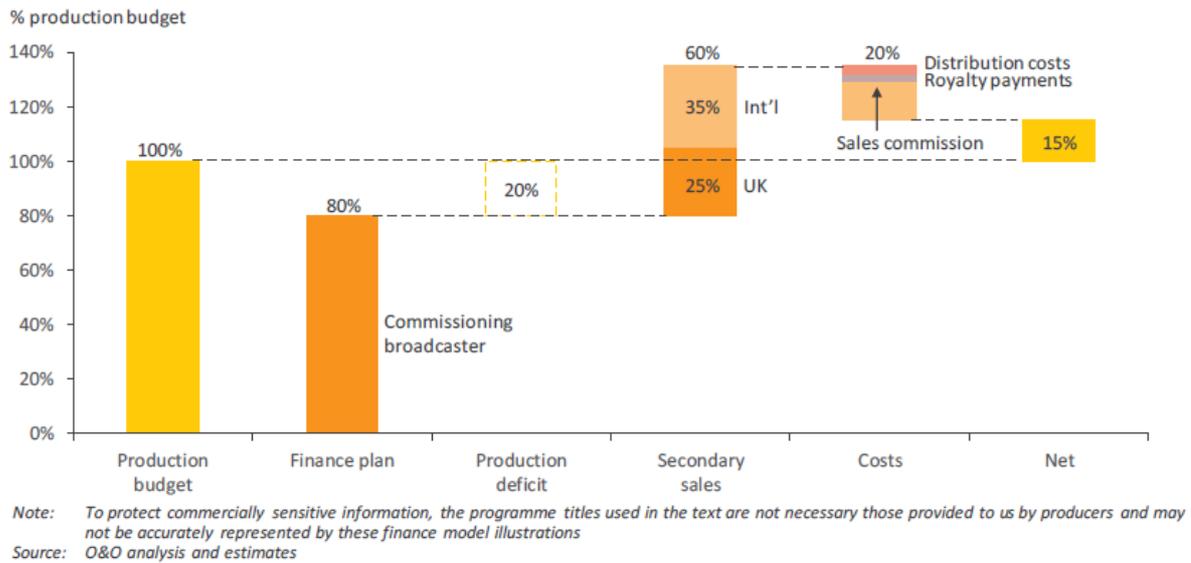
#### *Distribution Exploitation*

1.21 The commissioning broadcaster will often pay for a percentage of the programme budget – the amount varies widely, depending on the genre – and the producer will fund the deficit through presale agreements and by investing money which it calculates it will be able to make back from finished programme sales. Distributors often invest a certain percentage of the production budget as part of presale agreements.

