
Annex 2: The BBC's commercial and trading activities – requirements and guidance

Updated text for consultation

This version of our [requirements and guidance](#) shows where we propose to change some sections of text, according to the proposals set out in our consultation, [How Ofcom regulates the BBC's impact on competition](#).

Our revisions are marked up in yellow highlight. New text is simply highlighted (**example**), and text that we propose to remove has a line through (~~example~~).

Trading and separation requirements

Schedule

Part 1: Definitions and Interpretation

1. In this Schedule -

“Agreement” means the Agreement Between Her Majesty’s Secretary of State for Culture, Media and Sport and the British Broadcasting Corporation, dated December 2016;

“BBC Annual Report” means the annual report which is published each Financial Year pursuant to Article 37 of the Charter and which includes the statutory financial statements required by the Companies Act 2006;

“Budgeted Figures” means the numbers used in the BBC’s budgets and/or business plans which are also used by the BBC in calculating the Target Rates of Return;

“Charter” means the Royal Charter for the Continuance of the British Broadcasting Corporation, dated December 2016;

“Commercial Subsidiary” means a company which carries out Commercial Activities and includes: (i) BBC Commercial Holdings Limited; (ii) BBC Studios Group Limited which consolidates BBC Studios Limited and BBC Worldwide Limited; (iii) BBC Studioworks Limited; and (iv) BBC Global News Limited;

“Commissioning Requirements” means the requirements contained in paragraph 7 of Schedule 3 of the Agreement;

“Contracted Amounts” means, for the purposes of Requirement D.7(b), the amounts of Transfer Charges agreed as part of the service level agreements or the BBC’s budgeting process between the Public Service and any of its Commercial Subsidiaries before the relevant goods and/or services are provided;

“Enforcement Procedures” means Ofcom’s “Procedures for enforcement of BBC competition requirements” as published on 28 June 2017;¹

“Financial Year” means 1 April to 31 March;

“Joint Venture” means a joint arrangement whereby one or more Commercial Subsidiaries have joint control of the arrangement and have rights to the net assets of that arrangement;

“Operational Separation Statement” means a statement published pursuant to Requirement D.2;

“Pricing Methodology Manual” means a manual published pursuant to Requirement D.5;

¹ The Enforcement Procedures are available at:
https://www.ofcom.org.uk/data/assets/pdf_file/0010/102520/Procedures-for-enforcement-of-BBC-competition-requirements.pdf.

“Public Service” means the BBC’s UK Public Services, Trading Activities and Non-service Activities;

“Requirements” means the requirements set out in Part 2 of this Schedule;

“Target Rates of Return” means, for the purposes of Requirements D.10 to D.12, the rates of return which the BBC sets prior to the start of each Financial Year to achieve rates of return in that Financial Year, and in any future Financial Years;

“Transfer Charges” means, for the purposes of Requirements D.5 to D.8, the total amounts charged for any transaction or group of transactions between the Public Service and the Commercial Subsidiaries and includes by way of example the total rent charged for all properties used during a Financial Year; and

“Transfer Prices” means, for the purposes of Requirement D.5, the unit prices charged between the Public Service and the Commercial Subsidiaries and includes by way of example the rent charged for a specific property for the relevant period.

2. Except in so far as the context otherwise requires:
 - a) words or expressions shall have the meaning assigned to them in paragraph 1 of Part 1 of this Schedule, and otherwise any word or expression shall have the same meaning as it has in the Charter and/or the Agreement; and
 - b) words in the singular shall include the plural and, in the plural, shall include the singular.
3. A reference to a statute or statutory provision is a reference to it as amended, extended or re-enacted from time to time.
4. The Interpretation Act 1978 (c. 30) shall apply as if this Schedule were an Act of Parliament.
5. Headings and titles shall be disregarded.
6. Expressions which cognate with those referred to in this Schedule shall be construed accordingly.

Part 2: Requirements and Guidance

A. Separate subsidiary and operational separation requirements

Requirements

- A.1 The BBC must not directly undertake any Commercial Activities. All Commercial Activities must be undertaken through Commercial Subsidiaries at arm's length from the Public Service and on commercial terms.
- A.2 The BBC must have in place appropriate measures, controls and processes to ensure that its Commercial Subsidiaries and Joint Ventures do not have access to information about the Public Service's strategy, priorities and activities that is not available to third parties, other than:
- c) information that is necessary to ensure that the Commercial Activities fit with the BBC's Mission and Public Purposes;
 - d) information that is necessary for the fulfilment of any contract; or
 - e) information that if shared, does not carry any risk that Commercial Subsidiaries or Joint Ventures could, as a result of having access to that information, distort the market or gain an unfair competitive advantage.
- A.3 The BBC must have in place appropriate measures, controls and processes to ensure that information falling within Requirements A.2(a) and A.2(b) is only used for the specific purpose for which it was obtained.
- A.4 The Commercial Subsidiaries must be run by boards and executive committees of directors which are distinct and separate from the BBC Board and its executive committees. These boards and executive committees must also consist of an appropriate number of directors who are not members of the BBC Board and/or its executive committees.
- A.5 The BBC must have in place appropriate measures, controls and processes to ensure that where a director serves on the board and/or executive committee of both the Public Service and a Commercial Subsidiary or Joint Venture, any potential conflicts of interest are identified, recorded and addressed.

Guidance

Exchange of information

- A.6 The relationship between the Public Service and the Commercial Subsidiaries or Joint Ventures creates a risk that the Commercial Subsidiaries and/or Joint Ventures obtain information which gives them an unfair competitive advantage or distorts the market. The purpose of Requirements A.1 to A.3 is to ensure that this risk is addressed.
- A.7 In order to comply with Requirements A.1 to A.3, we expect the BBC to carry out an ongoing and comprehensive risk assessment to identify areas which present a risk of an unfair competitive advantage or market distortion, and to implement the appropriate measures,

controls and processes to ensure that information flows are managed as necessary. These measures, controls and processes should reflect the extent of risk identified. This risk assessment should be reviewed regularly and include, as a minimum, the following:

- a) an identification of all interfaces between the Public Service and Commercial Subsidiaries and/or Joint Ventures where information is, or could be, shared;
- b) an assessment of what types of commercially sensitive Public Service information, which if not available to third parties, could put the Commercial Subsidiaries and/or Joint Ventures at an unfair competitive advantage or lead to market distortion; and
- c) a determination of whether the information sharing is necessary to ensure that the activities of the Commercial Subsidiaries and/or Joint Ventures fit with the BBC's Mission and Public Purposes or for the fulfilment of a contract.

