



BBC Studios' lines of business

BBC Response

December 2020

Table of contents

Table of contents.....	2
Executive summary.....	3
Context – BBC Studios	5
Does BBC Studios have access to an “extensive back catalogue of Public Service content” somehow makes it unique in the market?	7
The extent to which others have access to an equivalent back catalogue ..	8
BBC Studios access to ‘Public Service content’ or ‘IP owned by the Public Service’	12
BBC Studios profitability from distribution of BBC IP	14
Ofcom’s new proposed reporting requirements.....	20
New notification requirements around lines of business.....	20
Provision of information on achieved rates of return	22
Other comments on proposed new requirements.....	25

Executive summary

BBC Studios is the BBC's commercial global production and distribution arm. It is pivotal to offering value for money to licence fee payers through its high quality programme production and financial contribution to the BBC. It operates in highly competitive global markets and is financially and operationally separate from the BBC. In 2019/20 BBC Studios returned £276m to the BBC in the form of both financial dividends and investment in new programming, making a significant contribution to the BBC's programming budgets.

BBC Studios derives no unfair competitive advantage as a result of its relationship with the BBC. It produces TV programmes for the BBC and other broadcasters and distributes IP owned by the BBC and a wide range of independent producers, all on market terms. BBC Studios is comparable in size to other similar companies, and like its peers its success is based on its extensive catalogue of TV programmes and pipeline of productions. It is one of a number of distributors that have licensed the rights to BBC commissioned programmes, which are increasingly made by independent producers who own and control their own IP. BBC Studios is by no means the sole distributor of content funded by the BBC licence fee.

BBC Studios' commercial strategy is focussed on creating new IP and reducing its reliance on programmes originally commissioned before the BBC spun out its in-house production as a commercial subsidiary in 2017. As the BBC – unlike other broadcasters – moves towards ensuring competition for all relevant TV programmes by 2027, BBC Studios must invest to generate new IP for other broadcasters. Commercial revenue from selling older TV programmes declines over time, and BBC Studios must continually create fresh new content to continue to thrive. Its ongoing revenue from older titles and franchises originally commissioned by the BBC from BBC in-house production is a consequence not of some unfair legacy gifted to BBC Studios but of BBC Studios' historic and ongoing investment into these programmes and brands. Rights Archive (i.e. non-invested) BBC archive programmes are an insignificant part of BBC Studios business. Invested franchises and brands require continued investment by BBC Studios to ensure they continue to deliver.

We strongly welcome Ofcom's conclusion that production and distribution together is one line of business for the purposes of financial reporting to Ofcom. The evidence gathered by Mediatique for Ofcom clearly supports this view, as does our own analysis including the findings of our 2018 Commercial Review¹.

¹ BBC Commercial Review, December 2018:
http://downloads.bbc.co.uk/aboutthebbc/insidethebbc/howwework/reports/pdf/commercial_review_2018.pdf

BBC Studios' lines of business

We understand that BBC Studios is a complex business operating in a complex and highly dynamic sector, and that Ofcom requires oversight over its activities to satisfy itself that there is no inappropriate relationship between BBC Studios and the BBC. We are therefore comfortable with Ofcom's proposal to clarify in its requirements that we will continue to provide Ofcom with BBC Studios' management accounts. We consider this will provide Ofcom with improved visibility over BBC Studios' ongoing operations. We also welcome the additional clarity in Ofcom's new proposed notification process for changes to the lines of business in our commercial arm; we consider this will aid overall transparency.

However, it is important for Ofcom to have regard to proportionality when considering imposing new reporting requirements on the BBC to save unnecessary and costly bureaucracy on both sides. We think several aspects of the proposed new reporting requirements do not meet this proportionality test:

- Ofcom's proposal that we notify any future changes to lines of business three months before making a change is overly burdensome given the level of analysis we expect would be required. One month is more appropriate. The revised process would also benefit from further clarity that it relates specifically to financial reporting and not the organisational structure of the BBC's commercial arm.
- Ofcom's proposal that we provide details of the allocation between BBC Studios' production and distribution activities – including specifically at the level of individual titles – is much more granular than the information we routinely analyse to manage BBC Studios. We do not consider it would provide any relevant information for Ofcom to use in monitoring BBC Studios' rates of return, especially in light of Ofcom's conclusion that production and distribution activities cannot meaningfully be separated for the purposes of benchmarking.

Context – BBC Studios

BBC Studios is the BBC's commercial global production and distribution arm. It is pivotal to offering value for money to licence fee payers through high quality programme production and its financial contribution to the BBC. In 2019/20 BBC Studios returned £276m to the BBC in the form of both financial dividends and investment in new programming, making a significant contribution to the BBC's programming budgets.

BBC Studios today is the successor to BBC commercial subsidiaries dating back to BBC Enterprises, first set up in 1979. Historically its focus as BBC Enterprises – and latterly as BBC Worldwide – was on exploiting IP licensed from the BBC and others, delivering a commercial return to supplement the BBC's licence fee income and investing in new BBC programmes. Over time the products and services it offers have changed from focussing on books and magazines to VHS and DVD, into secondary programme sales to other broadcasters and streaming services in the UK and globally.

BBC Studios (production) was set up as a commercial subsidiary in April 2017. This followed an approval process by the BBC Trust, including a public consultation on the proposed change under the BBC Trust's process for managing changes to the BBC's Commercial Subsidiaries. In April 2018 the BBC brought together BBC Studios (production) and BBC Worldwide into a single entity trading as BBC Studios. This reflected ongoing consolidation in production and distribution markets and the market model of focussing on the whole lifecycle of IP from original development through to commercial exploitation.

Today BBC Studios operates 33 TV channels in 120 countries worldwide, including the seven UKTV channels in the UK and partnerships with AMC for BBC America in the US, and Sony for BBC Earth in India. BBC Studios also operates BritBox in the US, Canada and Australia as part of a joint venture with ITV, and BBC Player in Malaysia and Singapore. Outside of these branded services, BBC Studios sells content to a wide range of broadcasters and streaming services around the world. Its catalogue comprises archive BBC-produced programmes as well as indie-produced content.

Since launch in 2017, BBC Studios productions has seen strong performance, winning a number of commissions from broadcasters and streamers including Netflix, Amazon, Apple, Channel 4, Channel 5, UKTV, Discovery and PBS in North America as well as the BBC. It operates production bases across the whole of the UK and in key territories worldwide. Through its content partnerships BBC Studios invests in a range of independently produced programmes, helping to fund the

BBC Studios' lines of business

development and production of new IP. It also has investments in 15 British independent production companies, including Lookout Point and Baby Cow.

