
BBC Studios' lines of business

Assessment of BBC Studios' changes to its lines of business

[Statement: BBC Studios' lines of business](#) – Welsh overview

STATEMENT:

Publication date: 30 April 2021

Contents

Section

1. Overview	1
2. Background	3
3. Our proposals, analysis and decisions	10

Annex

A1. Modifications to trading and separation requirements	22
--	----

1. Overview

This statement sets out our decisions relating to BBC Studios' changes to its lines of business and the process for notifying future changes set out in the trading and separation requirements.

The BBC undertakes commercial activities to generate a return, which can be reinvested in BBC programmes and services and supplement income from the licence fee. These activities need to adapt to the changing environment and respond to opportunities as they arise. Our role as regulator is to ensure that the relationship between the licence fee funded part of the BBC Public Service (the Public Service) and the commercial activities does not distort the market or create an unfair competitive advantage. We therefore imposed a number of trading and separation requirements on the BBC (the requirements) to protect fair and effective competition.¹ We support the need for the BBC to innovate, grow and change as long as this is done fairly.

BBC Studios produces and distributes content, owns and operates channels (e.g. UKTV), has a joint venture international subscription video on demand service (BritBox in countries such as the US, Canada and Australia), sells programme formats and consumer products such as DVDs and merchandise.

The requirements state that the BBC must earn a commercial rate of return for its commercial subsidiaries and lines of business. It also needs to set lines of business that are appropriate. In 2019, BBC Studios decided to reduce its lines of business from five to two, and, in particular, to combine the production and distribution activities into a single line of business. This statement assesses these changes to BBC Studios' lines of business as part of a broader programme of work to review the interaction between BBC Studios and the Public Service (BBC Studios Review).² It also sets out a new process for the notification of future changes to the lines of business by the BBC.

What we have found – in brief:

We consider that BBC Studios' changes to its lines of business are appropriate

We are satisfied that production companies of a similar size and scope to BBC Studios usually have an integrated distribution arm. This has become more important as producers and distributors are expected to help fund the costs of making programmes. As such, we consider BBC Studios' changes to its lines of business are appropriate and will allow the BBC to benchmark its production and distribution activities with competitors of a similar size and scope, in line with our requirements. Accordingly, we will continue to monitor BBC Studio's rate of return at the level of the new/combined line of business.

We recognise that the relationship between the combined production and distribution lines of business and the Public Service is complex and as such we will be undertaking further work to understand how this relationship works, and how it may impact BBC Studios' rate of return, as part

¹ [The BBC's commercial and trading activities: requirements and guidance](#), 11 February 2019.

² [Review of the interaction between BBC Studios and the Public Service: Call for Evidence](#), 9 October 2020.

of the BBC Studios Review. Therefore, at this time we are not proceeding with our proposal to require additional reporting on BBC Studios' production activities to be provided to Ofcom.

What we are doing – in brief:

We are making a change to the process the BBC must follow when notifying future changes to its lines of business

Given the significant changes that BBC Studios has made to its lines of business since its inception in 2017, we are also imposing a change to the requirements. The BBC will now be required to give Ofcom three months' notice of any future changes to the existing composition of its commercial subsidiaries and the lines of business within those subsidiaries.³ If we consider the BBC's changes to be inconsistent with the requirements, the BBC Charter or the BBC Framework Agreement, we would, subject to consultation, be able to step in to prevent them.

³ This period can be shortened with written approval from Ofcom.

2. Background

Regulating the BBC's commercial activities

- 2.1 Under the Agreement,⁴ Ofcom must set requirements in relation to the BBC's commercial activities. We set trading and separation requirements (the requirements)⁵ that we consider appropriate to ensure that the BBC's commercial activities do not, as a result of their relationship with the Public Service, trading activities or non-service activities, distort the market or create an unfair competitive advantage.
- 2.2 One of the requirements is that each subsidiary that carries out commercial activities and each line of business within the subsidiaries must earn a commercial rate of return over an appropriate period of time. The BBC must notify us and take appropriate steps where it fails to meet this requirement. The BBC must also publish the revenues, costs and rate of return for all its subsidiaries and lines of business.

BBC Studios' lines of business

- 2.3 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. The requirements state that the BBC must set appropriate lines of business. Effective oversight of BBC Studio's lines of business is important to ensure that its commercial activities do not, as a result of their relationship with the Public Service, distort the market or create an unfair competitive advantage. If the BBC fails to make a commercial rate of return over an appropriate period of time that could indicate that it is not acting as a rational investor and potentially impact fair and effective competition. Ofcom and other stakeholders need visibility that the BBC is generating a commercial rate of return over an appropriate period of time, as any other commercial entity would.
- 2.4 In March 2019, the BBC informed us of its intention to change the lines of business within BBC Studios from five to two (see Figure 1 below).

⁴ The Agreement we refer to in this document is [the Agreement between the Secretary of State for Culture, Media and Sport, and the BBC](#).

⁵ [The BBC's commercial and trading activities: requirements and guidance: Ofcom's requirements and guidance](#), 11 February 2019.