A.8 Where measures, controls and processes are necessary to manage information flows in accordance with these Requirements, these may, for example, include the following:

- a) training of staff and internal guidance;
- b) appropriate arrangements for co-located employees;
- c) IT system controls;
- d) conflicts of interest procedures; and
- e) internal compliance checks of the BBC's risk assessment and the measures, controls and processes in place to manage information sharing risks.

A.9 An example of an area where information sharing could result in an unfair competitive advantage or market distortion is programme commissioning by the Public Service.² If a Commercial Subsidiary has access to commercially sensitive information regarding the commissioning strategies and needs of the Public Service in advance of independent producers, it may be in a better position to prepare and submit tailored ideas and pitches and win commissions. Examples of commercially sensitive information that could raise competition concerns include advance notice of plans to commission large amounts of programmes on a particular theme, and changes to genre strategies or specific decisions in relation to recommissioning of existing programmes.

A.10 Further examples of areas where information sharing could result in an unfair competitive advantage or market distortion relate to:

- a) content distribution – for example, if a Commercial Subsidiary had advance knowledge of the Public Service's confidential plans to adapt its strategy for the distribution of content for which the intellectual property rights are held by the Public Service, such as children's programming and ongoing drama series; and
- b) viewer research and performance measures – for example, a Commercial Subsidiary could be at an advantage relative to its competitors if it had preferential access to the

² The BBC is also required to comply with the Commissioning Requirements, including the requirement to commission on a fair, reasonable, non-discriminatory and transparent basis.

depth and breadth of data which can be collected by the Public Service through the BBC iPlayer. This could provide that Commercial Subsidiary with a competitive advantage by assisting it in securing future commissions to produce and/or distribute content for the Public Service.

- A.11 Some information may need to be shared to ensure that the Commercial Activities fit with the BBC's Mission and Public Purposes, and this is permitted pursuant to Requirement A.2(a). An example of an area that may fall within this exception is news production. BBC News and BBC Global News may need to share information to ensure that the output of BBC World News³ fits with the BBC's Mission and Public Purposes, which includes the provision of impartial news and information and reflecting the UK, its culture and values to the world.
- A.12 Pursuant to Requirement A.2(b), information may be shared if it is necessary for the fulfillment of a contract. For the purposes of this Requirement, a contract may be oral or in writing, and includes pre-contractual negotiations. An example of when this exception would be likely to apply is if BBC Studioworks has entered into a contract to provide studio space for live productions produced by the Public Service.
- A.13 As set out in Requirement A.2(c), there may be categories of information that carry no risk of market distortion or an unfair competitive advantage if shared between the Public Service and Commercial Subsidiaries or Joint Ventures. These may include, for example, administrative information associated with shared business support functions, such as payroll administration information.

Governance arrangements

- A.14 The purpose of Requirements A.4 and A.5 is to:
- a) ensure that the governance of the Commercial Subsidiaries is consistent with an arm's length relationship with the Public Service, and that Commercial Subsidiaries are sufficiently independent in objective setting, strategy and decision making;⁴
 - b) support the BBC's compliance with the remainder of the Requirements.
- A.15 Ofcom recognises that the BBC Board has duties which require it have a degree of oversight over the governance of the Commercial Subsidiaries. Therefore, a reporting line between the BBC Board and the board(s) of the Commercial Subsidiaries, and the presence of one or more BBC Board member(s) and/or executives with Public Service roles on the boards of the Commercial Subsidiaries is not prohibited pursuant to the Requirements, provided the BBC ensures that it complies with those Requirements.
- A.16 It is for the BBC Board to decide how to structure the boards and executive committees of the Commercial Subsidiaries in a way that complies with Requirement A.4. In assessing the BBC's compliance with Requirement A.4, we will focus on:

³ The commercial news channel that is broadcast outside the UK.

⁴ The duties of directors of any subsidiary company will be as set out in sections 170 to 177 of the Companies Act 2006, including acting in the interests of the company and avoiding conflicts of interest.

- a) the balance between non-executive (independent and BBC Board) and executive directors;
- b) whether the chair is sufficiently independent from the Public Service;
- c) the extent of overlap in membership between the boards or executive committees of the relevant Commercial Subsidiary and the BBC Board and Public Service executive committees; and
- d) the degree of influence that the Public Service has on governance and decision making within the relevant Commercial Subsidiary.

Reporting requirements for Section A

A.17 We also gather information on how the BBC is complying with Requirements A.1 to A.5 inclusive through separate monitoring, reporting and transparency requirements. These are set out in Section D of the Requirements, Requirements D.1 to D.4.

B. Supply and pricing of goods and services

Requirements

- B.1 Where the Public Service provides goods and/or services to the Commercial Subsidiaries or Joint Ventures, it must ensure that this takes place at arm's length from the Public Service and on commercial terms.
- B.2 Where the Public Service supplies goods and/or services to third parties, the BBC must not discriminate unduly as to terms⁵ and prices:
- a) against third parties when such goods and/or services are supplied to third parties and the Commercial Subsidiaries or Joint Ventures; and
 - b) between different third parties.
- B.3 Subject to the exceptions set out in Requirements B.4 and B.78, the BBC must set prices and terms for goods and/or services supplied by the Public Service to Commercial Subsidiaries, Joint Ventures or third parties on the basis of the following principles:
- a) Set prices and terms for goods and/or services, using an open market process (e.g. competitive tendering), or appropriate market benchmarks.
 - b) In the absence of market information as referred to in Requirement B.3(a), or where it is disproportionate to undertake specific benchmarking exercises, set prices for goods and/or services using cost as a proxy for market prices. The BBC must ensure that each such price includes all relevant long-run incremental costs of providing the good and/or service in question, an appropriate contribution to the relevant common and capital costs, and an appropriate margin.
 - c) The BBC must not set prices below short-run incremental cost under any circumstances.
- B.4 Requirement B.3 does not apply to business support goods and/or services which the Public Service only shares with the Commercial Subsidiaries. For such business support goods and/or services, the BBC must set prices that at least cover the long-run incremental costs of providing those goods and/or services.
- B.5 Requirement B.3 does apply to the supply of content / IP for secondary exploitation by the Public Service to the Commercial Subsidiaries. The Public Service must ensure that the value it receives from the Commercial Subsidiaries is at least equivalent to the revenue the Public Service could have earned if the content / IP for secondary exploitation was sold to a third party i.e. in line with the opportunity cost principle as set out in B.12.
- B.56 Where the Commercial Subsidiaries supply goods and/or services to the Public Service, the BBC must set prices and terms for those goods and/or services so as to ensure that they do not exceed market prices or appropriate market benchmarks. This Requirement does not

