



SKY'S RESPONSE TO OFCOM'S CONSULTATIONS ON COMPETITION REGULATION OF THE BBC

EXECUTIVE SUMMARY

1. The BBC remains an enormous intervention by the state in the UK media sector. Its vast scale and remit means it has an inevitable impact on competition in the wider market, at all levels of the value chain. Without appropriate safeguards, the BBC's public and commercial services have the potential to harm the ability of others to compete effectively – whether through crowding out commercial services, deterring investment or otherwise distorting competition.
2. Consequently, there is a need to ensure that the BBC's impact on the wider market is effectively scrutinised and controlled. Both the BBC Board and Ofcom have obligations to consider the impacts of the BBC's activities on competition, with Ofcom having a specific role to protect fair and effective competition in the areas that the BBC operates.
3. Sky welcomes and supports much of Ofcom's proposed approach to overseeing the various areas of the BBC's activity that are likely to give rise to competition concerns. In the main, they represent a marked improvement on the various BBC Trust regimes established under the previous Charter. We have a greater degree of confidence that the market impact of the BBC's activities will be robustly and independently scrutinised, with appropriate corrective action being available wherever concerns are identified.
4. Notwithstanding this broad support, however, Sky has some observations on Ofcom's proposed processes and guidance which are set out in this response to Ofcom's various consultations.
5. In general, Ofcom should be extremely wary of relying on the BBC's own assessments as part of the regulatory framework given the clear incentives for the BBC to underplay any potential market impact. Sky notes that the BBC Board is envisaged as playing a substantial role in, for example, initial assessments of materiality (both for changes to UK public services and commercial subsidiaries), and in the BBC's distribution policy. Ofcom's processes must ensure robust checks and balances for all areas where assessments made by the BBC are key components in the regulatory process.
6. Given the high value that UK audiences place on BBC content, its availability may act as an important determinant of a content platform's success. Ofcom's approach to regulating the BBC's content distribution policy is therefore of particular importance, and Sky welcomes Ofcom's involvement and looks forward to the establishment of more rigorous requirements and enforcement. Ofcom's challenge is to create a regulatory framework that can specifically and swiftly address the BBC's current restrictive approach to content distribution. This means requiring the BBC to operate with an obligation to supply to all reasonable requests from third parties, without the ability to otherwise justify a refusal to supply. While there are legitimate protections that the BBC should be able to secure in relation to third party distribution of its content, Ofcom should ensure that these 'conditions' are set at the minimum necessary, as well as take due note of arrangements

that platform operators have been able to agree with other broadcasters when considering the reasonableness of the BBC's position.

7. One area of particular concern is the regulation of the BBC's commercial services. As with the BBC Trust's regulatory regime, Ofcom's proposals fall short of measures sufficient to enable proper scrutiny of the BBC's commercial activities, and therefore provide no guarantee that the BBC is trading fairly. In particular, Sky is concerned that Ofcom appears to broadly accept the BBC commercial subsidiaries may have non-standard relationships or interactions with the UK public services (such as sharing information, assets or management/employees), and provides little in the way of guidance to combat this. In Sky's view, Ofcom's requirements in this area should be more robust - including a requirement for all goods and services from the BBC's public services to be made available to the wider market as standard, rather than the subject of preferential agreements with BBC commercial subsidiaries.
8. Finally, it is also critical that Ofcom's demonstrates resolute intent on regulating the BBC from the outset. Ofcom must underpin its framework with a strong and stated will to act where circumstances require, supplemented by the resources required to take action if necessary.
9. Sky looks forward to engaging further with Ofcom as it develops its regulatory framework for the BBC in more detail.



SECTION 1: INTRODUCTION

- 1.1 Sky welcomes the opportunity to respond to Ofcom's consultations on competition regulation of the BBC, specifically:
- (a) Assessing the impact of proposed changes to the BBC's public service activities ("the Change Consultation");
 - (b) Assessing the impact of the BBC's public service activities ("the Review Consultation");
 - (c) Distribution of BBC public services ("the Distribution Consultation"); and
 - (d) The BBC's commercial activities ("the Commercial Consultation"), (together, "the Consultations")
- 1.2 The BBC has an unparalleled position in the UK media sector, in particular, broadcasting. Its guaranteed and substantial funding of £3.7bn from the television licence fee is further strengthened by the prominent EPG positions it is afforded, its substantial reserved spectrum holdings and its profitable commercial subsidiaries. This gives it the ability to influence and condition what its competitors can achieve. The scale of the BBC and its wide remit makes it inevitable that its impact is felt far beyond the creation and supply of public service content, with the consequent risks that it might adversely impact fair and effective competition.
- 1.3 Effective regulation of the BBC's impact on competition is therefore critical to ensuring a thriving UK broadcasting sector that is not distorted by this significant public intervention. Sky has long argued for Ofcom to act as regulator of the BBC's activities – its expertise and understanding of the sector as a whole makes it well placed to design and implement the necessary regulatory processes.
- 1.4 In this section, Sky gives a brief overview of our various interactions with the BBC as both collaborator (for the distribution of the BBC's content) and competitor (in the creation of content and channels as well as for the distribution of the BBC's content), while also noting the legal framework which underpins Ofcom's new regulation.
- 1.5 In the sections that follow, we address each of the Consultations.
- 1.6 Sky notes that Ofcom is consulting on other aspects of its regulation of the BBC, and will publish further consultations. We look forward to contributing further to these processes as they progress.