Figure 1: Changes to the BBC's lines of business within BBC Studios

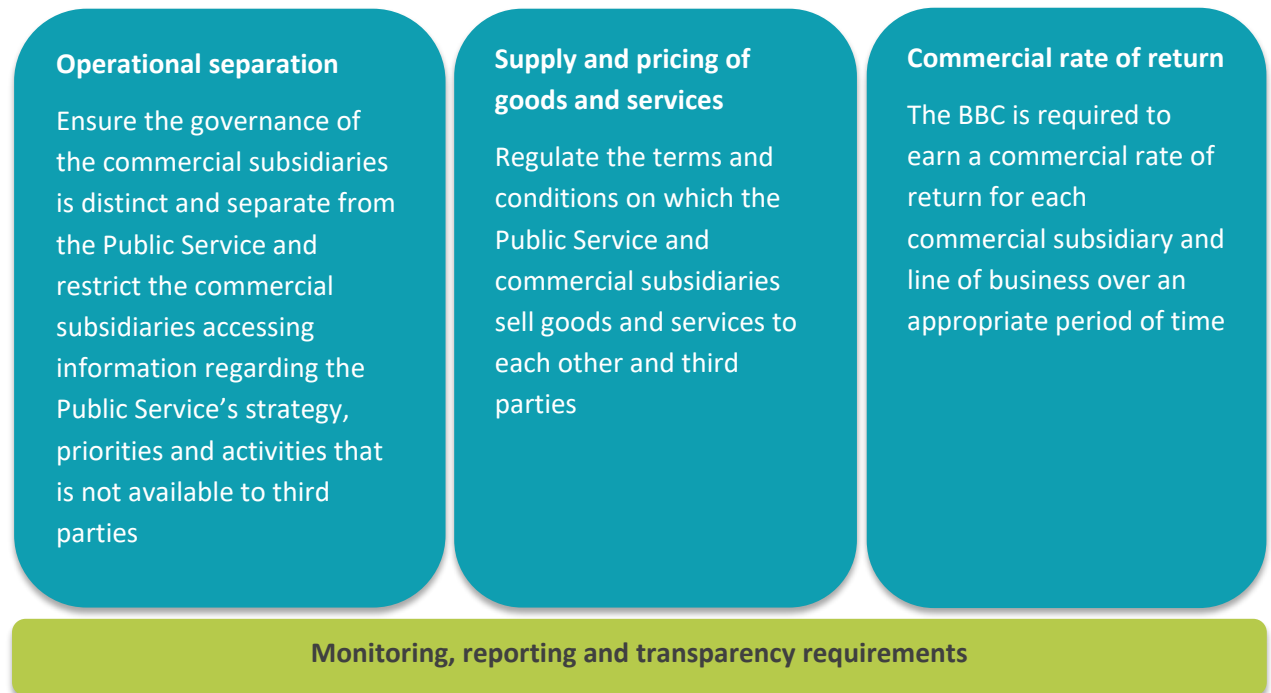
Previous lines of business	New lines of business
UK television production (making television programmes) International production and formats (production of programmes for international markets) Content sales (selling or the licensing of both BBC content and content made by other producers) Consumer products (activities such as live events and the sale of programme related goods such as DVDs)	Production and distribution (including consumer products and international production)
Branded services (BBC channels and digital platforms including ventures such as BBC America and BritBox US, Canada and Australia)	Branded services

Legal framework and our role in relation to the BBC's commercial activities

- 2.5 Ofcom's role in relation to the BBC's commercial activities is to ensure that they do not distort the market or create an unfair competitive advantage as a result of their relationship with the Public Service. We therefore focus on issues concerning the separation of the Public Service from the commercial activities carried out by the commercial subsidiaries.
- 2.6 Under the Agreement, Ofcom must set the requirements it considers appropriate to ensure separation between the Public Service and the commercial subsidiaries, which may include requirements to ensure that:
- the commercial subsidiaries operate at arm's length from the Public Service on commercial terms;
 - the commercial activities are carried out in accordance with normal market principles, including making a commercial rate of return; and
 - the relationship between the Public Service and the commercial subsidiaries is appropriately transparent, including provision of financial reporting information to Ofcom and the publication of information to demonstrate there is no adverse impact on fair and effective competition (without jeopardising the ability of the commercial subsidiaries to operate effectively in the market).

- 2.7 Under the Agreement, Ofcom must also set out how it will regulate the trading activities and the procedures to be followed, including such requirements as Ofcom considers appropriate to protect fair and effective competition.

Figure 2: A brief summary of the requirements



Current rate of return requirements

- 2.8 The main rate of return requirement is that the BBC must earn a commercial rate of return over an appropriate period of time both for each subsidiary, and for each line of business. To determine what a commercial rate of return should be for a line of business and subsidiary, the BBC should monitor and research the relevant markets, including using benchmark rates of return.
- 2.9 These requirements help to ensure that the Public Service acts like a rational private investor, i.e. if it is engaged in activities that are not expected to generate sufficient returns to justify the risks associated with those activities, it is required to take steps to modify or stop those activities. If it was not the case, it could suggest that the BBC was instead using its position as a public funded entity to sustain an activity that would not usually be considered sufficiently profitable. There is therefore a risk that without appropriate safeguards, the BBC's public funding could be used to subsidise or benefit its commercial subsidiary. This has the potential to distort the market in which the subsidiary operates or create an unfair competitive advantage for the BBC's subsidiary.
- 2.10 Even if a BBC subsidiary as a whole was making a commercial rate of return over an appropriate period of time, we might still be concerned if a particular line of business was

not making a commercial rate of return. This is because market conditions and the potential to affect the ability of rivals to compete may vary by business activity. To safeguard against this potential negative impact on competition, the rate of return requirements apply to individual lines of business as well as the subsidiaries.