⁵ All references in the Requirements and Guidance in Section B to "terms" are to be read as "terms and conditions".

apply to the supply of original programming and content by BBC Studios to the Public Service through the commissioning process, which is subject to the Commissioning Requirements.

B.67 The BBC must ensure that:

- a) any pricing methodologies and terms are reviewed regularly, and consistent approaches are applied to any similar goods and services, including agreements for use of the BBC brands; and
- b) market benchmarks are relevant, verifiable and reviewed regularly in line with market practice.

B.78 Requirements B.1 to B.67 inclusive do not apply to pricing of tickets for the events referred to in clause 49(4)(h) of the Agreement (“The Proms, Proms in the Park, Cardiff Singer of the Year, Young Musician of the Year; and other similar events which contribute to the BBC’s Mission and Public Purposes”).

Guidance

Supply of goods and services by the Public Service

B.89 The Public Service sells a range of goods and services to third parties, Commercial Subsidiaries and/or Joint Ventures. This includes licence fee funded content and intellectual property which could be sold to the Commercial Subsidiaries and/or other market participants as well as business support goods and/or services (such as human resources, IT, legal and finance) that are only shared with the Commercial Subsidiaries.

B.910 It is important to ensure that the prices that the Commercial Subsidiaries, Joint Ventures and third parties are charged for these goods and services are set appropriately so that the market is not distorted and so that the Commercial Subsidiaries do not gain an unfair competitive advantage.

B.1011 We consider that a “competition on the merits” approach is the relevant starting point for considering how a significant, publicly funded organisation, such as the BBC, should operate with respect to setting prices to both its Commercial Subsidiaries and third parties. This approach allows the Commercial Subsidiaries to benefit from certain legitimate advantages of scale and/or scope enjoyed by the Public Service, provided that those advantages are replicable by comparable third parties.

B.1112 Where the Public Service is supplying goods and/or services either to its Commercial Subsidiaries and/or third parties, or solely to its Commercial Subsidiaries, we consider that the relevant economic concept for the pricing of those goods and/or services is the “opportunity cost” to the Public Service. The opportunity cost reflects what the Public Service is giving up by choosing to supply a good or service to a particular party. That is, where the Public Service supplies a commercial subsidiary, or Joint Venture partner, rather than a third party, it is giving up the market price it could get from supplying that third party instead. Equally, where there are goods and services that the Public Service would only ever share with its Commercial Subsidiaries, then the Public Service is incurring incremental costs in providing those products to the Commercial Subsidiaries.

Discrimination

- B.12¹³ To address the concerns that we have about discriminatory access and pricing, where the Public Service supplies goods and/or services to third parties, the BBC must not discriminate unduly against or between third parties. However, we recognise that in some cases there may be a fair and objective justification for offering different prices to different parties or refusing to supply goods and/or services to certain parties. For example, there may be cases where supplying to certain third parties could conflict with the BBC's Mission and Public Purposes.
- B.13¹⁴ The Public Service may supply goods and/or services solely to the Commercial Subsidiaries only if there is a clear reason for exclusivity or where the goods and/or services are being shared for reasons of operational efficiency (such as business support goods and/or services). For instance, we do not expect the BBC to supply such business support goods and/or services to third parties given that the BBC is not "in the business" of supplying such goods and/or services.

Market-based pricing requirements

- B.14¹⁵ We consider that in most cases, the transfer price should be set on the basis that if the BBC did not supply the good or service to one of its Commercial Subsidiaries or Joint Ventures, it would supply it to a third party instead. Therefore, the appropriate basis for the transfer price in these instances should be the relevant market price or market benchmark. Where the Public Service is already supplying goods and/or services to third parties and it has used an open market process, it should use the output of that process. Where the BBC is starting to supply a good and/or service for the first time, we would expect it to assess the most relevant approach, for example, whether to make use of an open market process or market benchmarks.
- B.15¹⁶ We set out below a number of examples of different types of goods and services that we would expect to be priced using market prices or benchmarks:
- a) Supply of content / IP for secondary exploitation – the opportunity cost to the Public Service of supplying content / IP to its Commercial Subsidiaries would be the revenue the Public Service could have earned if the good or service had been sold to a third party.
 - b) Licensing of the BBC brand – the BBC brand is one of the most recognisable media brands in the world⁶ and its development and maintenance has been funded by the licence fee. The Commercial Subsidiaries use the BBC brand as part of their corporate names (e.g. BBC Studios) and the goods and services they offer (either in their own right or as part of a Joint Venture e.g. the BBC Earth and BBC America channels). Where there is a possibility of licensing the use of the BBC brand in this way, in conceptual terms the opportunity cost to the Public Service would be assessed in terms of what a third party might be willing to pay for the use of the BBC brand. The transfer price should take into account any restrictions that the Public Service might reasonably

⁶ For instance, it was valued as the 10th most valuable media brand in the world – Brand Finance 2018
http://brandirectory.com/league_tables/table/global-500-2018.

impose on the licensee of the BBC brand to protect the reputation and value of the BBC brand.