#### **Figure 6 Illustrative Finance Model for Mid Drama and Comedy**

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<sup>24</sup> IBID



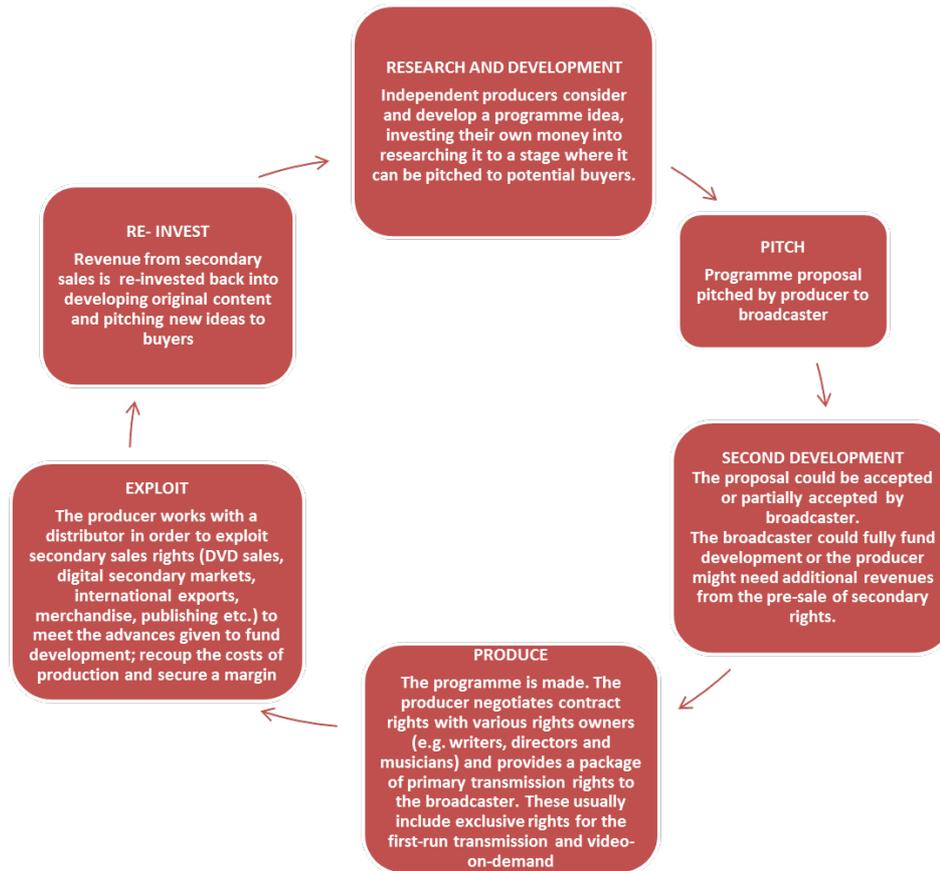
1.22 The amount they contribute will depend on a number of factors such as the producer’s track record, genre, international sales forecast, and the UK rights availability. So for example, a popular genre with high profile talent attached being produced by a production company that has a well-established relationship with the distributor may get an advance of around 30% of the production budget. The producer might also seek a co-production deal with an overseas broadcaster who could also invest in the cost of programme production.

1.23 Some of these sources of finance are known at the outset i.e. the amount on offer from the primary commissioner or co-producer but the remaining elements of secondary sales will be estimated.

1.24 This means that expectations of what can be achieved in secondary rights windows is important. The current arrangements that frame the Codes of Practice ensure that indies have onward rights exploitation. Secondary sales can be the source of income which determines whether a project is expected to cover all of its costs and become financially viable for the producer.

1.25 This demonstrates how the UK independent production sector and IP exploitation impacts all points of the production cycle and plays a critical role in supporting UK public service broadcasting.

**Figure 8: the TV programme production cycle**



1.26 Ofcom must consider the above process when considering how best to implement any future PSM framework and understand how crucial the PSB obligations to the Terms of Trade plays a key part in the production cycle. As evidenced above there are risks associated with amending even one element of the guidance which underpin the Terms of Trade. What might appear to be a small change to these Guidance notes – for example, by stipulating different arrangements for primary (i.e. TV) or secondary rights (e.g. the resale of rights after they have initially been aired, for example to another broadcaster in the UK or abroad, or to a digital distribution platform such as Netflix) - could have a material effect on the ability of independent producers to monetise their intellectual property, and therefore their ability to continue investing in original content production..

1.27 Given the fragility of the market due to COVID-19 further disruption as a result of any amendments to the Ofcom guidance will have a chilling effect on the market and freeze investment.

1.28 There has never been a formal complaint to Ofcom - by any party - about the operation of the legislation. And two reviews since 2004 have found them to be fit for purpose.

*Removal/amendment of the existing rules could damage the successful PSB ecosystem*