The merger of BBC Studios and BBC Worldwide

- 2.11 In November 2017, the BBC announced a proposed change to its commercial activities by merging two of its commercial subsidiaries, BBC Studios and BBC Worldwide into a single entity, also named BBC Studios. The merger brought together the BBC's commercial production, sales and distribution activities which were carried out by BBC Studios and BBC Worldwide under a shared management and leadership structure. The BBC implemented this new structure from the beginning of April 2018.
- 2.12 Ahead of the merger between BBC Studios and BBC Worldwide the BBC gave commitments to Ofcom in March 2018 which included committing to retaining the existing lines of business within the new BBC Studios.⁶ In particular, it committed to continue to report on its production and distribution activities separately.
- 2.13 We subsequently decided that the merger itself did not constitute a material change and therefore we did not conduct a formal assessment of the proposed change under the Agreement. Our decision was influenced by the characteristics of the BBC's proposed change, our trading and separation requirements and the commitments provided by the BBC.
- 2.14 In our July 2018 consultation on the requirements, we explicitly referenced the need to understand the performance of production and distribution activities separately given their different cost and profit drivers.⁷

Changes to the lines of business within BBC Studios post-merger

- 2.15 In September 2019, the BBC announced that it had made some changes to the lines of business within BBC Studios with immediate effect. As set out above, it went from five lines of business to two – Production and distribution, and Branded services.
- 2.16 As a result of the changes to the lines of business, the BBC withdrew Commitment number 6 and replaced it with a revised Commitment:
- “the BBC Board will set commercial rates of return (informed by market norms) for all lines of business within BBC Studios. The BBC Board will review the performance of new BBC Studios against these targets and report to Ofcom in accordance with the requirements set out in Ofcom's trading and separation rules. The lines of business will be determined by

⁶ The merger of BBC Studios and BBC Worldwide: [The BBC's commitments](#), 23 March 2018, pages 5-6.

⁷ [The BBC's commercial and trading activities: requirements and guidance](#). A consultation on proposed modifications to Ofcom's requirements and guidance, July 2018, Page 36.

market norms and shall only be changed in accordance with Ofcom's trading and separation rules".⁸

- 2.17 The BBC stated that these changes to the lines of business were in response to Ofcom's regulation and the findings of the BBC's Commercial Review.⁹ It said that following the March 2018 merger, it had carried out work to re-evaluate what it considered the appropriate lines of business to be within BBC Studios and that this work had been undertaken by both BBC Studios and the Public Service as a shareholder.
- 2.18 The BBC cited Christopher Saul's BBC Commercial Transparency Review which found the lines of business disclosure in BBC Worldwide and BBC Studios' financial statements were more granular than peer businesses.¹⁰ It also cited EY's report for the BBC Board's Commercial Review, which found that it was only possible to benchmark meaningfully at a combined production and distribution level.
- 2.19 Finally, the BBC stated that due to the ongoing integration of the production and distribution business, it was increasingly important for BBC Studios and the BBC Group to track performance of production and distribution as a whole. The BBC considered that the existing BBC Studios reporting was not at the level of detail consistent with BBC Studios' commercial peers and as such this affected the ability of the BBC Board to effectively hold BBC Studios to account for its commercial performance, as well as to set meaningful targets. The BBC argued that its regulatory obligations to earn at least a commercial rate of return across all lines of business, which rests on being able to accurately benchmark against commercial peers, meant that the misalignment between BBC Studios and the market was problematic.
- 2.20 This new structure was reflected in the 2018/19 BBC Studios financial statements and subsequently in the 2019/20 financial statements, where it split its activities into two main categories:
- a) **Production and distribution:** The production and distribution of scripted and unscripted programmes to broadcasters and platform owners, including BBC Studios' share of the results of joint ventures and associate production companies, format sales and other content and brand-associated licensing and merchandise; and
 - b) **Branded services:** The activities of the BBC-branded channels and digital consumer propositions, including the share of results from joint venture and associate operations in BBC America, BritBox (non-UK), and UKTV, BBC Earth with Sony and those of digital branded services including BBC iPlayer in Asia.¹¹

⁸ [BBC commitments for BBC Studios-Worldwide merger](#) – version 2, updated on 27 September 2019.

⁹ [BBC Commercial Review](#), December 2018.

¹⁰ [BBC Commercial transparency review](#), Christopher Saul, December 2018.

¹¹ [BBC Commercial Holdings Limited, Annual Reports and Consolidated Financial Statements for the year ended 31 March 2019](#), Page 6.

Purpose and scope of this statement

2.21 The BBC has modified its lines of business, and we have considered whether the BBC's new lines of business continue to allow us to address our competition concerns. In October 2020 we consulted on BBC Studios' changes to its lines of business (the 2020 Consultation).¹² This document sets out our conclusions in light of consultation responses and sets out our actions to address the concerns identified through the modification of the requirements.

Impact assessment

2.22 Impact assessments provide a valuable way of assessing different options for regulation and showing why the preferred option was chosen. They form part of best practice policy making. This is reflected in section 7 of the Act, which means that generally we have to carry out impact assessments where our proposals would be likely to have a significant effect on businesses or the general public, or when there is a major change in Ofcom's activities. However, as a matter of policy Ofcom is committed to carrying out impact assessments in relation to the great majority of our policy decisions.¹³

2.23 We set out our impact assessment in the 2020 Consultation. In this statement, we take into account relevant responses and set out our conclusions on the impact of the changes.