The BBC has in place robust frameworks to ensure that there is a level playing field when BBC Studios pitches against third parties for BBC commissions, as well as rigorous financial and operational separation between the BBC and BBC Studios. The controls the BBC has in place pre-date – but continue to align with – Ofcom's trading and separation requirements. When the BBC setup BBC Studios (production) as a commercial subsidiary in 2017 it undertook a significant amount of work to formalise the relationships between producers and commissioners and ensure there was appropriate financial separation. This built on the rules the BBC Trust put in place to ensure that the relationship between the BBC and its commercial subsidiaries was at arm's length. The BBC Board also has a clear remit to drive the greatest possible profitability from the BBC's commercial activity to ensure that as much revenue as possible is available to the BBC to invest in delivering the UK Public Services.

Does BBC Studios have access to an “extensive back catalogue of Public Service content” somehow makes it unique in the market?

Ofcom's consultation on the new proposed reporting requirements cites as a theory of harm that:

“The production and distribution line of business, with its extensive back catalogue of Public Service content, has some activities that the BBC's competitors of similar size and scope are unlikely to be able to replicate to the same extent.”²

Ofcom elaborate further that:

“Given a significant proportion of BBC Studios' content sales comes from IP owned by the Public Service, there is a risk that this will impact the returns of the production and distribution line of business as no other distributor is likely to have a profitable back catalogue the extent of the Public Service owned IP BBC Studios has access to... We therefore consider that there are some activities that BBC Studios undertakes that its competitors will not be able to replicate to the same extent.”³

While Ofcom concludes that this theory of harm is not sufficient to require the BBC to continue to report production and distribution as separate lines of business – a conclusion which we strongly welcome – Ofcom does conclude that it is sufficient to warrant the additional financial reporting requirements on which Ofcom is consulting. Leaving aside the proportionality of these new requirements – which we discuss in the next section – we do not agree with Ofcom's assessment that BBC Studios ability to exploit BBC IP makes it in any way unique or incomparable against peers in the market.

We consider there are three possible elements to Ofcom's theory of harm, which we assess in further detail in this section:

1. The extent to which other integrated producer/distributors may have access to an equivalent back catalogue;
2. The extent to which BBC Studios has access to BBC IP that other distributors do not; and
3. The extent to which BBC Studios' business relies on this IP to drive revenue and profit.

²Ofcom, Assessment of BBC Studios' changes to its lines of business, October 2020 (https://www.ofcom.org.uk/_data/assets/pdf_file/0019/204490/consultation-bbc-lines-of-business.pdf) p1

³ Ibid p17

The extent to which others have access to an equivalent back catalogue

The Mediatique report Ofcom published alongside this consultation clearly sets out some of the core features of the market dynamics that apply in this context, for example:

“The UK distribution market is less fragmented than the UK production sector and is dominated by a small cohort of large, international players able to take advantage of global reach and scale.”⁴

and

“scale has become an important goal in its own right for content players in particular, both in terms of global reach and in terms of access to content (i.e. libraries, volume, hours).”⁵

This report provides further details of BBC Studios' peers, including an analysis of recent merger and acquisition activity which underscores Mediatique's point about the ongoing consolidation in the market and the fact that integrated producer-distributors (or super-indies) are seeking to maximise the scale of their content libraries. Mediatique are clear that BBC Studios is no different from its peers in this respect:

“The integrated studio model adopted by the BBC is consistent with the direction of travel in the UK and in key international markets and with the underlying sectoral drivers...By combining production and distribution, the BBC can, like other groups, pursue an integrated studio strategy, generate revenues across the value chain, rooted in the control of critical IP.”⁶

It is worth reiterating that integrating in this way in line with wider market trends was the BBC's original rationale for merging BBC Studios (production) and BBC Worldwide in 2018. As we set out to Ofcom at the time, we were following the rest of the market rather than establishing a new model. BBC Studios' structure – including the fact that it has a significant library of IP under its control – is in line with the sector. This is evidenced in Mediatique's report which provides details of BBC Studios' peers, including in production and distribution. Several important points are worth emphasising and expanding upon in relation to the features that characterise BBC Studios' closest competitors.

⁴ Mediatique, State of the markets in which BBC Studios operates, A report for Ofcom, October 2020 (https://www.ofcom.org.uk/__data/assets/pdf_file/0021/204492/bbcs-markets-mediatique-report.pdf), p4

⁵ Ibid p23

⁶ Ibid p24

ITV Studios' sales website clearly shows that it has an extensive back catalogue of material. This includes a range of classic titles resulting from the integration of historic ITV franchises – including the likes of Granada Productions and Carlton Productions – as well as newer ITV commissions and content produced for other broadcasters (including significant volumes of business with the BBC) by ITV Studios and the indies it owns. Some of the indies ITV has bought also provided it with a rich back catalogue, like World Productions. ITV Studios' catalogue now contains over 46,000 hours⁷ of content and as Mediatique note, “*ITV made two of the most successful recent dramas to air on British television – Line of Duty and The Bodyguard (both from World Productions)*”⁸. Both were also BBC commissions, part funded by the licence fee. ITV Studios has a significant pipeline of new content – nearly 9,000 hours last year in 12 different countries⁹. ITV's vertically integrated strategy with both its production and distribution divisions being preferred suppliers wherever ITV considers this is in its best interests – which the BBC due to its regulatory obligations cannot replicate – contributes to this. End-to-end control of its IP is optimised in this model.

Banijay recently acquired EndemolShine, reinforcing an already strong global position in production and distribution. As Banijay state “*The deal makes Banijay the largest international content producer and distributor, ramping up its distribution division, Banijay Rights, and building a catalogue of over 88,000 hours of multi-genre premium entertainment brands*”¹⁰. This represents a significant back catalogue of titles, including many well-known UK programmes made, for example, by indies like TigerAspect (producer of *Peaky Blinders*, another commercially successful BBC commission part-funded by the licence fee). Mediatique's report is clear that this acquisition fits the wider patterns of consolidation and the overall drive towards greater scale in the sector. It also – like ITV – allows greater vertical integration across production, commissioning and distribution in a way that the BBC cannot replicate.