- 1.29 Some discussion has been had previously about removing the current production sector rules. We have commissioned Oliver and Ohlbaum to look more closely at how this would impact the sector, which is annexed to our response.
- 1.30 The report found that if the rules were changed ranging from broadcasters taking a larger share of global rights to allowing for broadcasters to control more rights within the UK secondary market it would have significant impacts on the whole system – triggering a steady decline for both the PSB system and UK indies. The current system relies on an interdependent relationship between broadcasters and the indie sector.
- 1.31 The system would revert to producers operating on a work-for-hire basis and the diversity and increase in SMEs participating in the market which we see today would fall away. These SMEs would occupy a much smaller share of the market returning to the shape of the market in 2001, before the Terms of Trade were introduced. Furthermore, those larger indies would likely consolidate and the existing PSB Studios would acquire more of the smaller indies. This scenario would also impact the movements we are beginning to see in more Nations and Regions indies being commissioned by PSBs. PSB commissioning is a major source of programme demand outside London. In 2019, almost half of spend by PSBs was outside of London (up from 38% in 2009)<sup>25</sup> and PSBs represented 61% (c.£600m) of commissioning revenue for independent producers in these areas<sup>26</sup>.
- 1.32 O&O also considered the impact this would have on SVoDs who although commission within a different market to PSBs play a considerable part in the wider UK AV ecosystem. O&O found that there would be ‘a gradual decline in attractiveness of the UK market to SVOD in terms of levels of creativity, skills, and potential producers or co-commissioners’. Subject to the attractiveness of UK tax reliefs, we could expect SVOD and multi-channel providers to use the UK as an industrial service provider to produce global content for a global market (as is happening in Australia and Canada).<sup>27</sup> This would reduce the indie sector towards becoming a service provider for SVoDs and PSBs and in turn with lower market entry by new independent producers, the broadcasters could not rely on sustaining their vitality through acquisitions. Instead, we would expect a gradual impact on the PSBs’ ability to commission the most innovative and diverse ideas for UK audiences and a corresponding fall in international demand for PSB exports.<sup>28</sup>
- 1.33 Whether ITV and BBC Studios alone would be incentivised and nimble enough to exploit the international markets remains to be seen. History suggests that broadcasters will not have the vibrant energy and incentives that the indie sector has to make the

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<sup>25</sup> Ofcom analysis of qualifying broadcaster spend data submitted in relation to the Made-out-of-London regulations

<sup>26</sup> Ofcom analysis of broadcaster data; Pact census 2020, Nations and Regions Annex

<sup>27</sup> Oliver and Ohlbaum report, Call for Evidence: Public Service Broadcasters and the UK production sector, 2020

<sup>28</sup> IBID

most of global markets. As O&O found 'the increasing market share of commissions taken by independents in the seven to ten years that followed Terms of Trade introduction was accompanied by a 22 per cent a year annual growth in exports to the rest of the world by the combined UK content sector. Distributors, including BBC and ITV, have to offer competitive terms to producers and to show results.'<sup>29</sup> Roll back these incentives and competitiveness in the market would bring suboptimal results.

**Question 2: Is there any change to the independent production quota which Ofcom should recommend to Government as part of its 'Small Screen Big Debate' programme?**

2.1 The 25% independent production quota for PSBs as set out in 1990 Broadcasting Act ensures that there is a diversity of supply to the UK's public service broadcasters. The aim of the independent production quota is threefold:

- to promote cultural diversity and to open up the production system to new energies and voices;
- to stimulate the growth of small and medium-sized enterprises, promoting creativity and fostering new talent; and
- to tackle vertical integration within the UK programme supply market.

2.2 Government reconfirmed this intention in 2014 in its introduction of the 2014 amendments of the indie producer definitions, at the time Lord Gardiner of Kimble confirmed that 'it is widely considered that the independent productions quota has been working well over a number of years, providing competition and a stimulus to originality that has benefited programme supply in the UK.'<sup>30</sup> Pact considers that the three branches of rationale continue to be relevant today - we will explain in the following paragraphs why each original rationale behind the indie quota continue to be relevant to today's UK media landscape:

*Cultural diversity*

2.3 By requiring PSBs to commission from indies it continues a wide supply of voices to be represented. This also helps PSBs to meet their PSB purposes of which representing diversity and alternative viewpoints is one key purpose. Looking to the future Pact considers that this will become more important than ever as Ofcom note that young people in their survey found that they put greater emphasis on programmes that reflect the diversity of the UK and distinctiveness (programmes with new ideas and different approaches).<sup>31</sup>