Equality impact assessment

2.24 Section 149 of the Equality Act 2010 (the 2010 Act) imposes a duty on Ofcom, when carrying out its functions, to have due regard to the need to eliminate discrimination, harassment, victimisation and other prohibited conduct related to the following protected characteristics: age; disability; gender reassignment; marriage and civil partnership; pregnancy and maternity; race; religion or belief; sex and sexual orientation. The 2010 Act also requires Ofcom to have due regard to the need to advance equality of opportunity and foster good relations between persons who share specified protected characteristics and persons who do not.

2.25 Section 75 of the Northern Ireland Act 1998 (the 1998 Act) also imposes a duty on Ofcom, when carrying out its functions relating to Northern Ireland, to have due regard to the need to promote equality of opportunity and regard to the desirability of promoting good relations across a range of categories outlined in the 1998 Act. Ofcom's Revised Northern Ireland Equality Scheme explains how we comply with our statutory duties under the 1998 Act.

¹² [BBC Studios' lines of business](#), 9 October 2020.

¹³ For further information about our approach to impact assessments, see the guidelines, [Better policy-making: Ofcom's approach to impact assessment](#).

- 2.26 To help us comply with our duties under the 2010 Act and the 1998 Act, we may carry out a formal equality impact assessment (EIA) to help us assess the impact of our proposals on persons sharing protected characteristics and in particular whether they may discriminate against such persons or impact on equality of opportunity or good relations.
- 2.27 We do not consider that our proposals have equality implications under the 2010 Act or the 1998 Act and have not considered it necessary to carry out a formal EIA.

Structure of this statement

- 2.28 The remainder of this document is organised as follows:
- Section 3 sets our consultation proposals, analysis and decisions with respect to the changes to the BBC's lines of business including the new requirements around the process for the BBC to make changes to its lines of business; and
 - Annex 1, published separately, sets out our modified requirements and guidance.

3. Our proposals, analysis and decisions

- 3.1 In this section, we briefly set out the proposals we outlined in our consultation document, the responses we received¹⁴ and our subsequent consideration of the issues before setting out our decisions.
- 3.2 In summary, we consider BBC Studios' changes to its lines of business are appropriate and will allow the BBC to benchmark its production and distribution activities with competitors of a similar size and scope. We have also decided not to go ahead, at this time, with our proposals to require additional reporting of the activities included within the production and distribution line of business.
- 3.3 However, we agree with the BBC that we need to understand more about the relationship between the BBC Studios production and distribution line of business and the level of payments made to the Public Service for content it has commissioned (particularly where the Public Service continues to own the IP for the content). We consider this is best considered as part of our wider BBC Studios Review which is considering the interaction between BBC Studios and the Public Service. It is possible that, as a result of this work, we may propose further modifications to the requirements including but not limited to changes to the reporting requirements.
- 3.4 Finally, we have decided to go ahead with a change to the requirements so that the BBC has to notify Ofcom three months in advance of future changes to the composition of its commercial subsidiaries and the lines of business within those subsidiaries. We have allowed for this time period to be reduced where requested by the BBC and approved by Ofcom.

Are the lines of business consistent with the sectors BBC Studios operates in?

2020 Consultation position

- 3.5 On the basis that production companies of a similar size and scope to BBC Studios also have an integrated distribution arm, we considered that BBC Studios' changes to its lines of business were consistent with its competitors.
- 3.6 We recognised that the combined production and distribution line of business reduced transparency for the majority of small production companies who did not distribute their own content. However, due to the lack of suitable comparators of a similar size and scope to BBC Studios we considered it would be difficult to benchmark its production and

¹⁴ We received three responses to our 2020 Consultation from Directors UK, Pact and the BBC. [They are available on our website.](#)

distribution activities separately and determine what might represent a commercial rate of return.

3.7 Our views were informed by a report we commissioned from Mediatique.¹⁵

Stakeholder responses

3.8 Directors UK and Pact agreed with Ofcom's conclusion that BBC Studios' decision to combine its production and distribution activities is consistent with market practice of similar sized competitors.^{16,17}

3.9 The BBC strongly welcomed Ofcom's conclusion that production and distribution together was one line of business for the purposes of financial reporting. It considered the evidence gathered by Mediatique for Ofcom clearly supported this view, as did its own analysis including the findings of its 2018 Commercial Review.¹⁸

Our analysis and final decision

3.10 BBC Studios' decision to combine its production and distribution activities is consistent with the sector – particularly for production companies of a similar size and scope. This will allow the BBC to benchmark the production and distribution rate of return with comparable competitors. We recognise that this reduces transparency for the majority of small production companies who do not distribute their own content. However, due to the lack of suitable comparators it would be difficult for BBC Studios to benchmark its production and distribution activities separately and determine what might represent a commercial rate of return.

3.11 In addition, the sale of consumer products and formats is in effect a form of distribution and the value of these activities is directly linked to production and the ownership of the underlying rights. We therefore consider it is appropriate these activities are included in the production and distribution line of business.

3.12 We received no objections to our proposals nor any evidence to suggest that combining the production and distribution activities was not consistent with market practice. We are therefore satisfied that the combined production and distribution line of business is appropriate and this is the level at which the BBC is required to earn a commercial rate of return.