Fremantle, like ITV, has a very strong pipeline of new content – over 12,800 commissioned hours in 2019¹¹ – driven, again, by vertical integration within the RTL group. Likewise its distribution arm has an extensive catalogue of over 20,000 titles, increasing each year as it generates new IP. Fremantle owns key UK production labels like Talkback and Thames that have generated significant IP over the past 30

⁷ ITV, Annual Report and Accounts 2019 (<https://www.itvplc.com/~media/Files/I/ITV-PLC/documents/reports-and-results/annual-report-2019.pdf>), p24

⁸ Mediatique, State of the markets in which BBC Studios operates, p58

⁹ <https://www.itvstudios.com/>: “Last year, talented teams at the 60 production labels within the ITV Studios family produced nearly 9000 hours of programming in 12 different countries”

¹⁰ <https://www.banijay.com/banijay-completes-landmark-deal-to-acquire-endemol-shine-group/>

¹¹ RTL, Annual Report 2019 (https://www.rtlgroup.com/files/pdf3/rtlgroup_annualreport2019.pdf) p12

BBC Studios' lines of business

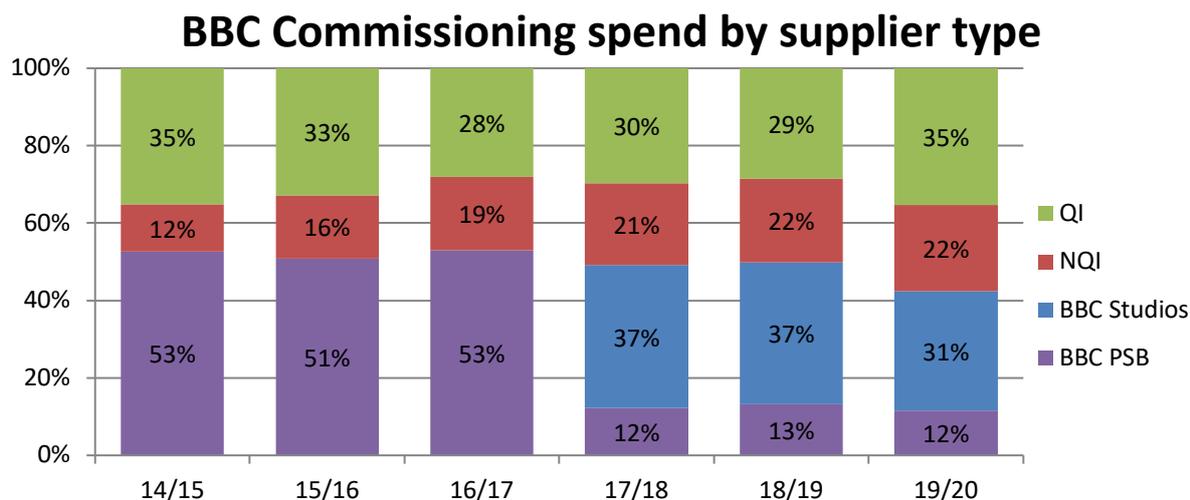
years, including classic BBC shows (such as *The Apprentice* and *QI*) part-funded by the licence fee, all contributing to a significant UK back catalogue.

Against these comparators BBC Studios' catalogue of 48,000 hours and ongoing pipeline of 2,500 hours per year of new content is clearly neither the largest nor even significantly out of step with the rest of the market. Moreover, the BBC is unable to replicate the vertical integration others have the freedom to use to increase their own in house production pipelines and therefore distribution catalogues which they can profitably control. BBC Studios is reliant on generating the best ideas and winning commissions from the BBC and third-party commissioners to keep adding to its distribution catalogue. Our peers will continue to have natural incentives to favour their own in-house production arms to do the same, while also competing for and winning BBC commissions.

There is clearly no evidence that BBC Studios' catalogue is *larger* than its main competitors, nor that it has the ability to seek to achieve such a goal. The value of a back catalogue is clearly a function not just of scale but also quality and commercial value of titles. It may be (although it is not clear from the consultation document) that Ofcom considers BBC commissioned and produced TV programmes to be of a unique quality and commercial potential and therefore in some way distinguishable as intrinsically more valuable than the IP that other broadcasters have been able to commission historically. Alternatively, it may be that Ofcom considers the very fact that BBC IP was funded wholly or partly by the licence fee historically means it is somehow different to IP other super-indies own.

We firmly believe that we commission the best and most diverse content. However, our evidence shows that commercial returns on content are generally skewed towards recent productions not older or archive titles (i.e. freshness of content is a key factor driving secondary sales). Furthermore, increasing volumes of BBC commissions are made by indies. These indies own the IP they create and many are now increasingly part of super-indies – like BBC Studios' competitors analysed above – that have been set up to deliver precisely the scale of owned or substantially controlled IP that Ofcom asserts is a concern in relation to BBC. Studios. Many of the most successful newer BBC commissions are not BBC IP and are distributed by competitors like ITV Studios, Banijay or Fremantle.

Indie commissions are – and historically have been – wholly or partly funded by the licence fee in the same way as BBC IP. Whether contributing to BBC IP or not it is simply a sunk cost the BBC has made historically to commission and/or produce programmes for the UK Public Services.



The chart clearly shows that the share of BBC commissioning spend with BBC producers – both in house and BBC Studios – is declining, with a similar pattern for hours of productions. Over 50% of all spend is now with indies. We expect that this trend will continue over time. There will always be an important role for BBC Studios in producing content for the BBC. However it is also clear that BBC Studios will lose BBC commissions (e.g. when titles are decommissioned or put out to tender) and replace these with work for other broadcasters. This was a key theme emerging from the recent National Audit Office report on BBC Studios: BBC Studios is investing heavily in creating new IP for this very purpose¹².

The effect of this is two-fold:

- Ofcom’s assumption that BBC Studios could gain an advantage not open to its peers due to its access to a high comparative volume of BBC IP increasingly will not hold as BBC Studios’ invested titles are replaced by new IP originated in BBC Studios.
- Increasingly many popular and commercially valuable titles in the BBC slate are produced by indies. Under the terms of trade, all qualifying indies working with the BBC own their IP, so this generates no new BBC IP. An increasing proportion of the BBC’s licence fee spend on content is therefore with indies, not BBC Studios. Indies are then free to commercialise this IP within the contractual terms they have agreed with the BBC as commissioner.