*Stimulate the growth of SME enterprise*

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<sup>29</sup> IBID

<sup>30</sup> [Broadcasting \(Independent Productions\) \(Amendment\) Order 2014 - Monday 17 November 2014 - Hansard - UK Parliament](#)

<sup>31</sup> [Public Service Broadcasting: omnibus survey findings \(ofcom.org.uk\)](#), Ofcom 2020, page 1

- 2.4 The number of new companies starting up in the UK is testament to the system continuing to work; in a report we commissioned O&O to complete on the production sector it found that at ‘least 50 new independents spring up in the UK every year’<sup>32</sup> showing that there are low barriers to entry but high hurdles in terms of achieving a hit in an intensely competitive market. The share of the UK PSB commissioning market taken by super-indies is lower today than it was back in 2010.<sup>33</sup>

*Tackle vertical integration within the UK programme supply market*

- 2.5 Vertical integration within the UK programme supply market has continued to be an aspect within the UK programme supply market particularly if you look at the UK public service broadcasters who now have commercial arms to their entities. Although much has been made about the vertical integration of independent producers over the last 10 years this has done little to impact the buyer power that continues to exist in the UK commissioning market. None of the independent producers within the UK have as much as a direct link to production and distribution lines as much as BBC Studios. What is more significant now compared to 2015 is the fact that we have also have a significantly vertically integrated BBC and some could say this poses more of a threat to the UK commissioning market than any of the increased producer revenues that the sector has seen in the last five years. The BBC now has a direct content pipeline that they could easily use to benefit themselves without necessarily being outside of Ofcom’s requirements, Ofcom is well aware of this and we acknowledge that much work has been completed to ensure BBC Studios and its distribution and production arms are operating without due influence but this marked change cannot be overlooked.
- 2.6 Pact considers that given the above, the requirement, as was Parliament’s rationale at the time of the introduction of this legislation, remains relevant and that it continues to be appropriate for the public service broadcasters, who receive privileged PSB benefits such as EPG prominence, and in the BBC’s case licence fee payer funding, in return for their PSB obligations, should be required to commission content from a larger pool of suppliers.
- 2.7 As noted above, we disagree with Ofcom’s assumption that the impact of increased international revenues is changing the relationship between PSBs and the UK production sector, especially in the supply side of the market. The balance of power remains with the PSBs as buyers.
- 2.8 In a new report we commissioned O&O to carry out it concluded that the UK programme supply market still has a highly concentrated buy-side, the level of public service broadcaster spend on new UK programmes is broadly comparable to 2004 at about £2.6 billion each year, 77% of demand in the market.<sup>34</sup>
- 2.9 The market therefore can still be said to operate on the basis of differentiated demand – i.e. each broadcaster looks for something different, making it harder for a single actor to consolidate supply or leverage a higher price from two rival buyers. From experience,

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<sup>32</sup> Oliver & Ohlbaum: Strengthening UK Culture and Creativity in a globalising TV marketplace, 2020