Sky's relationship with the BBC

- 1.7 Sky has a multi-faceted relationship with the BBC, with the two organisations competing and collaborating at several points in the broadcasting value chain. Of particular note is the BBC's role as a:

- (a) **Content provider:** The BBC is one of the most important content providers on Sky services. Millions of households choose to watch BBC Public Service content through Sky's services, while the BBC's commercial arm, BBC Worldwide, is also a content provider, both directly and through its UKTV joint venture.
 - (b) **Content competitor:** Sky's channels and the BBC's compete for share of audience, while from a production point of view we compete to some extent in commissioning and talent acquisition.
 - (c) **Platform operator:** The BBC has significant interests in the operation of a number of television platforms including Freeview, Freesat, iPlayer and YouView, which compete with Sky's own platform. Sky also looks to distribute its content (both linear channels and the NOW TV service) via those platforms in which the BBC has an interest.
- 1.8 Sky has a long history of working with the BBC to deliver its content to Sky customers. While historically the relationship has been a relatively simple one, centring on the availability of BBC free to air channels on the Sky DTH platform, it is increasingly multi-faceted and highly complex.
- 1.9 In common with other providers, the nature of the pay television services and products Sky operates mean we seek an array of rights from the BBC to enable customers to enjoy this content using the full functionality of the technology in their home – linear channels delivered via different distribution technologies, catch-up content, on-demand box sets, ancillary rights and so on. Each of these agreements will include further variables such as how long catch-up content is available for, or with the example of in-home streaming, how long the content is able to be accessed on the customer's device. A comprehensive list is provided at Annex 1.
- 1.10 There are other areas where Sky has a relationship with the BBC as a third party content provider itself. For example, several Sky channels (Sky News, Pick and Challenge) are available via platforms in which the BBC is a joint operator (i.e. Freeview and Freesat). Sky has also sought to make its NOW TV service available on YouView, which was created by the BBC.
- 1.11 Sky's response to Ofcom's consultations is framed by these various roles and interests, and further informed by our experiences of dealing with the BBC under the previous Charter and Agreement.

Ofcom's duties in relation to the BBC

- 1.12 The new BBC Royal Charter confers a number duties on Ofcom, including:
- (a) An obligation to have regard, in the carrying out of its functions, to the desirability of protecting fair and effective competition in the UK.¹
 - (b) An obligation to publish an Operating Framework which contains the provisions Ofcom considers appropriate to secure the effective regulation of the activities of the BBC as set out in the Charter and Framework Agreement.²
 - (c) An obligation to set requirements in the Operating Framework to protect fair and effective competition in the UK in relation to:

¹ Article 45(2) of the Charter.

² Article 46(2) of the Charter.

- material changes proposed by the BBC to the carrying on of UK public services and non-service activities
 - the effect of fair and effective competition of UK public services , trading activities and non-service activities
 - agreements with, and conduct affecting, third parties in relation to UK public services, trading activities and non-service activities.³
- (d) An obligation to set requirements in the Operating Framework in relation to interaction between the BBC and its commercial activities, to ensure that the commercial activities do not, as a result of their relationship with the UK public services, trading activities or non-service activities, distort the market or gain an unfair competitive advantage.⁴
- 1.13 Sky notes that Ofcom’s general duties under section 3 of the Communications Act 2003 also apply to its functions in respect of the BBC. Those duties include Ofcom’s principal duty to “*further the interests of consumers in relevant markets, where appropriate by promoting competition*”, as well as the factors to which Ofcom must have regard when performing its duties which include:
- (a) “*the desirability of promoting the fulfilment of the purposes of public service television broadcasting in the United Kingdom*”;
 - (b) “*the desirability of promoting competition in relevant markets*”; and
 - (c) “*the desirability of encouraging investment and innovation in relevant markets*”.⁵
- 1.14 The overarching aim of the above BBC specific duties is the *protection* of fair and effective competition in relation to the BBC’s activities whose unique funding arrangements and privileged status represent a significant intervention into broadcasting and related markets. It is therefore essential that Ofcom takes a *precautionary* approach to regulating the BBC’s activities: where there is a potential risk of a proposed or ongoing activity harming fair and effective competition, the BBC should not be given the benefit of the doubt. The presumption should be that the proposal may not proceed, or that the activity in question should be appropriately remedied with conditions to secure effective regulation of the BBC and protection for fair and effective competition.
- 1.15 Under the previous Royal Charter the BBC Trust’s duties were less well defined and lacked such a precautionary approach. This in turn saw BBC activities which had a clear adverse impact on the market being allowed to proceed and/or persist. Particularly notable instances include the approval of Project Canvas on the basis of the claimed public value, notwithstanding significant adverse impact on the wider market. The Trust compounded those adverse impacts by failing to secure adequate controls on the BBC’s joint venture to achieve the levels of public value that supported the approval. This permissive approach has resulted in significantly less public value being generated as the platform has become subsumed into the partner ISPs pay TV offerings. [X].
- 1.16 The challenge for Ofcom is ensuring that it does not make the same mistakes as the BBC Trust in this regard. Ofcom must meet its more clearly defined duties and ensure that fair