- B.16~~17~~¹⁷ One way of determining market prices is to put the good or service out to tender. If one of the Commercial Subsidiaries were successful at winning a fair and open tender, it would demonstrate that that Commercial Subsidiary placed the most value on the good or service in question. This would be the market price and there would be no concern about discrimination or about the Commercial Subsidiary receiving an unfair competitive advantage.
- B.17~~18~~¹⁸ An open market process may also be an important input into establishing relevant market benchmarks for use in the transfer pricing of goods and services, as previous actual sales to third parties would be considered a legitimate source of benchmarking data.
- B.18~~19~~¹⁹ However, we also recognise that it is not always practicable to tender goods and/or services. Another way of determining market prices is for the BBC to establish what a market price would be through benchmarking of suitable comparators. When using benchmarks to set prices, the BBC should consider how representative the benchmark is in relation to the good or service in question and how recently that benchmarking analysis was undertaken. We would expect the BBC to be able to show that it had gathered relevant, verifiable and comparable evidence on prevailing market practices, including both prices and terms, for the benchmarks it has used. This could include publicly available sources (e.g. published rate cards),⁷ benchmarking studies or independent experts. We recognise that the relevant market rate for a given activity may vary depending on the nature of the arrangement in question. For example, prices for studio capacity booked at short notice may differ from prices for capacity booked well in advance.
- B.19~~20~~²⁰ The BBC should ensure that its benchmarks are reviewed regularly in line with market practice and be able to demonstrate that the data is up to date and takes into account the nature and duration of the underlying contractual arrangements.
- B.20~~21~~²¹ It may not be possible for the BBC to determine a precise market benchmarks for some of its goods and/or services; for example, if there was a range of benchmark products that were imperfect substitutes. In these circumstances, it is likely that there would be a range of prices within the benchmark and the BBC should set a price within this range.
- B.21~~22~~²² With respect to the licensing of the BBC brand, we recognise that determining a market price or market benchmark might be difficult in practice. However, we note that the BBC currently charges its Commercial Subsidiaries for the use of the BBC brand as a proportion of the revenues that are directly linked to its use. We consider that this may be a reasonable proxy for the value of the BBC brand.
- B.22~~23~~²³ The Requirements also allow for prices to be set based on costs in some rare cases where the Public Service is unable to identify appropriate, reliable benchmarking data or where it may not be proportionate to undertake benchmarking, for example for immaterial, one off

⁷ We recognise that published rate-cards may not always be an accurate representation of actual prices paid for goods and/or services. That is, the rate-card may only serve as a starting point for commercial negotiations over price. An example of where a rate-card may be used is hiring a studio.

transactions. In these instances, to derive a proxy for a market price, we would expect the transfer price to be based on the long-run incremental cost of providing the good or service together with an appropriate contribution to the relevant common and capital costs and an appropriate margin.

B.2324 We consider that using a long-run measure of costs is appropriate because prices based on long-run costs will allow for a sustainable recovery of costs over time. Using a long-run incremental cost (LRIC) measure takes account of the resources used to provide a good or service and includes the fixed costs which are incremental to that good or service and needed to produce it. In the context of long-run incremental cost measures, the long run is the time period over which costs can be considered to be variable (i.e. changing according to the change in output) and will therefore be dependent on the increment in output being considered. However, LRIC does not include the common costs which a service may share with other services and the recovery of common costs through mark-ups over incremental cost would therefore usually be seen as necessary for sustainability. This is why for our requirements to proxy a market price, the BBC must set prices that cover all long run incremental costs together with a contribution to common and capital costs and an appropriate margin. The scale of that contribution will depend on the product or service in question.

B.2425 In exceptional circumstances the BBC may depart from pricing under Requirement B.3(b) provided it ensures that prices are not below short-run incremental cost. For example, for ad hoc spot sales of unused studio space at short notice, that would otherwise have been left vacant, there may be circumstances where prices that cover short-run incremental costs may be appropriate even if the contribution to fixed costs is small (so long as there is no repeated pattern of such sales).

Shared business support services pricing requirements

B.2526 Where the Public Service is only sharing, and is only ever likely to share, goods and/or services with its Commercial Subsidiaries, the opportunity cost is the long-run incremental cost of providing the goods and/or services to the Commercial Subsidiaries by the Public Service.

B.2627 The alternative would be for the Public Service to scale back or discontinue provision, rather than offer the good or service to third parties. This should be the case in the specific situations where the Public Service is sharing business support goods and/or services with the Commercial Subsidiaries. In these instances, cost-based transfer prices could be derived from either:

- a) the long-run incremental costs incurred by the Public Service in providing these goods and/or services; or
- b) the long-run costs avoided if the Public Service no longer provided the goods and/or services to the Commercial Subsidiaries.⁸

⁸ Unlike prices set under Requirement B.3(b), transfer charges for business support goods and/or services based on costs do not need to include an appropriate margin because they are not intended to be acting as a proxy for market prices. This

- B.27²⁸ We expect that these two approaches would have equivalent outcomes.
- B.28²⁹ An example of transfer charging for shared support services could be where the Public Service supplies staff on a temporary basis to a Commercial Subsidiary, an appropriate estimate of the relevant incremental cost might be the direct costs of employing that person (i.e. salary costs, pension and national insurance contributions and any relevant benefit costs to the employer). Where appropriate, it might also include the associated support costs in relation to IT, accommodation, HR and finance costs on a pro-rata basis to reflect the amount of time that a person is working for the Commercial Subsidiary. However, we recognise that in practice these costs might be captured separately as a transfer charge for the direct staff costs, and a transfer charge for the associated support costs.
- B.29³⁰ Where the BBC has procured a contract on behalf of both the Public Service and the Commercial Subsidiaries, the cost of that contract is likely to be higher as a result of the inclusion of the Commercial Subsidiaries. It is thus important to ensure that at a minimum an appropriate increment of the contract cost is charged to the Commercial Subsidiaries.
- B.30³¹ However, we recognise that in practice it may not be possible to set transfer prices on a pure, long-run incremental cost basis or that it may not be proportionate to do so. For example, reliable data may not be available on the level of the long-run incremental costs. In these cases, a fully allocated cost measure derived from the BBC's internal cost information systems could act as a reasonable proxy for one based on long-run incremental costs and would have the advantage of being verifiable.