3.13 However, we note that it is not consistent with market practice for production and distribution activities to be combined with branded services/channel activities. There are a number of competitors that BBC Studios can use as comparators for the branded services activities and it should therefore be able to benchmark its own rate of return to ensure it is

¹⁵ [State of the markets in which BBC Studios operates](#), October 2020.

¹⁶ [Directors UK's response to the BBC Studios lines of business consultation](#), paragraph 4.

¹⁷ [Pact's response to the BBC Studios lines of business consultation](#), paragraph 2.1.

¹⁸ The [BBC's response to the BBC Studios lines of business consultation](#), page 3.

within a commercial range. If this line of business was combined with production and distribution in the future, then there would be a risk that the current high level of returns in branded services could mask low returns in other areas which could impact fair and effective competition.

Is the rate of return from the production and distribution line of business comparable with BBC Studios' competitors?

2020 Consultation position

- 3.14 In the 2020 Consultation, we noted that there were many activities that BBC Studios undertook that were comparable with commercial rivals:
- a) Consumer product activities can be undertaken by any commercial rival subject to licensing;¹⁹
 - b) BBC Studios' production activities do not give it an advantage over its competitors as it competes against other production companies for an increasing number of Public Service commissions over the course of this Charter period and returning series will become 100% contestable by 2027.²⁰ It also competes against other production companies to make programmes for third parties; and
 - c) Any commercial rival could compete with BBC Studios in bidding for the distribution rights for programmes commissioned by the Public Service (where BBC Studios is not the producer) and programmes commissioned by third parties (where BBC Studios is not the producer).
- 3.15 However, we also considered that there were some activities, primarily related to the distribution of Public Service content, that the BBC's competitors of similar size and scope may not be able to replicate to the same extent. Primarily we noted that distribution of Public Service productions (i.e. those made prior to the establishment of the commercial production company) and returning series where the Public Service still owns the Intellectual Property (IP) rights even where the more recent series were made by BBC Studios production may not be replicable to the same extent by commercial rivals.
- 3.16 We said that given a significant proportion of BBC Studios' content sales came from IP owned by the Public Service, there was a risk that this would impact the returns of the production and distribution line of business as no other distributor was likely to have a profitable back catalogue the extent of the Public Service owned IP BBC Studios has access to. We said that we would also be concerned if the profits from the Public Service owned IP were being used to prop up BBC Studios' production activities (and for example BBC

¹⁹ Given revenues and returns from the sale of consumer products are small and declining.

²⁰ Schedule 3(7) of the Agreement.

Studios was able to price lower than its rivals for new business or mask its under-performance).

Stakeholder responses

- 3.17 Pact stated that while combining the production and distribution activities may be consistent with similar sized entities in the market, this overlooked the fundamental differences between BBC Studios and other companies in the market, and the many advantages that BBC Studios has had since its inception. In Pact's opinion:
- a) There are very few entities in the market which are directly comparable to BBC Studios;
 - b) There are also no equivalent independent production companies that own a UK broadcaster channel as part of its portfolio;
 - c) There is no other entity in the UK production market that would have access to the output deals that the BBC enjoys;
 - d) When BBC Studios was spun out of the Public Service, it had an underpinning of scale and financial resources which no other UK production entity could replicate; and
 - e) BBC Studios has been gifted output deals and all IP from BBC Studios went to its own in-house distributor, something which was not common practice in the market.²¹
- 3.18 Directors UK said that the BBC should seek to exploit its back catalogue to gain maximum return for UK content and the content creators. It considered that, if the money from BBC back catalogue sales enabled BBC Studios to spend more on new content, that would not negatively affect its members – provided this did not unfairly distort the overall production market and its members were appropriately compensated for the creation and use of their work.²²
- 3.19 The BBC did not agree with Ofcom's assessment that BBC Studios' ability to exploit BBC IP made it in any way unique or incomparable against peers in the market. It argued that:
- a) BBC Studios does not have the largest back catalogue and other integrated producer/distributors of a similar size and scale have access to an equivalent back catalogue. Further, other integrated producer/distributors back catalogues contain productions which have been funded in part by the licence fee;²³
 - b) BBC Studios distributes and makes titles whereas the BBC owns the IP, however the returns BBC Studios 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 Public Service for the original distribution rights (on commercial

²¹ Pact's response to the BBC Studios lines of business consultation, paragraph 2.1 – 2.3.

²² Directors UK's response to the BBC Studios lines of business consultation, paragraph 7.

²³ The BBC's response to the BBC Studios lines of business consultation, page 17. Note: The BBC referred to some programmes from other producers that have been funded in part by the licence fee, namely ITV Studios (page 8), Banijay (page 9) and Freemantle (Page 9).

terms) and its continued investment in new series. It noted that BBC Studios also retains the ability to renew these deals over time where relevant (e.g. when it continues to invest in titles). As such, the BBC argued there was no unearned profit resulting from historic licence fee funding of these programmes;²⁴