³ Article 46(5) of the Charter.

⁴ Article 46(6) of the Charter.

⁵ Section 3(4) of the Communications Act 2003.

and effective competition is protected. With this in mind, we recommend that Ofcom commit to reviewing its procedures on a regular basis, and no less than every two years.

SECTION 2: COMPETITION ASSESSMENTS AND REVIEWS

- 2.1 This section contains Sky's response to the Change Consultation and the Review Consultation.⁶
- 2.2 As noted above, one of the key concerns underpinning the debate about the regulation of the BBC has been the need to ensure that its impact on the wider market is effectively scrutinised and controlled. Ofcom's *ex ante* and *ex post* assessments of the impact of the BBC's public service activities are critical to achieving this aim. It is therefore essential that Ofcom's procedures and guidance in relation to such assessments are clear and robust.

The BBC and Ofcom's duties in relation to competition assessments and reviews

- 2.3 Along with the general duties outlined in 1.12 above, the new BBC Royal Charter also confers a number of specific duties on both the BBC and Ofcom in relation to the impact of the BBC's public service activities and any changes to such services.
- 2.4 In the first instance, it is for the BBC (under clauses 7 and 8 of the Framework Agreement) to carry out and satisfy a public interest test for any material change to its public service activities. The BBC is required to publish any proposed material change (and send a copy to Ofcom) if it wishes to implement the proposal.
- 2.5 Clauses 9-11 of the Framework Agreement require Ofcom to assess whether any change made to the BBC's public services is material, and if so to carry out a competition assessment. Ofcom is required to assess any adverse impact on fair and effective competition, and whether the public value justifies an impact.
- 2.6 This approach differs in some important respects from the previous 'Public Value Test' operated under the previous Charter. Of particular significance is the fact that Ofcom has final approval as an independent regulator, rather than the BBC Trust in its hybrid role as regulator and advocate.
- 2.7 Clause 12 of the Framework Agreement requires Ofcom to carry out a competition review where it has reasonable grounds for believing that a public service activity is having a significant adverse impact on fair and effective competition. Such a review must assess whether the public value of the activity justifies its current and future impact on fair and effective competition.
- 2.8 The BBC Trust previously had no effective mechanism for carrying out *ex post* reviews, which was a key failing of this regime. Such a mechanism is crucial in order to hold the BBC to account properly and ensure that the adverse impacts of such a significant intervention in the market do not, over time, outweigh their public value.

Ofcom's proposals are a welcomed improvement but concerns remain

- 2.9 Sky broadly supports Ofcom's proposed approach to *ex ante* competition assessments and *ex post* competition reviews, both in relation to the proposed procedures and analytical approach. On the face of the proposals, they are a clear improvement on the

⁶ We note that the proposed procedures and guidelines are intended to cover the BBC's UK Public Services and non-service activities, as per footnote 4 of each of the consultation documents. Accordingly, in this section of Sky's response, references to BBC public services include references to non-service activities.

regulatory approach under the previous Royal Charter, which was beset by clear conflicts of interest.

2.10 However, we have a number of outstanding concerns with Ofcom's proposal. In particular, we are wary of the potential for too great a reliance to be placed on the BBC's own assessments (of materiality, public value and market impact) by Ofcom.