Setting transfer prices above market prices or costs

- B.31³² These requirements do not prevent the BBC from setting transfer prices for goods and services supplied to the Commercial Subsidiaries that are higher than the market price or cost (depending on the methodology used), provided that the BBC ensures that it complies with the rate of return requirements as set out in Section C. Accordingly, setting transfer prices higher than the market price or cost cannot be used by the BBC as a justification for either planning to earn a rate of return below the commercial rate of return, or earning less than a commercial rate of return when assessed on an ex post basis.

Supply by Commercial Subsidiaries to the Public Service

- B.32³³ There are a number of instances where the Commercial Subsidiaries supply goods and services to the Public Service. This includes studio capacity, post production facilities and new content. Where this is the case our main competition concern is that the Public Service could use its special funding position to pay inflated prices for goods and/or services supplied by its Commercial Subsidiaries and so distort markets and/or confer an unfair competitive advantage on them by boosting their revenues and overall rates of return.
- B.33³⁴ The guidance set out above in relation to market prices and benchmarks also applies when determining how much the Public Service should pay for goods and/or services supplied by

is because these services are only shared between the Public Service and the Commercial Subsidiaries and we would not expect commercial companies to include a profit margin when charging for such intra-company services. It also avoids double-marginalisation.

the Commercial Subsidiaries. In particular, if market benchmarks are used, they should be relevant, verifiable and regularly reviewed.

Exception for ticket sales

B.3435 Clause 49(4)(h) of the Agreement envisages the BBC recovering a contribution to the costs of staging certain events from the proceeds of ticket sales in accordance with a statement of policy that is agreed with the Secretary of State. The events are “The Proms, Proms in the Park, Cardiff Singer of the Year, Young Musician of the Year; and any other similar events which contribute to the BBC’s Mission and Public Purposes”. In recognition of this, our Requirements do not apply to the pricing of tickets for these events. Therefore, the BBC may continue to price tickets for these events in line with a statement of policy that is agreed with the Secretary of State pursuant to clause 49(4)(h). We recognise that the BBC can seek to recover a contribution to the costs of staging these events from the proceeds of ticket sales but that this cost recovery might not extend to covering the costs of broadcasting these Public Service events.

Reporting requirements for Section B

B.3536 We also gather information on how the BBC is complying with Requirements B.1 to B.78 inclusive through separate monitoring, reporting and transparency requirements. These are set out in Section D of the Requirements, Requirements D.5 to D.9.

C. Commercial rate of return

Requirements

- C.1 The BBC must, over an appropriate period of time, earn a commercial rate of return on its Commercial Activities:
- a) at the Commercial Subsidiary level; and
 - b) at the line of business level.
- C.2 Subject to Requirement C.3, the BBC must:
- a) assess an appropriate commercial rate of return for each of the activities referred to in Requirements C.1(a) and C.1(b); and
 - b) set a target rate of return for each of the activities referred to in Requirements C.1(a) and C.1(b) that is at least the commercial rate of return referred to in Requirement C.2(a).
- C.3 Where a rate of return which a Commercial Subsidiary (the “Consolidated Commercial Subsidiary”) earns is consolidated into an overall rate of return earned by a parent Commercial Subsidiary which is a trading company subject to these Requirements, the BBC is not required to:
- a) assess an appropriate commercial rate of return for the Consolidated Commercial Subsidiary; and/or
 - b) set a target rate of return that is at least the commercial rate of return for the Consolidated Commercial Subsidiary.
- C.4 Where the BBC considers that one or more of the activities referred to in Requirements C.1(a) and C.1(b) are not likely to earn a commercial rate of return over an appropriate period of time, the BBC must, as soon as practicable, conduct a performance review. Following that review the BBC must implement any necessary steps, including revising its business plan, to enable the activities in question to earn a commercial rate of return over that period of time.
- C.5 For the purposes of Requirements C.1 to C.4, the BBC must:
- a) set appropriate lines of business; and
 - b) inform Ofcom as soon as practicable where it proposes to make any changes to the composition of any of its lines of business.

Guidance

Appropriate commercial rate of return

- C.6 Requirements C.1 to C.5 inclusive help to ensure that:
- a) BBC public funding is not used to finance Commercial Activities other than on a commercial basis; and

- b) Commercial Activities are undertaken on an arm's length basis and in accordance with normal market principles.
- C.7 A key aspect of the return earned by a Commercial Activity will be the price the Commercial Subsidiary or the line of business in question has paid for its inputs. We do not focus on the rate of return in isolation and in each case, we will usually consider a Commercial Activity's rate of return in combination with transfer pricing to assess whether the relationship between the Public Service and a Commercial Activity has had an unfair competitive advantage or a market distorting effect. We also consider that it would not be appropriate to focus on a single, universal measure of rate of return but rather to use the rate of return metric that is most relevant to the market or line of business in question.⁹
- C.8 The BBC is required to assess what an appropriate commercial rate of return is for Commercial Activities at the Commercial Subsidiary level and the line of business level. However, the BBC is not required to carry out such an analysis at the level of individual goods and/or services or specific activities (e.g. individual book titles).
- C.9 In assessing whether the commercial rate of return of a Commercial Subsidiary and each line of business within that Commercial Subsidiary is appropriate, we would consider, amongst other things, whether a rational private investor would invest in that Commercial Subsidiary and/or that line of business.
- C.10 In using this approach, it is important to recognise:
- a) A Commercial Subsidiary and/or line of business need not generate a profit every year, particularly if it is a new activity. For example, a business plan may project a loss in the early years of a new activity as the business grows. However, the plan must forecast that it will achieve a commercial rate of return over an appropriate period of time;
 - b) Requirement C.1 provides that Commercial Activities at the Commercial Subsidiary level and at the line of business level must earn a commercial rate of return over an appropriate time period. However, in some circumstances an investment in one line of business could generate indirect returns elsewhere, and a rational investor may accept low returns on a specific investment if this investment produces high returns for the same investor from other assets. Where this is the case, we would expect the BBC to be able to demonstrate how low returns on one line of business supported higher returns elsewhere, in order to show that the low returns nevertheless represent appropriate commercial rates of return; and
 - c) The actual (ex-post) return could be very different (higher or lower) than the estimated return at the time the investment is made.
- C.11 What constitutes a commercial rate of return will depend on the specific market circumstances. The Requirements do not specify rates of return. Instead, the BBC must monitor and research the markets in which Commercial Subsidiaries and the lines of

⁹ For example, rates of return can be measured in terms of: return on capital employed; return on sales; return on investment etc.

business operate, including using benchmark rates of return, to ensure that the returns generated by their Commercial Activities are in line with commercial rates of return.