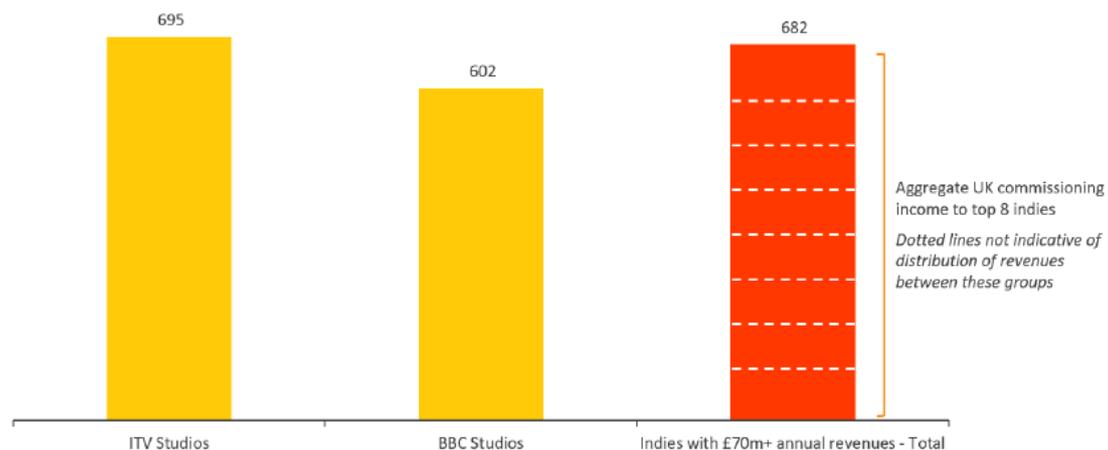
<sup>33</sup> IBID

<sup>34</sup> Oliver and Ohlbaum report, Call for Evidence: Public Service Broadcasters and the UK production sector, 2020

we know that it is extremely rare in the UK market for a producer to pitch an idea for a programme to more than one broadcaster at a time (which happens regularly in other markets, such as in the USA). In the UK, programme ideas are usually pitched with a particular broadcaster in mind and are tailored to fit with the channel’s unique brand and values.

- 2.10 While there are a number of larger indies within the market, no single independent group has been able to secure as great a share of the UK commissioning market as currently enjoyed by ITV Studios. The production arms of the BBC and ITV still capture a significantly larger share of the UK production market than any individual independent. As shown in **Figure 9**, ITV Studios’ reported UK production income is around the same level as *the eight largest indies combined*, and BBC Studios is not far behind (despite it excluding the BBC’s production activities relating to sport, children’s, and news content – which remained in-house when the rest of production was spun out in 2016).

**Figure 9: UK production revenues of BBC Studios, ITV Studios, and top 8 independent producers**



Note: Excludes spending on news, as well as BBC spending on children’s and sports production and inward investment  
 For this reason, totals here do not sum to the total shown in Figure 15  
 Source: ITV Annual Report, BBC Studios Annual Report, PACT annual census, Oliver & Ohlbaum analysis

- 2.11 The 25% quota helps to ensure diversity of supply for UK indies and there are a number of larger companies who no longer qualify for the quota, such as *All3Media*, *Warner Brother’s TV Production UK (formerly Shed Media)*, *TwoFour*, and *Eleven Film*.
- 2.12 Changing the regulations, for example, to only the smallest firms would be a disincentive to growth and difficult to implement. Research by Oxera<sup>35</sup> suggests this would reduce competition, innovation and quality from companies of all sizes. The introduction of a size threshold “would trigger a variety of effects, with possibly adverse

<sup>35</sup> Oxera: Assessment of potential changes to the terms of trade in the independent TV production sector, 2015

implications for producers both above and below the threshold”<sup>36</sup> This has also been reconfirmed in more recent research we commissioned O&O to complete where it found that ‘the independent production would be squeezed and either move out of the UK or become consolidated as a result of rolling back Terms of Trade, the 25 per cent quota and the fair trading framework.’<sup>37</sup> Incentives for talent to invest in and nurture their own ideas and businesses are vital for the long term growth of the sector. Remove this from the system and the vibrant sector and market growth of UK talent we see today will most likely disappear.

- 2.13 Pact considers that weakening the 25% independent production quota would just further increase the bargaining power of the PSBs and allow them to give more work to their own production units.

**Question 3: Do you have any recommendations for potential changes to the definitions of ‘qualifying programmes’ or ‘independent production’ which Ofcom should recommend to Government as part of its ‘Small Screen Big Debate’ programme?**