Given that ‘freshness’ is one of the key drivers of sales of secondary content for distributors, this change in the BBC’s supply base in recent years is particularly significant in the context of Ofcom’s theory of harm. We have analysed BBC Studios’ sales over recent years by the year of transmission of a series. These data show that both the volume of titles sold as well as the value of each title decreases as the

¹² National Audit Office, BBC Studios, January 2020 (<https://www.nao.org.uk/wp-content/uploads/2020/01/BBC-Studios.pdf>), p32

content gets older.¹³ While BBC Studios sold some older titles, there were fewer of these than more recent series. Moreover, the data clearly show that the revenue per title is generally lower for older IP than it is for new programmes. This pattern fits with the way that BBC Studios amortises its distribution rights, as it is required to for accounting purposes (like all of its peers). For TV distribution rights in which BBC Studios has invested it typically amortises over 50% of this investment in the first year, with the bulk of the investment value being depreciated over the first three years. This depreciation policy for programme investments has been set to align with relevant accounting standards and has been endorsed by the National Audit Office in its role as financial auditor of the BBC. More importantly, it accurately reflects the potential value of BBC Studios' investments based on expectations around future sales. There will clearly be exceptions to this general rule, but any consideration of the potential contribution of back catalogue and archive titles to BBC Studios – and what regulatory measures should be imposed on the BBC by reference to this component of BBC Studios' business – must take reasonable account of what in practice drives sales in the market.

BBC Studios access to 'Public Service content' or 'IP owned by the Public Service'

As set out above, "Public Service content" shown on the BBC increasingly comprises titles where the BBC does not own the underlying IP. Ofcom's consultation references different types of IP distributed by BBC Studios, yet it also then asserts that the BBC's ownership of this IP may in and of itself mean that BBC Studios' financial returns are not comparable with its peers. We consider this assumption also warrants further explanation and analysis.

There are three main categories of IP BBC Studios distributes: the Rights Archive, invested in-house/indie titles distributed by BBC Studios and new IP. Most of this IP (the exception being invested indie titles) is ultimately owned by the BBC. There is no legal entity called the "BBC Public Service" that has any legal ownership over any BBC IP or any IP created within the BBC group; rather it is held by the British Broadcasting Corporation or one of its subsidiaries.

Rights Archive

¹³ We have used data we previously analysed for our BritBox Materiality Assessment which we have shared confidentially with Ofcom.

BBC Studios' lines of business

This is any BBC IP that is (or was) not invested in by BBC Studios (including any of its predecessor legal entities) or another distributor at the point of commission. This IP is therefore owned by the BBC and is available to license for distribution.

It includes old titles produced in-house by the BBC dating back to 1932, as well as new titles from in-house production in which distributors have not invested. For newer titles, this essentially means that these have been deemed at the point of commission to be unlikely to generate significant returns in the secondary market – if they were, someone would have looked to invest upfront to acquire the rights at the point of commission. Given that secondary markets for TV programmes have evolved over time, there is not a complete back catalogue of all BBC commissioned or produced content since the BBC's inception. Indeed the BBC does not have archive material for many older popular titles, a fact that is reported on from time to time¹⁴ when some of our best, most creative output is not available in the secondary market.

The vast majority of licensed titles in the Rights Archive are licensed via BBC Studios and agreements between the BBC and third parties are not significant in terms of either volume of revenue. However, this is not due to some exclusive arrangement and one of the main drivers is the fact that the BBC requires distributors to undertake their own clearances for the content, which reduces its commercial attractiveness. By nature the material in the rights archive that is available to license is likely to be less obviously commercially valuable (i.e. it was not deemed attractive enough to attract distribution interest at the point of commission). A large volume of material in the Rights Archive is therefore unlicensed – either via BBC Studios or a third party – and we expect will remain unlicensed because it is not commercially attractive. The BBC does not in general regard it as a significant potential generator of commercial income in future.

Invested in-house/indie titles distributed via Studios:

There is a range of BBC commissioned titles that BBC Studios distributes as a consequence of its historical and ongoing investment. This applies to titles originally produced in-house as well as by indies. Previous in-house production teams in certain genres are now part of BBC Studios; BBC Studios has also acquired stakes in some of the independent producers it has licensed content from over the years.

¹⁴ See for example a recent Financial Time article on Z Cars: <https://www.ft.com/content/ab18b432-ac93-405d-adf9-5e1b19933421> which is available (unofficially) on YouTube but not in the BBC Rights Archive. The BBC Archives website has additional information: <https://www.bbc.co.uk/archive/bbc-archives--wiped-missing-and-lost/z4nkvk7>

BBC Studios' lines of business

This makes up a certain proportion of the overall BBC commissioning slate over time, but it does not mean that every programme the BBC has commissioned is licensed to BBC Studios. As our analysis demonstrates, over time the BBC has done more and more business with indies and there is a range of funding models for upfront investment.

Investment was made by BBC Studios on market terms – this includes the ability for BBC Studios to continue to renew deals over time where relevant (e.g. when it continues to invest in titles).

New IP

Content / IP created by BBC Studios (production) – since it was set as a commercial subsidiary – is not public service content as defined by Ofcom. The BBC is ultimately the owner of this IP as BBC Studios is a wholly owned subsidiary of the BBC.

However it is in practice controlled in the short term by BBC Studios to allow BBC Studios to operate its business and deliver revenue and fresh investment back into the BBC. New IP includes new BBC commissions since BBC Studios production was launched as a commercial subsidiary, but it also includes BBC Studios' commissions for third parties, which is an increasingly important aspect of BBC Studios' business.

BBC Studios profitability from distribution of BBC IP

Firstly, we agree with Ofcom that all New IP is irrelevant to this theory of harm as it was originated within BBC Studios as a commercial subsidiary. This is not 'public service' under Ofcom's definition, although BBC commissions are funded at least partly by the licence fee. BBC Studios' decision to invest its revenues or profits in creating new IP for the BBC or other broadcasters is irrelevant to Ofcom's stated concern about the impact of BBC Studios' back catalogue. This IP is clearly the product of BBC Studios' own creative endeavours and to the extent that it is deployed to support other areas of its business that is a legitimate commercial judgment for BBC Studios in common with any other business.

While superficially it may appear that Rights Archive material is a potentially significant source of commercial revenues for both BBC Studios and the BBC – given how long the BBC has been making and commissioning highly regarded TV programmes – the facts do not support this conclusion. As set out, the majority of the content is not commercially attractive, and the titles that are distributed generally do not earn significant revenues, especially when the costs of rights clearances – borne by BBC Studios – are taken into account. Licence fee investment in this content is effectively sunk; there is no historic investment that BBC considers it must recoup.