- C.12 Given that Commercial Activities must be separate from the delivery of the Public Purposes and are only required to fit with the BBC's Mission and Public Purposes, a non-commercial rate of return cannot be justified on the grounds of assisting the delivery of the BBC's Mission and Public Purposes. However, in considering whether to (i) investigate a potential breach of Requirements C.1 to C.5, and (ii) impose a penalty in the event that a breach is found, we will take into consideration, among other factors set out in our Enforcement Procedures, any link between the Commercial Activity in question and the other activities carried out by the BBC which are subject to the regulatory regimes established by the Operating Framework.
- C.13 The BBC may of course set additional rate of return benchmarks either for its own internal investment appraisal purposes or in terms of setting performance targets for existing Commercial Activities. For instance, the BBC may set specific targets for its Commercial Activities which are intended to be more challenging than simply earning a commercial rate of return.

Suspected failure to achieve an appropriate commercial rate of return

- C.14 We recognise that there may be situations where returns are low, particularly in the short term. For example, unexpected changes to market or economic conditions may cause performance to deviate from expectations.
- C.15 However, if the BBC considers that an activity is not likely to earn a commercial rate of return over an appropriate period of time, under Requirement C.4 the BBC is obliged to follow the specified process and take remedial steps. In reviewing performance and implementing any necessary steps to move to earning a commercial rate of return, the BBC must decide whether the line of business should be modified, scaled back, stopped, or divested.
- C.16 Where we are concerned that the BBC has not complied with one or more of Requirements C.1 to C.5, we will consider whether to launch an investigation. If, following such an investigation, we find that the BBC has failed to comply with the Requirements, we may direct the BBC to take action to ensure that the Commercial Subsidiary and/or the line of business earn an appropriate commercial rate of return within an appropriate time period or do anything else we consider appropriate to remedy the breach. In considering whether to open an investigation and whether to impose a penalty in the event that a breach is found, we will take into account, among other factors set out in the Enforcement Procedures, the extent of any risk of market distortion, or the Commercial Activity in question gaining an unfair competitive advantage, as a result of its relationship with the Public Service.
- C.17 For the avoidance of doubt, where a Commercial Subsidiary has entered into a Joint Venture, the Commercial Subsidiary's share of revenues and costs associated with this Joint Venture must be included in the relevant lines of business.

Reporting requirements for Section C

- C.18 We also gather information on how the BBC is complying with Requirements C.1 to C.5 inclusive through separate monitoring, reporting and transparency requirements. These are set out in Section D of the Requirements, Requirements D.10 to D.17.

D. Monitoring, reporting and transparency

Requirements

Separate subsidiary and operational separation

- D.1 The BBC must publish, each Financial Year at the same time as the BBC Annual Report is published for that Financial Year, total revenues of the Trading Activities with third parties which have been carried out by the Public Service. The total revenues of the Trading Activities must be split by key categories including, as a minimum, rental income and royalties' income.
- D.2 The BBC must publish, each Financial Year at the same time as the BBC Annual Report is published for that Financial Year, an Operational Separation Statement setting out how the BBC has complied with Requirements A.1 to A.5 inclusive during that Financial Year. Each Operational Separation Statement must include as a minimum the following:
- a) an overview of the processes the BBC has adopted in identifying areas of risk for information sharing;
 - b) a description of the material risks identified;
 - c) a description of all measures, controls and processes implemented to address areas of risks identified and to ensure compliance with Requirements A.1 to A.5 inclusive, including in the following areas:
 - i) information sharing;
 - ii) governance arrangements;
 - iii) conflicts of interest;
 - iv) IT systems;
 - v) appropriate arrangements for co-located employees, including controls applicable if employees of the Public Service and one or more of the Commercial Subsidiaries or Joint Ventures share the same building(s); and
 - vi) training of the employees of the BBC and internal guidance on ensuring the BBC's compliance with Requirements A.1 to A.5 inclusive;
 - d) an explanation of any issues with the effectiveness of the BBC's measures, controls and processes during the previous Financial Year and what steps the BBC has taken to improve their effectiveness.
- D.3 The BBC must inform Ofcom, each Financial Year at the same time as the BBC Annual Report is published for that Financial Year, of all conflicts of interest identified pursuant to Requirement A.5 during that Financial Year, including the details of each conflict and the action the BBC has taken to address each conflict.
- D.4 For each board and executive committee governing: (i) BBC Commercial Holdings Limited; (ii) BBC Studios Group Limited including BBC Studios Limited and BBC Worldwide Limited; (iii) BBC Studioworks Limited; and (iv) BBC Global News Limited, and any other Commercial

Subsidiary as notified by Ofcom to the BBC from time to time, the BBC must publish and keep updated on an ongoing basis in a prominent place on the relevant publicly available website operated or controlled by the BBC, the following:

- a) terms of reference;
- b) a list of all members sitting on each board and executive committee;
- c) identification of those members who are Public Service employees; and
- d) the reporting arrangements between each board and executive committee.¹⁰

Supply and pricing of goods and services

D.5 Except where Ofcom agrees otherwise, the BBC must publish each Financial Year at the same time as the BBC Annual Report is published for that Financial Year:

- a) Pricing Methodology Manuals, which must set out the methodologies the BBC has used in that Financial Year to establish:
 - i) Transfer Prices for each category of goods and/or services that the Public Service supplies to the Commercial Subsidiaries, indicating for each category of goods and/or services whether the relevant Transfer Prices have been set in accordance with Requirement B.3(a), or Requirement B.3(b), or Requirement B.4;
 - ii) Transfer Prices for each category of goods and/or services that each Commercial Subsidiary supplies to the Public Service; and
 - iii) prices for each category of goods and/or services that the Public Service supplies to third parties;
- b) a list of all changes that the BBC has made during that Financial Year to any of its methodologies for calculating Transfer Prices and prices referred to in Requirements D.5(a)(i) to D.5(a)(iii) inclusive, including:
 - i) an explanation of the reasons for those changes; and
 - ii) a statement of the impact of those changes;
- c) total Transfer Charges for that Financial Year charged by the Public Service to each Commercial Subsidiary, and total Transfer Charges for that Financial Year charged by each Commercial Subsidiary to the Public Service, each total split by the total amounts that were paid or written off during the Financial Year, or remained unpaid as at the end of the Financial Year; and
- d) the methodologies the BBC has used in that Financial Year for valuing the BBC brands.