- 3.1 The current definition of independent production and qualifying programmes are working well, and Pact does not support any amendment made to these definitions. While we understand that Ofcom are seeking views on how amendments would benefit or harm PSM delivery, and the sector more generally; there is very little information and analysis contained within the consultation document on how exactly amending the definitions would benefit PSM.
- 3.2 The current definition of independent production is clear, encourages investment in the sector and addresses vertical integration. If the definition were to change and indies were to be defined by turnover for example, something which has been looked at in previous PSB Reviews, this would cause a number of practical procedural problems. Ofcom and the broadcaster would need to have an accurate understanding of the company’s turnover in order to comply with the indie quota. Questions over how this would be calculated without commercial confidentiality being at risk would arise, many companies within the indie sector have varying levels of turnover from one year to the next depending on what stage of the production cycle they happen to be in. It may be tempting to amend the definition of independent so only the smaller companies would classify as an indie, however the practicalities of this would make the system for defining an indie overly complex and impractical; and ultimately hinder the benefits to SMEs. In research we commissioned O&O to carry out it found that ‘it would weaken the incentives for new talent to set up or spin-off new production companies as there would

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<sup>36</sup> IBID

<sup>37</sup> Oliver & Ohlbaum: Strengthening UK Culture and Creativity in a globalising TV marketplace, 2020

be no path to growth while retaining their independent status with guaranteed IP with which to generate returns and attract investment'.<sup>38</sup>

3.3 The definition of a qualifying independent production as set out in the Broadcasting (Independent Productions) Order, which was most recently amended in 2014, remains fit for purpose.<sup>39</sup> Article 3(4) of the Broadcasting (Independent Productions) Order 1991 (as amended) defines an independent producer as a producer:

- Not employed by a broadcaster;
- Who does not have a shareholding greater than 25% in a UK broadcaster; or
- In which no single UK broadcaster has a shareholding greater than 25% or any two or more UK broadcasters have an aggregate shareholding greater than 50%.

3.4 The definition was amended in 2014 as there was an anomaly between the policy and the legislation as drafted. The legislation prevented producers connected with any non-UK/EEA broadcaster from qualifying as an independent producer. This did not properly reflect Parliament's intention which was that ownership ties between an independent producer and a broadcaster should not affect the independent status of the producer, unless the broadcaster operated television services in the UK. As a result of this, there were a number of producers who were part of a group of companies which also included a broadcaster which did not aim any broadcasts in the UK which could not be classified as independent and so their programmes could not count towards the indie quota. The purpose of the change was not to amend the definition itself but to reflect Parliament's intention, something which was commonly accepted for many years. During the 2014 amendments, no convincing arguments were made regarding the need to amend the definition. We note that Ofcom's consultation document also contains no argument as to why the definition should be amended and what benefit this would bring the PSBs or the independent production sector. We continue to consider that the definition of an independent producer based on ownership, as set out in the Order, remains fit for purpose and that any change could have a detrimental impact on the whole broadcasting ecology.

#### *Qualifying Programme*

3.5 Pact would not support any amendments being made to the current definition of qualifying programme. The qualifying programme definition needs to remain defined as it is currently, narrowing the breadth or widening the breadth of the definition will likely have unintended consequences. The definition of a qualifying programme should remain as a programme made by a qualifying production company.

3.6 The current definition excludes repeats and acquisitions, which we believe is correct and should remain in place. Allowing acquisitions to count as a qualifying programme would weaken the UK content market and ultimately the production sector. While the

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<sup>38</sup> Oliver and Ohlbaum report, Call for Evidence: Public Service Broadcasters and the UK production sector, 2020

<sup>39</sup> [http://www.legislation.gov.uk/ukdsi/2014/9780111118825/pdfs/ukdsiem\\_9780111118825\\_en.pdf](http://www.legislation.gov.uk/ukdsi/2014/9780111118825/pdfs/ukdsiem_9780111118825_en.pdf)

broadcasters do acquire some content, the majority of their content is first-run UK origination. First-run UK originations are what makes the indie sector so successful. This investment by the PSBs help grow businesses of scale and subsequently contribute to the UK economy and new jobs in the wider creative industries. While the PSBs do acquire some programmes, these are often already well-established popular shows, many of which are international. UK viewers want to see their own lives reflected on screen and much of the international content acquired by the PSBs does not do this and would not in fact be considered public service broadcasting. Ultimately, an increase in acquisitions may lead to a decrease in PSB content.