- c) Freshness of content is one of the key drivers of sales and revenues and as such the Rights Archive content and older invested IP is not particularly lucrative for BBC Studios or the Public Service. Independent production companies are winning a larger share of new Public Service commissions and therefore increasingly the IP for this content is not owned by the BBC (and cannot advantage BBC Studios);²⁵ and
 - d) The current arrangements within BBC Studios simply reflect the fact that the titles were originally made by in-house production. Had production been spun out of the Public Service 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 Public Service production competed against third parties (e.g. under the WOCC (window of creative competition)) to produce 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. The BBC considered that BBC Studios should be free to allocate the returns on its investments internally in the way best calibrated to deliver its commercial strategy.²⁶
- 3.20 The BBC also argued that as the Public Service commissioning spend with BBC Studios decreases,²⁷ its invested titles will become less relevant (and less profitable) and therefore Ofcom's assumption that BBC Studios could gain an advantage from a high volume of BBC IP would not hold going forward.²⁸
- 3.21 The BBC also highlighted that due to the Public Service's shift to using non-BBC producers and the level of comparative investment in BBC commissioned productions, the overall significance of investment from BBC Studios as a distributor was declining.²⁹
- 3.22 The BBC also considered that a risk of undercutting competitors on price completely ignored the nature of competition for creative commissions as commissioners generally want the best programmes for their channels and services to drive viewing, not the cheapest programmes, the emphasis being on quality rather than cost.³⁰

²⁴ The BBC's response to the BBC Studios lines of business consultation, pages 15 & 17.

²⁵ The BBC's response to the BBC Studios lines of business consultation, page 7.

²⁶ The BBC's response to the BBC Studios lines of business consultation, pages 15 & 17.

²⁷ Due to the requirement that 100% of relevant TV programmes be competitively tendered by 2027.

²⁸ The BBC's response to the BBC Studios lines of business consultation, page 10.

²⁹ The BBC's response to the BBC Studios lines of business consultation, page 11.

³⁰ The BBC's response to the BBC Studios lines of business consultation, page 18.

Our analysis and final position

- 3.23 As set out above, we consider that an integrated producer distributor is the model used by BBC Studios' closest competitors. However, we have also considered whether there are any activities within the new production and distribution line of that make the rate of return less comparable with that of a commercial rival.
- 3.24 We continue to consider that BBC Studios' competitors have the opportunity to undertake most of the production and distribution activities that BBC Studios undertakes and earn a comparable rate of return for those activities.
- 3.25 However, we are less clear that the distribution rights BBC Studios holds for historic and returning series where the Public Service owns the IP are comparable. The arrangements for producing and selling this content are complicated, particularly as some of these deals were made some time ago. As a result we are engaging with the BBC to better understand the terms on which this content is produced and distributed and how this compares with third parties winning Public Service tenders. This is to ensure that the rate of return of the production and distribution line of business is comparable with commercial benchmarks.
- 3.26 We agree that when BBC Studios, or its predecessor BBC Worldwide, made investment into these historic series, this should be reflected in our rate of return analysis.
- 3.27 We also agree that this element of the relationship with the Public Service is likely to continue to reduce in significance over time as third-party producers win more Public Service commissions and BBC Studios wins more commissions where it owns the IP from the Public Service and other commissioners.
- 3.28 We plan to continue this work as part of the BBC Studios Review to better understand the relationship between the producer, distributor and commissioner, particularly in relation to returning series. This work will be carried out as part of our work on the supply and pricing of goods and services (transfer pricing) as the Public Service should set prices for goods and services based on the relevant market price or market benchmark as appropriate. If our transfer pricing rules are being followed, this helps to ensure that the rate of return of the production and distribution line of business is comparable with commercial benchmarks.

Additional reporting to Ofcom

2020 Consultation position

- 3.29 Based on our concerns articulated in the 2020 Consultation (paragraphs 3.15 to 3.16), we proposed to require the BBC to provide additional information to Ofcom on a confidential basis. We proposed that the BBC should provide this information on an annual basis when it provides the annual submission (at the same time as the publication of its annual report). The information included:

- a) Full year BBC Studios management accounts;
- b) The total amount of revenue which was allocated from distribution to production in the financial year to which the achieved rates of return relate;
- c) A breakdown of the total revenue allocated from distribution to production split by title which would allow us to closely monitor a production only rate of return; and
- d) An explanation of any material change in the total amount of allocated revenue between the current and prior financial year.

Stakeholder comments

- 3.30 Directors UK agreed that it is appropriate for Ofcom to amend its reporting requirements such that the BBC would be required to provide separate lines of reporting on its production and distribution activities. It also considered that it was reasonable that Ofcom should be able to review the returns the BBC gets from the Public Service owned IP as part of our trading and separation requirements to understand whether BBC Studios was receiving a benefit from the Public Service back catalogue in a way other comparable sized companies would not be able to replicate.³¹
- 3.31 Pact was also supportive of our proposals to introduce new requirements on the BBC to confidentially report on its lines of business.³²
- 3.32 The BBC re-stated its commitment to continue working transparently and co-operatively with Ofcom and sharing information where doing so was not disproportionately burdensome for the BBC. It said that this was the case for provision of BBC Studios' management accounts to Ofcom (as this would not result in significantly more effort for the BBC). However, it had serious concerns about the proportionality of the proposed new reporting requirements, in particular whether they would allow Ofcom to undertake any meaningful monitoring or analysis. The BBC considered the key test should be whether the proposed reporting requirements are in line with good regulatory practice and our own duties as there were likely to be alternative and more flexible ways to address the need for transparency short of embedding additional information requirements in the regulatory framework. The BBC's concern was particularly acute given the analysis it presented setting out why it did not consider our theory of harm to be supported by the evidence.³³
- 3.33 The BBC also said that providing revenue by programme in a particular year could skew perceptions of profitability as it would not recognise the high levels of historical investment by BBC Studios. It noted that additional information would have to be provided for us to have an accurate picture of an individual programme's financial performance.³⁴

³¹ Directors UK's response to the BBC Studios lines of business consultation, paragraphs 6-8.