BBC Studios' lines of business

In 2019/20 BBC Studios retained just £3.4m of revenue generated through Rights Archive content sales. BBC Studios does not internally allocate costs to Rights Archive sales given how little revenue they contribute, so does not monitor profitability directly. The revenue retained in BBC Studios after costs is insignificant to BBC Studios' business, and the bulk of revenues flow back the BBC. This is the real profit derived from this material. We do not consider there is any reasonable argument that BBC Studios' activity in this area is in any way significantly affecting its profitability – or the appearance of its profitability – when compared to its peers in the market who, as noted, also have significant archive catalogues (and may not return the majority of revenues to the original commissioner). We consider that if these titles were uniquely valuable as Ofcom suggest, they would generate higher revenues for BBC Studios and the BBC and would also be likely to attract greater interest from the wider market. As set out, older IP tends not to be as valuable as fresher content as our analysis of Rights Archive sales clearly demonstrates.

With respect to BBC Studios invested titles, we consider Ofcom's categorisation of these as 'legacy' titles could be misleading. Legacy implies some form of inheritance or bequest from the BBC, which in this instance seems to equate to unearned or undeserved revenue and profit for BBC Studios, hence being relevant to Ofcom's theory of harm based on unfair cross-subsidisation. Given that for each of these titles – whether originally produced by BBC in-house production or an independent producer – BBC Studios has invested in the title, we consider it imperative that this investment – historical and ongoing – is taken into account in any discussion of whether there is any risk of market distortion from any returns BBC Studios generates. While some of the costs to make these programmes came from the licence fee, BBC Studios also invested on commercial terms for the rights to commercially exploit the titles in question.

We assume from Ofcom's consultation that the concern in this area relates to titles originally produced in-house by the BBC and not by indies (although the mix of funding between BBC Studios investment and BBC licence fee would be the same). BBC Studios is contractually obliged to honour its agreements with indies, which includes paying back-end share to producers. These agreements are all on market terms and BBC Studios continues to make investments in new indie commissions for the BBC. Moreover, these payments cannot by definition contribute to any potential unfair advantage for BBC Studios' productions. BBC Studios presence as an investor is a win-win for the BBC and the indies it works with – it enables the BBC to commission better content and return profit back to indies who produce that content, which in turn funds the development of new ideas in co-operation with the indie sector, as well as earning a commercial return to reinvest in new BBC commissions. This is the market model established by the Communications Act 2003. We do not consider that the existence of BBC Studios as an investor dealing

BBC Studios' lines of business

with indies on market terms in a highly regulated environment could be seen as a cause for concern given the diversity of funding models available including deficit financing and tax credits. BBC Studios' ongoing investment in BBC commissioned titles in fact helps to resolve some of the risks Ofcom cites as a concern around the BBC's reliance on third-party investment in its latest Annual Report on the BBC¹⁵. BBC Studios is legally required to uphold the BBC brand and is aligned in its values with the BBC; we consider it is the best possible investor – on market terms – in BBC commissioned content to ensure it delivers both public and commercial value.

Turning to BBC Studios' distribution of invested content originally produced by BBC in-house production, we think it is important to recognise two factors:

- Looking at current revenues and equating that with profitability ignores the very high levels of both historical and ongoing investment by BBC Studios. Recognition of this investment is largely absent from Ofcom's analysis.
- BBC Studios as distributor has invested to obtain the distribution rights; it now adopts the same model for the producer share of secondary revenues as with indies; namely that there is an internal return of value to production teams.

BBC Studios distribution has invested heavily in many of these titles over the years and – in the case on continuing brands/franchises – will continue to do so as long they remain on the slate. The 'value' of the underlying IP commercially is therefore a function of this scale of investment over time, as well as what the BBC as commissioner has invested and the creative input of production teams. Over the period 2012/13 to 2016/17 (i.e. the final years during which BBC Worldwide invested heavily in the BBC in-house produced titles that relate to Ofcom's theory of harm) BBC Worldwide invested £280m in programmes made by BBC in-house production, an average of £56m each year. For context, BBC Worldwide's headline profits over this period averaged £149m each year. This level of investment represented a significant contribution from BBC Worldwide into this programming without which profits would have been very significantly higher. All of this investment was on market terms. BBC Studios should be free to allocate the returns on this investment internally in the way best calibrated to deliver its commercial strategy.

BBC Studios is also continuing to invest heavily in titles still in commission to ensure they deliver public value for the BBC while also enabling BBC Studios to earn a return in the market. Between 2017/18 and 2019/20, BBC Studios invested a total of £158m – £53m a year on average – into invested titles originally produced in-

¹⁵ Ofcom, Third Annual Report on the BBC, November 2020
(https://www.ofcom.org.uk/_data/assets/pdf_file/0021/207228/third-bbc-annual-report.pdf) p50

house by the BBC and now made by BBC Studios productions. However, these headline figures obscure BBC Studios' significant ongoing investments into key titles and brands that – viewed simply in terms of revenue – may appear to be highly profitable.

As Ofcom's consultation and the NAO's recent report on BBC Studios allude to, several key brands drive the bulk of revenues and profit on BBC Studios' invested titles¹⁶. Our data show that while revenues are significant, so is ongoing investment. In the case of titles like the Natural History Landmarks, BBC Studios has funded over 75% of the production costs of recent series. BBC Studios has not been gifted the rights to distribute these titles by the BBC; it has paid for these rights through its initial investment. BBC Studios is not advantaged in some way because a proportion of the original (and ongoing) production costs were funded by the licence fee; it continues to invest in these titles and brands alongside the BBC as commissioner. This arrangement – where original investment deals are extended at the point of recommission – is in line with the market. Indeed, as noted, for many of BBC Studios' vertically integrated competitors there is not even any consideration of having to extend a distribution agreement as all IP sits within the same group so is not licensed in the same way it must be within the BBC.

Balanced against these titles – which remain profitable – BBC Studios also makes investments that do not deliver. This is the reality of running a portfolio business and why scale of catalogue and pipeline are so significant to both BBC Studios and its peers – a point clearly noted by Mediatique in its report for Ofcom. Alongside the good and bad performers there is also a significant number of titles that neither generate very high or very low profitability but do contribute overall to the catalogue that BBC Studios is able to offer. Again, scale is important, but it does not represent an unearned advantage for BBC Studios capable of causing real or potential harm to fair and effective competition.