D.6 Requirements D.5(a)(ii) and D.5(b) do not apply to any transactions between the Public Service and the Commercial Subsidiaries which are subject to the Commissioning Requirements.

D.7 The BBC must provide to Ofcom at the same time as the BBC Annual Report is published for that Financial Year:

- a) the total amounts of all the transactions conducted in that Financial Year between the Public Service and each Commercial Subsidiary split by key categories showing how the balances at the end of the Financial Year have been derived from the balances which were in place at the start of the Financial Year; the key categories of transactions conducted between the Public Service and each Commercial Subsidiary must include, as a minimum, total Transfer Charges, dividends and loans; and
- b) explanations and calculations showing how the transactions referred to in Requirement D.7(a) are treated in preparing the consolidated balance sheet and income statement in the BBC Annual Report for the Financial Year.

D.8 The BBC must provide to Ofcom:

- a) any changes that the BBC has made since the most recent publication pursuant to Requirement D.5(b) to any of its methodologies for calculating Transfer Prices and prices referred to in Requirements D.5(a)(i) to D.5(a)(iii) inclusive, including:
 - i) an explanation of the reasons for those changes; and
 - ii) a statement of the impact of those changes; and
- b) a breakdown of total Transfer Charges charged by the Public Service to each Commercial Subsidiary; and each Commercial Subsidiary to the Public Service, each breakdown split by:
 - i) the key categories used in the Pricing Methodology Manuals, which as a minimum must include property, human resources, business affairs, finance, legal and procurement;
 - ii) for each key category, the amounts charged in the first half of the Financial Year and the whole of that Financial Year compared with the Contracted Amounts for the first half of the Financial Year and the whole of that Financial Year respectively (as applicable);
 - iii) the total amounts that were paid or written off during the first half of the Financial Year and the whole of that Financial Year (as applicable), or remained unpaid as at the end of the first half of the Financial Year and at the end of that Financial Year (as applicable); and
 - iv) the total amounts that were paid or written off in that Financial Year in relation to previous Financial Years' Transfer Charges, and the amounts that remained unpaid as at the end of the Financial Year from previous Financial Years' charges.

D.9 The information pursuant to Requirement D.8 must be provided:

- a) for the first half of the Financial Year, no later than three months after the end of the first half of the Financial Year as applicable; and
- b) for the whole of the Financial Year, at the same time as the BBC Annual Report for that Financial Year is published as applicable.

Commercial rate of return

Publication of reports on financial performance

- D.10 The BBC must publish, each Financial Year at the same time as the BBC Annual Report is published for that Financial Year, reports on the financial performance of each Commercial Subsidiary in that Financial Year which must:
- a) contain a clear description of the activities carried out by each Commercial Subsidiary and each line of business within that Commercial Subsidiary; and
 - b) set out the financial performance of that Commercial Subsidiary and each line of business within that Commercial Subsidiary, including in each case:
 - i) the rates of return;
 - ii) a definition of the metrics used for those rates of return;
 - iii) the revenues, costs, assets, liabilities, capital employed and cash flows used in the calculation of those rates of return split into key categories together with a description of those key categories;
 - iv) a demonstration of how the figures required in D.10(b)(iii) reconcile to the statutory accounts of the relevant Commercial Subsidiary; and
 - v) explanations of the financial performance as required by D.10(b)(i) and D.10(b)(iii).

Provision of Target Rates of Return information to Ofcom

- D.11 The BBC must provide to Ofcom no later than the first day of each Financial Year the Target Rates of Return the BBC considers appropriate for each Commercial Subsidiary and each line of business within that Commercial Subsidiary, setting out in each case:
- a) a clear description of the activities carried out by each Commercial Subsidiary and each line of business within that Commercial Subsidiary;
 - b) a definition of the metrics used for assessing those Target Rates of Return and reasons for selecting those metrics;
 - c) the revenues, costs, assets, liabilities, capital employed and cash flows used in the calculation of those rates of return, split into key categories together with a description of those key categories;
 - d) explanations of cost attribution methods applied to common costs in the calculation of those Target Rates of Return; and
 - e) reasons and evidence that the BBC has used in forming its view on whether each of those Target Rates of Return is appropriate, including all information concerning market benchmarks and/or reports prepared by the BBC and/or third parties for the BBC.
- D.12 The information required under Requirement D.11 must be provided for all the future Financial Years included in the period for which the BBC has prepared its budgets and/or business plans.

- D.13 In the event that the Target Rates of Return for any Commercial Subsidiary or any line of business within a Commercial Subsidiary fall below the BBC's assessment of the commercial rate of return, the BBC must provide to Ofcom as soon as practicable the following information:
- a) explanation of the steps the BBC is planning to take for the Commercial Subsidiary or the line of business in question to reach a commercial rate of return;
 - b) the period of time after which the BBC expects that that commercial rate of return will be reached and the reasons why the BBC considers that period of time to be appropriate; and
 - c) any business planning and budgeting information necessary to support the information provided under D.13(a) and (b).