³² Pact's response to the BBC Studios lines of business consultation, paragraph 4.1.

³³ The BBC's response to the BBC Studios lines of business consultation, page 21.

³⁴ The BBC's response to the BBC Studios lines of business consultation, page 23.

Our analysis and final decision

- 3.34 In the consultation, we proposed additional reporting to Ofcom so that we could monitor the rate of return of the production activities separately from distribution and the distribution revenue for BBC owned IP i.e. below line of business level reporting. This was for two reasons:
- a) We recognised that production was a relatively new activity and wanted to understand how returns were evolving over time; and
 - b) We recognised the BBC had a valuable back catalogue and this might impact the rate of return for the combined line of business.
- 3.35 As outlined above (paragraph 3.28), we are undertaking further work to determine whether the distribution rights BBC Studios holds for historic and returning series where the Public Service owns the IP are comparable with commercial benchmarks. As we are unable to conclude on this at the moment, we have decided not to impose additional reporting requirements for the production activities on the BBC at this time. We will take into account the stakeholder responses to the 2020 Consultation in our future work. It is possible that following the conclusion of our work as part of BBC Studios Review, we may propose further modifications to the requirements including but not limited to changes to the reporting requirements.
- 3.36 We welcome the BBC's commitment to continue working transparently and co-operatively and share information with Ofcom. We will look to engage informally with the BBC to continue to receive the BBC Studios management accounts on an ongoing basis so that we can better understand the rate of return of the production and distribution line of business over time.

Notification of proposed changes to the BBC's lines of business

2020 Consultation position

- 3.37 The significant changes in the composition of both BBC Studios and the individual lines of business within it since it was incorporated in 2017 made it more difficult for us and stakeholders to understand how the performance of the different lines of business have changed over time and how it compares with its rivals. As such, we proposed that the BBC should notify us of changes to the composition of the commercial subsidiaries and/or lines of business three months in advance of the proposed change taking effect. We said that this notification should include a description of the change, the reason(s) for it and its impact. We considered that this would allow us to assess whether the changes are appropriate and consistent with the requirements, the Charter and the Agreement prior to their implementation. We stated that we would only consult on a direction not to implement the changes if our investigation raised concerns that were not able to be addressed through discussions with the BBC.

Stakeholder comments

- 3.38 Directors UK supported our proposal and considered it was appropriate that Ofcom, as the industry regulator, had advance notice of proposed changes to the BBC's commercial structure in order to assess the justification and impact of these, and had the scope to intervene as necessary. However, it stated that this oversight needed to be dealt with in a way that recognised the need to be agile in this fast changing market, and did not put the BBC at a significant commercial disadvantage compared to global competitors who did not have such additional regulatory burdens.³⁵
- 3.39 Pact was supportive of Ofcom's proposals to introduce new requirements on the BBC to give three months' notice to Ofcom of any future changes to its commercial services. However, it wanted clarity on how Ofcom and/or the BBC would consult with third parties if there are any changes to their commercial services, including whether the consultation would involve third parties. Pact considered that wide consultation with stakeholders ahead of any changes was preferable.³⁶
- 3.40 The BBC considered our proposed notification period of three months before it was able to implement a change was too long. It argued that one month at the most would be appropriate. The BBC said it must retain flexibility on its commercial activities to be able to respond to the market as it changes. It considered that Ofcom had the necessary enforcement powers to direct the BBC to rectify any step where it was satisfied that there had been a breach of a specified requirement; and therefore there was no need to hardwire a lengthy process into the requirements where this could be avoided.³⁷
- 3.41 The BBC also raised some points about the wording of the proposed modifications to the requirements:³⁸
- a) Requirement C.5(a) was unnecessary because C.5(d) required Ofcom to approve a change before it could be made by the BBC;
 - b) The term "composition" used in the proposed modification of requirement C.5(a) was too broad and could be open to misinterpretation. The BBC considered the term "grouping of activities for the purposes of financial reporting" would be more appropriate; and
 - c) The modified requirement would more appropriately sit within Section D of Ofcom's trading and separation rules rather than Section C.³⁹

³⁵ Directors UK's response to the BBC Studios lines of business consultation, paragraph 12.

³⁶ Pact's response to the BBC Studios lines of business consultation, paragraph 3.1.

³⁷ The BBC's response to the BBC Studios lines of business consultation, page 22.

³⁸ The BBC also made comments in relation to the proposed definition of BBC Studios for the purposes of our requirements. We have modified the definition reflecting on the BBC's comments.

³⁹ The BBC's response to the BBC Studios lines of business consultation, pages 21-22.