As Ofcom notes, some of this commercial value (i.e. distribution revenue) flows back to BBC Studios production as back-end pay away for these invested titles. This allocation is in line with market norms and is so well-established in the market that it doesn't even warrant analysis or discussion by Mediatique in their report for Ofcom: "*Distributors (which may be directly linked or owned by producers, or third-party players) will secure cash flows from client broadcasters or aggregators; they will retain a share of income and pay the residual to producers and rights owners.*" There is no conditionality in this statement: paying back-end to producers is how the market works. If BBC Studios did not do it with invested indies it would be in breach of contract. We continue to find it strange that Ofcom considers the same arrangement

¹⁶ National Audit Office, BBC Studios, p17

BBC Studios' lines of business

a cause for concern when applied to BBC Studios production teams giving them visibility over their commercial “hits”.

In reality, the current arrangement within BBC Studios simply reflects the fact that the titles were originally made by in-house production. Had BBC Studios productions been spun out of the BBC earlier then a number of these titles would be ‘new IP’ not invested titles. In many cases the same production teams now work in BBC Studios (e.g. the Natural History Unit) and BBC in-house production competed against third parties (e.g. under the WOCC) to produce many of these programmes in the first instance. As invested titles, the original IP was created with a mix of licence fee funding as well as BBC Studios’ investment. We consider it must be legitimate for BBC Studios to continue to incentivise its own producers to create new IP by rewarding their historical creative efforts that have contributed – along with BBC Studios’ investment – to the success and therefore saleability of these titles. This is exactly the approach that BBC Studios takes with indies it works with and which the market intervention represented by the Terms of Trade seeks to foster – i.e. the broadcaster pays back-end so producers reap the benefit of their creativity and keep coming up with good ideas. As Mediatique note in their report for Ofcom “*The production sector is ultimately the foundation of value across the audio-visual (‘AV’) supply chain*”¹⁷.

To conclude:

- BBC Studios does not have a larger back catalogue than its commercial peers. Our analysis shows it to be broadly in line with relevant comparators like ITV Studios.
- BBC Studios’ distribution catalogue contains some highly regarded programmes and titles that deliver strong financial performance; other super-indies similarly have successful titles and increasingly also earn revenues from BBC commissions and the BBC’s licence fee investment – i.e. from the public service content the exploitation of which Ofcom has suggested could be a potential source of competition concern.
- Freshness of content is one of the key drivers of sales and revenues – Rights Archive content and older invested IP is therefore not particularly lucrative for BBC Studios or the BBC as a whole; indies are winning an ever larger share of new BBC commissions which means that increasingly the IP for this public service content is not owned by the BBC and cannot therefore advantage BBC Studios.
- BBC Studios does distribute and make titles where the BBC owns the IP; however the returns it makes are a consequence of its investment over the years to develop these programmes and formats and make them the success that they are; this includes paying the BBC for the original distribution rights

¹⁷ Mediatique, State of the markets in which BBC Studios operates, p2

and continuing to invest in new series of key brands. There is no unearned profit resulting from historic licence fee funding of these programmes.

- BBC Studios' funds flow model of allocating a percentage of the profit from these titles back to the teams that made them follows the market norm and is designed to drive creativity.

Ofcom's stated concern is that somehow this in reality non-existent potential unfair advantage for BBC Studios production might ultimately result in greater commercial success for BBC Studios in pitching for work (i.e. undercutting competitors). This assumption also ignores two crucial aspects of how commissioning works.

First, pitching for and winning work is fundamentally about developing the best ideas, not producing at the lowest cost. Ofcom's continued assertion that BBC Studios somehow may be able to gain by undercutting competitors on price completely ignores the nature of competition for creative commissions.

Commissioners generally want the best programmes for their channels and services to drive viewing, they do not want the cheapest programmes. The significant inflation in production costs in recent years – noted from a range of sources from Enders Analysis to the House of Lords¹⁸ – clearly demonstrates that commissioners are prepared to pay more for better content and compete fiercely for the best creative talent. Even when the BBC tenders for the production of programmes on a work for hire basis to achieve our contestability requirements price is only one factor of many we evaluate; this is the closest thing to a price-based competition that exists in the market and even here price is not the overriding concern.

Second, most broadcasters (except the BBC) are able to operate in line with their natural incentives to favour their own in-house production teams and invested indies to control the whole IP pipeline. This was clearly highlighted by Pact before the current regulatory barriers to this integration were placed on the BBC¹⁹. Such barriers do not exist elsewhere in the sector. The price BBC Studios pitches will always be balanced by these commissioners against the value of owning IP within the group if quality of ideas are comparable. BBC Studios' productions therefore face an inbuilt disadvantage compared to its vertically integrated peers and there is no real 'level playing field' in the wider market in the same way that there is for BBC commissions.

¹⁸ Enders Analysis, UK TV Production: Working for Netflix, Apple and the rest of the FAANGs, 11 May 2018, p 7; House of Lords Select Committee on Communications and Digital, Public service broadcasting: as vital as ever

(<https://publications.parliament.uk/pa/ld201919/ldselect/ldcomuni/16/16.pdf>), p33

¹⁹ Oliver & Ohlbaum for Pact: TV Producer consolidation, globalisation and vertical integration – myths and realities. March 2015

(https://www.ofcom.org.uk/_data/assets/pdf_file/0026/47582/pact_annex.pdf)

Ofcom's new proposed reporting requirements

It is in both our and Ofcom's interests to ensure that the regulatory requirements are proportionate and ensure there is no unnecessary cost and bureaucracy. The Communications Act 2003 requires Ofcom to have regard to the principles of better regulation: that regulation should be transparent, proportionate, consistent, accountable, and targeted only at cases where action is needed. There is necessarily therefore an evidential bar that Ofcom must clear when amending existing or imposing new regulations based on these principles.

Ofcom proposes two principal changes to the existing reporting framework:

1. A revised process for notification of changes to our commercial subsidiaries or their lines of business; and
2. New requirements for us to disclose significant amounts of information at a level below the production and distribution line of business.

The above analysis shows that Ofcom's view that BBC Studios is somehow unique amongst its peers is not supported by the available evidence. Therefore Ofcom cannot reasonably conclude in the light of that evidence that all of its proposed new reporting requirements meet the evidential bar required when Ofcom considers implementing new regulations. We set out further views below on all of Ofcom's proposed new requirements.

New notification requirements around lines of business

We note Ofcom's desire to put in place a clearer process around the existing requirement we have to notify Ofcom about changes to the lines of business in the BBC's commercial arm. In principle we are content with the proportionality of these requirements as we understand the need for transparency and for Ofcom to have oversight over the financial performance of our commercial activities given its duties.