Provision of achieved rates of return information to Ofcom

- D.14 The BBC must provide to Ofcom the following information for each Commercial Subsidiary and each line of business within each Commercial Subsidiary:
- a) the achieved rate of return, setting out the revenues, costs, assets, liabilities, capital employed and cash flows used in the calculation of those rates of return, each split into key categories together with a description of those key categories;
 - b) Budgeted Figures for the key categories of the revenues, costs, assets, liabilities, capital employed and cash flows, and an explanation of any differences between the actual figures and the Budgeted Figures;
 - c) explanations of cost attribution methods applied to common costs in the calculation of the rates of return;
 - d) a breakdown of total revenues and costs used in the calculation of the rates of return of each Commercial Subsidiary pursuant to Requirement D.14(a) and a breakdown of total revenues used in the calculation of the rate of return for each lines of business within each Commercial Subsidiary pursuant to Requirement D.14(a). Each breakdown must be split into the following:
 - i) those which relate to the Public Service;
 - ii) those which relate to other Commercial Subsidiaries;
 - iii) those which relate to other lines of business within the same Commercial Subsidiary; and
 - iv) those which relate to third parties.
- D.15 The information must be provided pursuant to Requirement D.14:
- a) for the first half of the Financial Year, no later than three months after the end of the first half of the Financial Year; and
 - b) for the whole of the Financial Year, at the same time as the BBC Annual Report for that Financial Year is published.

- D.16 In the event that a rate of return achieved by a Commercial Subsidiary and/or a line of business within that Commercial Subsidiary is lower than the target rate of return for the relevant period, the BBC must inform Ofcom as soon as practicable, after providing the specified information pursuant to Requirement D.14, of the following:
- a) the reasons for the difference between the target rate of return and the achieved rate of return; and
 - b) in the event that the achieved rate of return is lower than a commercial rate of return, explanation of the steps that the BBC has already taken, and/or is intending to take, in order to achieve a commercial rate of return.

Other requirements

- D.17 In addition to Requirements D.13 and D.16, if at any other point in time the BBC identifies that a Commercial Subsidiary and/or a line of business within a Commercial Subsidiary is not expected to earn a commercial rate of return over an appropriate period of time, the BBC must provide to Ofcom as soon as practicable the following information:
- a) explanation of the steps the BBC is planning to take in relation to the Commercial Subsidiary and/or the line or business in question;
 - b) if the BBC decides to take steps to ensure the Commercial Subsidiary and/or the line of business in question reaches a commercial rate of return, the period of time after which the BBC expects that that commercial rate of return will be reached and the reasons why the BBC considers that period of time to be appropriate; and
 - c) any business planning and budgeting information necessary to support the information provided under D.17(a) and D.17(b).

General

- D.18 Subject to Requirement D.19, the information published or provided pursuant to Requirements D.1 to D.17 must include information in relation to all Commercial Subsidiaries and all Joint Ventures in which the Commercial Subsidiaries may participate.
- D.19 Where information relating to a Commercial Subsidiary (the “Consolidated Commercial Subsidiary”) or a Joint Venture referred to in Requirements D.1 to D.17 has been consolidated into reports and accounts for a parent Commercial Subsidiary which is a trading company subject to these Requirements, the BBC is not required to publish or provide separate reports and accounts for the Consolidated Commercial Subsidiary or that Joint Venture under these Requirements.
- D.20 The BBC must include and/or take account of all material items of information in complying with Requirements D.1 to D.17. A material item of information is one which is reasonably expected to affect the views of a competent user of the publications and submissions which BBC is required to make under Requirements D.1 to D.17.
- D.21 Requirement D.5(c) applies to all transactions between the Public Service and the Commercial Subsidiaries, including transactions which are subject to the Commissioning Requirements.

- D.22 The information provided or published (as applicable) pursuant to Requirements D.5(b), D.5(c), D.7(a), D.8(a), D.8(b), D.11, D.12 and D.14 must be prepared, as a minimum, as to form and content in the manner set out in Part 3 of this Schedule.
- D.23 Any information published under Requirements D.1 to D.17 must be effected by the BBC by placing a copy of the information in a prominent place on the relevant publicly available website operated or controlled by the BBC.
- D.24 The BBC must maintain accounting records, including but not limited to relevant correspondence, contracts and invoices, for a period of six years from the date on which each record was created and ensure that those records are sufficient to provide an adequate explanation of how the BBC has complied with each of the Requirements, including an adequate explanation of the information published and provided to Ofcom (as applicable) pursuant to Requirements D.1 to D.17.

Guidance

Purpose of publication and provision of information to us

- D.25 We consider that publication and provision of information to us is important to ensure transparency. This in turn allows us to monitor Commercial Activities and Trading Activities carried out by the BBC and gives confidence to third parties that the BBC is complying with its regulatory requirements and its own policies.

Reporting of information concerning supply of goods and/or services

- D.27 In order to comply with Requirement D.7(b), the explanations and calculations provided by the BBC must demonstrate how the transactions and the balances due between the Public Service and each Commercial Subsidiary are adjusted or eliminated, in aggregating the income statements and balance sheets of those entities into the consolidated income statement and balance sheet in the BBC Annual Report for that Financial Year.

Reporting of commercial rate of return information

- D.28 Under the Requirements D.10(b)(iii), D.11(c) and D.14(a) and D.14(b), the BBC is required to provide to Ofcom or publish the information relating to the revenues, costs, assets, liabilities, capital employed and cash flows only to the extent that the BBC uses this information in its rate of return calculations. We expect the BBC to determine the appropriate “key categories” of the revenues, costs, assets, liabilities, capital employed and cash flows referred to in these Requirements.
- D.29 To comply with the Requirement D.14(d)(iv), the third parties category for the costs of a Commercial Subsidiary must include the costs of the goods and/or services provided to that Commercial Subsidiary by third parties, as opposed to the services provided to that Commercial Subsidiary by the Public Service, other Commercial Subsidiaries or other lines of business within that Commercial Subsidiary. For example, the costs of staff employed directly by a Commercial Subsidiary fall within the third parties category as the service providers are individuals (and not the Public Service, other Commercial Subsidiaries and

other lines of business within that Commercial Subsidiary). The third parties category for the revenues of a Commercial Subsidiary must include the revenues of the services sold by that Commercial Subsidiary to third parties, as opposed to the services provided by that Commercial Subsidiary to the Public Service, other Commercial Subsidiaries or other lines of business within that Commercial Subsidiary.

Requirement regarding the review of supply of goods and services

D.30 Where directed by Ofcom to do so, the BBC must carry out a review of its internal controls and accounting processes to ensure they are adequate and enable the BBC to comply with our requirements with regard to the supply of goods and services as set out in Section B.