Our analysis and final decision

- 3.42 As set out in Section 2, there have been significant changes in the composition of both BBC Studios and the individual lines of business since it was incorporated in 2017.
- 3.43 We agree with Directors UK and the BBC that it is important for BBC Studios to be able to adapt its operations and reporting to respond to changes in the market. We therefore consider that it is important that BBC Studios has the flexibility to change the composition of the lines of business to meet the needs of the business. However, we also consider it is appropriate that the regulator has an ability to intervene in the event that there are concerns about a specific change and its impact. Accordingly, Ofcom reserves the ability to direct the BBC not to make such a change. This could occur if we considered that the proposed change was inconsistent with the requirements, the Charter or the Agreement.
- 3.44 Having considered the effectiveness of the current requirements and stakeholder comments, we still consider that the BBC's ability to proceed with significant changes without appropriate oversight from Ofcom could be problematic given that once such changes have been implemented, it could be costly and burdensome to unravel them. To allow us to assess the change before it is implemented, we therefore consider it is appropriate for the BBC to notify us of changes to the composition of the commercial subsidiaries and/or lines of business in advance. This notification should include a description of the change, the reason(s) for it and its impact. This will allow us to assess whether the change is appropriate and consistent with our requirements, the Charter and the Agreement prior to its implementation. In response to Pact's concerns around consultation, we expect to consult on any direction to the BBC in relation to its proposed change with the BBC and other interested parties in line with our consultation principles.⁴⁰ Prior to issuing a draft direction we would first discuss any concerns we may have with the BBC to see if such concerns could be effectively addressed by the BBC without the need for formal action from Ofcom.
- 3.45 We have not seen any evidence to suggest that the advance notification would likely involve a significant additional administrative cost or cause disproportionate delay. Conversely, we note that it has taken considerable time for Ofcom to obtain the relevant information and fully understand the changes the BBC has implemented which have been considered in this statement. We therefore consider that the three-month notification period is appropriate. We encourage the BBC to discuss with us changes that it is considering making to the composition of the subsidiaries and the lines of business informally in advance so that we can complete our assessment as quickly as possible. If we have no concerns, we would inform the BBC as soon as possible that we do not propose further action.
- 3.46 However, we also recognise the need for flexibility and appreciate that not all changes may require three months for us to assess. As such, we have decided to adapt our proposal so

⁴⁰ We set out [our consultation principles](#) on our website.

that the BBC, with written consent from Ofcom, can shorten this notice period where appropriate. We will consider this on a case by case basis.

- 3.47 With regards to the points raised by the BBC on our proposed modifications to the requirements:
- a) We consider that proposed requirement C.5(a) should be included for clarity as it sets out the obligation on the BBC to maintain the existing composition of its commercial subsidiaries and lines of business, subject to the BBC having an ability to make changes in accordance with the process set out in the requirements;
 - b) We have decided to maintain the word “composition” as we believe that this better captures our intention that the BBC must notify us if it proposes to change the activities within a commercial subsidiary or a line of business. In the 2020 Consultation we explained that a line of business is a group of activities that the BBC combines for target setting as well as reporting purposes. This requirement forms an integral part of the requirements whose purpose is to provide visibility of whether the activities comprised within a commercial subsidiary or a particular line of business are able to earn a commercial rate of return over an appropriate period of time. As such, requirement C.5 captures a wider set of obligations than a grouping of activities only for the purposes of financial reporting; and
 - c) In light of the above, we consider that requirement C.5 continues to form part of the substantive rate of return requirements. We have therefore decided to maintain requirement C.5 as part of the rate of return requirements (Section C of the requirements) as proposed in the 2020 Consultation.
- 3.48 Our changes to the requirements are set out in Annex 1, and in summary require the BBC to:
- a) Provide three months’ notice to Ofcom of any future changes to the lines of business of any commercial subsidiary unless written consent is obtained from Ofcom to shorten this notification period. Ofcom will assess any such requests on a case-by-case basis;
 - b) Provide the following information to Ofcom as part of this notification:
 - i) A description of the proposed change;
 - ii) The BBC’s reasons and justifications for the change; and
 - iii) The impact of the change for the lines of business reporting.
 - c) Not to implement any proposed changes where the notification requirements have not been complied with or where Ofcom has directed the BBC not to proceed with those changes.

Other issues raised by stakeholders

- 3.49 Pact raised a number of additional points in its response which did not directly relate to our proposals:
- a) Ofcom must clearly set out what steps it will take if BBC Studios or a line of business is consistently missing its targets or not making a commercial rate of return. It also questioned whether BBC Studios will be allowed to fail like any other production/distribution business.⁴¹
 - b) Ofcom should also clearly state how the reporting and monitoring processes will aid transparency on BBC Studios' activities, including details on what information the BBC will be required to provide. Pact considered that this would give it confidence that the additional requirements and guidance are sufficient to monitor BBC Studios' impact on the market and competition.⁴²
- 3.50 With regards to these three points that Pact raised, they are all addressed within the current requirements:
- a) Where a line of business consistently does not make a commercial rate of return and is not forecast to make 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.⁴³ Where the BBC misses its targets but still earns and is forecast to earn a commercial rate of return over an appropriate period of time, we would not take further steps.
 - b) We considered the reporting on the BBC in our 2019 statement on the requirements.⁴⁴ We believe the current lines of business as considered in this statement provide the appropriate amount of transparency given the current framework i.e. we are able to compare the underlying activities of BBC Studios with those of commercial rivals of a similar size and scope.

⁴¹ Pact's response to the BBC Studios lines of business consultation, paragraphs 4.1 and 4.2.

⁴² Pact's response to the BBC Studios lines of business consultation, paragraph 4.3.

⁴³ Requirement C.4.

⁴⁴ [The BBC's commercial and trading activities: requirements and guidance: Ofcom's requirements and guidance](#), 11 February 2019.

A1. Modifications to trading and separation requirements

A1.1 This annex has been [published separately](#) on the Ofcom website.