In that context we welcome Ofcom's clarification that a 'line of business' is a regulatory construct for the purposes of financial reporting and not an operational or organisation requirement on the BBC. This is clear from Ofcom's consultation which sets out that: "*A line of business is a group of activities that the BBC combines for target setting and reporting purposes, they provide visibility of whether the activities are able to make a commercial rate of return over a suitable period of time.*"²⁰

²⁰ Ofcom, Assessment of BBC Studios' changes to its lines of business, p3

We consider Ofcom's proposals must therefore be consistent with this context. Ofcom's functions do not extend to determining the operational or organisational structure of the BBC's commercial arm or any of its constituent parts; this is clearly a decision for BBC management alone²¹ and distinct from any financial reporting requirements or controls that Ofcom might consider necessary to ensure there is no inappropriate relationship with the licence fee funded BBC. We are concerned that some of the wording in the proposed new requirements does not clearly reflect this. In particular, new proposed requirement C.5 a) is too broad and could be open to misinterpretation (i.e. it could be taken to apply to the operational structure of commercial subsidiaries which is clearly not what Ofcom intends). 'Composition' is too broad a term to use; we consider that "Grouping of activities for the purposes of financial reporting" would be more appropriate and would better support Ofcom's stated objectives and definition of what a line of business is (i.e. a regulatory reporting construct).

We note that significant or material changes to the actual composition of the BBC's commercial arm (i.e. what we actually do) are already addressed by the material change provisions within the BBC's Agreement with DCMS and the relevant sections of Ofcom's Operating Framework. Given Ofcom's stated intention in relation to these financial reporting provisions, it is not appropriate or necessary to create an overlap with those material change provisions.

This issue would be best resolved by the removal of clause C.5 a) which is – in fact – unnecessary because C.5 d) requires Ofcom to approve a change before it can be made by the BBC. There is no need to require us not to change something that we cannot in any event change without Ofcom's prior approval. If Ofcom wishes to retain this clause – or to replicate any of its existing intention elsewhere (i.e. in subsequent clauses) – we consider that it should clarify that "composition" means "grouping of activities for the purposes of financial reporting to Ofcom". This would ensure consistency with Ofcom's stated rationale and definition of lines of business and avoid unnecessary and disproportionate requirements.

Ofcom's proposed notification period of three months before implementing a change – as per C.5 b) – is too long. We consider that one month – at the most – would be appropriate. The BBC must retain flexibility in delivering commercial activities to be able to respond to the market as it changes. Ofcom has the necessary enforcement powers to direct the BBC to rectify any step where it is satisfied that there has been a breach of a specified requirement²²; there is therefore no need to hardwire an over-lengthy process into these requirements where it can be avoided. Furthermore, we

²¹ Article 20(6) of the Charter.

²² Article 49 of the Charter.

see no reason that Ofcom would require such a long period of time to approve any changes to our financial reporting. These timescales have been necessary to complete such processes as Ofcom's full BBC Competition Assessment on our iPlayer proposals and its detailed assessment of the BBC's participation in BritBox. Ofcom have not set out any reasoning on why any assessment under these proposed conditions which would be of more limited nature would require the same level of detailed analysis and timescales that Ofcom undertook for matters such as iPlayer or BritBox.

Finally, for consistency, as this is a reporting requirement, we consider that it would more appropriately sit within Section D of Ofcom's trading and separation rules rather than Section C. This change would be of little practical consequence, although it would aid overall transparency and better reflect the way Ofcom has chosen to structure its trading and separation requirements.

Provision of information on achieved rates of return

We understand Ofcom's desire to have sufficiently granular data to effectively monitor BBC Studios' compliance with its trading and separation rules. We have shared a significant volume of data with Ofcom since 2017 to aid Ofcom's understanding of the BBC, including the commercial subsidiaries and the markets in which they operate. We consider that in general the existing regulation and reporting requirements in this area should provide Ofcom with sufficient information to effectively monitor BBC Studios financial performance and compare its performance against relevant peers.

We have endeavoured to be as transparent as possible with Ofcom about our commercial activities. We have already agreed to share BBC Studios' management accounts with Ofcom, which will result in us providing more information than we are currently required to do under the Operating Framework or consider strictly necessary for Ofcom to discharge its duties. We recognise that BBC Studios is a complex business and that Ofcom has limited visibility of the markets in which it operates, and we would re-state our commitment to continue working transparently and co-operatively with Ofcom and sharing information where doing so is not disproportionately burdensome for the BBC. Sharing our management accounts – as per proposed new requirement D.14 h) – will not result in significantly more effort for the BBC because we will continue to produce management accounts irrespective of Ofcom's requirements, and is therefore a proportionate measure. We understand Ofcom's desire to now ensure that this is transparently reflected in the regulatory framework given the importance to Ofcom of ensuring that all stakeholders have visibility over the information it gathers from us and can therefore take comfort that Ofcom is discharging its duties.

However we have serious concerns about the proportionality of the proposed new reporting requirements D.14 e) – D.14 g) and – in particular – whether they will allow Ofcom to undertake any meaningful monitoring or analysis. This should be the key test of whether they are in line with good regulatory practice and Ofcom's own duties as there are likely to be alternative and more flexible ways to address the need for transparency short of embedding additional information requirements in the regulatory framework. This concern is particularly acute given the analysis we present above which sets out why we do not consider Ofcom's theory of harm to be supported by the evidence.

With respect to proposed new requirement D.14 e) on reporting total revenues "allocated" between production and distribution activities, Ofcom asserts in its consultation that it would not be appropriate to look only at production as a line of business given the scale and scope of activities: "*due to the lack of suitable comparators it may be very difficult for BBC Studios to benchmark its production and distribution activities separately and determine what might represent a commercial rate of return*"²³. We agree, which is why we have established production and distribution as a single line of business.

However, we consider that it would also be difficult for Ofcom to form a considered view on the comparative profitability of production specifically, unless Ofcom has access to information that is not available to the BBC (i.e. confidential information from one of BBC Studios' competitors). As such, we do not consider Ofcom would be able to use the information it proposes to gather under this requirement for any meaningful assessment of BBC Studios' performance. This therefore calls into question the necessity and proportionality of requiring the BBC to supply this information. Nothing is set out in Ofcom's consultation document analysis that explains how Ofcom might come to such a view, which in turn raises significant concerns about how Ofcom could properly take any enforcement action based in the necessarily only partial information that could be gathered under this proposed requirement.

Furthermore the requirement, as currently proposed, is not targeted at the activity that Ofcom has suggested could pose a harm to competition. There is no revenue allocation from production to distribution, only from distribution to production. Revenues flowing from distribution to production comprise both back-end pay away (i.e. an internal sharing of distribution revenues with production) as well as upfront investment (i.e. new funding to budgets to make programmes). Of these, only the former seems to be relevant to Ofcom's stated concern (i.e. this is the revenue that directly relates to invested titles and sales of catalogue content). It remains unclear

²³ Ofcom, BBC Studios' lines of business, p15

to us how Ofcom could make any meaningful judgement on whether the internal funds flow to support new investment are potentially harmful to competition or not. This is clearly a commercial decision for BBC Studios that would be reflected in success/failure in future years. The NAO has specifically highlighted the challenge of making such a judgement, noting that *“investing in content can be highly speculative as BBC Studios is seeking to identify successful shows in advance and faces stiff competition for the creative talent behind this content”*²⁴. Ofcom’s analysis does not reference upfront investment in new IP specifically as linked to its theory of harm, so we assume its inclusion in this proposed requirement must be unintentional. If it is intentional, no evidence has been presented to justify its inclusion, or how Ofcom would expect to use this information.

As regards back-end pay away, this is set in line with market norms and the arrangements for BBC Studios produced titles are designed to mirror BBC Studios’ indie investments. We have already shared details with Ofcom of how these funds flows work. Given this is consistent with how the wider market operates – as confirmed by the Mediatique report – there appears to be an insufficient overall justification to require the BBC to disclose this information on an ongoing basis.

Noting our position above that Ofcom’s current proposal for us to report the *total* allocation of revenues between distribution to production is not appropriate, we also consider that the proposed requirement to provide this information by title – as proposed in D.14 f) – is wholly disproportionate.

As we set out and as Mediatique’s report for Ofcom makes clear, scale and portfolio are the market norm for businesses such as BBC Studios. BBC Studios produces and invests in many programmes with, in common with its competitors, a mix of successes and failures. Some titles on their own may appear to be very profitable, others may appear to be very bad investments. This is particularly true when looking at individual years rather than a longer lifecycle on a title. It also ignores relevant commercial considerations like strategic value that BBC Studios management rightly take into consideration. BBC Studios management therefore focus on the overall performance of different business areas over time, not title by title performance each year. We do not consider BBC Studios is unique in this.

Ofcom will already have information on profitability via our management accounts, which we have already agreed to provide to Ofcom on a voluntary basis to aid its understanding of BBC Studios. It is unclear to us from the consultation document why Ofcom considers it necessary to require more detailed information than BBC Studios’ own management team to monitor profitability; especially when Ofcom will not be in a position to draw and meaningful conclusions about the impact on

²⁴ National Audit Office, BBC Studios, p32

competition of the BBC's relationship with BBC Studios by looking at these allocations.

Ofcom has not set out any details on which titles distributed by BBC Studios' competitors it considers might be relevant comparators for any title by title analysis it might seek to undertake using this data. Nor has Ofcom provided any details of how it might select such comparators in future, or where it expects to gather the data required to make such a comparison. It appears to us that to make any meaningful comparison Ofcom would require significant amounts of data to be provided by BBC Studios' competitors. This is not information in the public domain.

This proposed data requirement does not moreover capture historical sunk investment in titles but rather simply revenue earned in a particular year (and, as currently written, also new investment). For a number of BBC Studios titles this could significantly skew perceptions of profitability given the high levels of historical investment by BBC Studios. As such, any reporting under this condition would simply require additional reporting by the BBC for Ofcom to have an accurate picture of an individual programme's financial performance. It would still not form an evidential basis for Ofcom to draw any meaningful conclusions on potential harm to competition from it.

Given Ofcom has sufficient residual powers to request information in relation to its regulation of the BBC²⁵, we do not consider this proposed requirement is necessary or proportionate.

Finally, we have concerns about Ofcom's potential handling of the highly commercially sensitive information that this requirement would require us to disclose and Ofcom to therefore hold on and going basis. We consider it best for Ofcom to avoid holding such information unless strictly necessary as this avoids the risk of inappropriate and inadvertent disclosure by Ofcom to a third party.

Given that we do not consider proposed new requirements D1.4 e) and D.14 f) are proportionate or targeted, we also consider that proposed requirement D.14 g) also fails to clear the necessary evidential bar.

Other comments on proposed new requirements

We have two further comments on Ofcom's proposed amendments to *Part 1: Definitions and Interpretation* of the Trading and Separation requirements and guidance.

Firstly, Ofcom's proposed new definition of "Distribution Activities" could be more clearly expressed. The reference to "domestically and abroad" – while itself

²⁵ Article 47 of The Charter.

unnecessary as the definition previously refers to “all activities” which would clearly include activities in any territory – would be better expressed as “in the UK and internationally”. BBC Studios is a global business with offices around the world – domestically and abroad are relative terms; UK and international are not. We further note, however, that Ofcom has no jurisdiction over international activities – either under these trading and separation rules, through its remit in the Charter and Agreement (which explicitly refers to Ofcom having regard to “*the desirability of protecting fair and effective competition in the United Kingdom*”)²⁶ or the Communications Act 2003. Ofcom does not explain in the consultation document why it is seeking to extend the scope of its regulation beyond the UK in this proposed regulation and we strongly suggest Ofcom redraft this definition accordingly.

Secondly, the new definition of “BBC Studios” refers to “BBC Studios Group Limited”. The legal entity we believe Ofcom is attempting to refer to here is BBC Studios Limited as registered with Companies House. Furthermore, the phrase “which consolidates BBC Studios Limited and BBC Worldwide Limited” is both erroneous and redundant. BBC Studios Limited’s two subsidiaries are called BBC Studios Production Limited and BBC Studios Distribution Limited, and have been for over two years²⁷. However, once Ofcom has correctly identified the correct legal entity – i.e. BBC Studios Limited – that is surely sufficient. We think it is clear – to us, Ofcom and other stakeholders – what BBC Studios is and does. We do not consider there is a reasonable interpretation of this where the term “BBC Studios” would not apply to the entity currently trading as BBC Studios. Ofcom should therefore adopt a consistent approach as we note it has not found it necessary to record that BBC Studioworks was previously trading as BBC Studios and Post Production or that BBC Worldwide was previously BBC Enterprises.

²⁶ Article 46(5) of the Charter.

²⁷ Companies House: [BBC Studios Production Limited](#), [BBC Studios Distribution Limited](#) and [BBC Studios Limited](#).