2.11 In summary, we have the following concerns in relation to competition assessments:

- (a) *BBC materiality assessment:* Sky welcomes Ofcom's commitment to step in and prevent a proposed change that the BBC has not referred to it. However, Ofcom should go further and provide for the BBC to take a precautionary approach to its materiality assessment, while limiting the use of trials to allow for proper consideration of their impact;
- (b) *BBC public interest test:* stakeholders cannot be expected to disclose sensitive commercial information to the BBC for the purposes of its public interest assessment, and accordingly it is unlikely that such assessments can accurately reflect the likelihood of any adverse impact on fair and effective competition;
- (c) *Ofcom's Initial Assessment:* Ofcom should only rely on the BBC's assessment and carry out a shorter competition assessment in exceptional circumstances. To do otherwise risks confirmation bias;
- (d) *Ofcom's BBC Competition Assessment (BCA):* Ofcom must conduct a thorough and robust review of the BBC's public value assessment or risk not protecting fair and effective competition by balancing overstated public value against the market impact;
- (e) *Transitional period:* It is essential that no material changes to the BBC's public services or new public services are permitted during the current period and until Ofcom's procedures are in place. The current vacuum brought about by regulatory responsibility moving from the BBC Trust to Ofcom must not be exploited further by the BBC.⁷

2.12 Sky also has the following summary concerns in relation to competition reviews:

- (a) *Phase 1:* In addition to acting on requests from stakeholders and own initiative investigations, there is a case for regular, periodic reviews of the impact of existing BBC public services on fair and effective competition, for example in tandem with the operating licence reviews for each service, without such reviews becoming unduly burdensome for Ofcom; and
- (b) *Timeline:* Ofcom should be mindful of the need to act swiftly where a third party (or Ofcom itself) has identified a potentially significant adverse impact on fair and effective competition.

2.13 We set out these concerns in further detail below.

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Sky notes the approval of BBC Studios in December 2016. This proposed change was assessed under the BBC Trust's procedures, despite publication of the draft Royal Charter which contained new procedures for assessing changes to BBC services.

Ofcom's Competition Assessments

BBC assessment of materiality

Ofcom should conduct its own assessments

- 2.14 Under the new Framework Agreement, the BBC may only make a “material change” to its public service activities where it has determined that the public interest test is satisfied and Ofcom has determined that the BBC may carry out the change.⁸ The Framework Agreement defines a “material change” as:
- “(a) *The carrying out of any activity as a new UK Public Service; and*
- (b) *Any change to a UK Public Service which may have a significant adverse impact on fair and effective competition*”⁹
- 2.15 However, the initial assessment of materiality will be carried out by the BBC, not Ofcom, in accordance with the policy that the BBC is required to publish, setting out how it will consider material changes to the UK Public Services. If the BBC does not deem a proposed change to be material, then the BBC is not required to carry out a public interest test or publish the proposal to Ofcom.
- 2.16 While it is clear that any *new* UK public service would be subject to the public interest test and further scrutiny by Ofcom, there is a risk that the BBC fails to identify a potential adverse competition impact in respect of *a proposed change to an existing service*, and therefore that a potentially material change goes unassessed by Ofcom. In particular, Sky is concerned that the BBC’s decisions on materiality could be coloured by its incentives to avoid the scrutiny and delay of a competition assessment by Ofcom, together with the risk of conditions being imposed to protect fair and effective competition or a prohibition decision.
- 2.17 However, we recognise that it would not be practical for Ofcom to assess every proposed change to the BBC’s public services, in particular where these form part of the BBC’s day to day business. We therefore agree with Ofcom that the BBC Board should set out explicitly how it will assess materiality in its published policy on materiality, including the types of decision it considers to be BAU.¹⁰
- 2.18 Ofcom should, however, go further and require that the BBC’s policy on materiality reflect this risk. Ofcom should require that the BBC adopt a precautionary approach on this issue, operating a presumption in favour of materiality absent clear and compelling evidence to the contrary, including, where appropriate, supporting evidence from third parties.
- 2.19 It is nonetheless crucial that the BBC keeps stakeholders, including Ofcom, informed of developments across its activities so as to reduce the risk that changes which the BBC considers to be BAU, but that are nevertheless material, do not go unassessed prior to launch. We note that Ofcom is mindful of this risk, and refers to the requirement for the BBC to publish an annual plan, including a work plan. Ofcom also states that it expects the BBC to engage appropriately with Ofcom to keep it apprised of its pipeline developments.¹¹ In practice, we would expect the BBC to provide sufficient detail to enable

⁸ Clause 7(6) of the Framework Agreement.

⁹ Clause 7(7) of the Framework Agreement.

¹⁰ See paragraph 4.10 of the Change Consultation.

¹¹ Paragraph 4.12 of the Change Consultation.

Ofcom (and, where appropriate, third parties) to form an early view as to whether any proposal(s) are likely to be material, either on their own or cumulatively.

- 2.20 Further, where the BBC has concluded that a proposed change is not material, but such conclusion has not been straightforward to reach (for example, if it does not clearly sit under any of the types of BAU activities outlined in the BBC's policy on materiality), then the BBC should be required to notify this to Ofcom.

The BBC should be required to consult on its materiality policy

- 2.21 In such circumstance, it may also have been appropriate for the BBC to consult with third parties on the materiality of the proposal. The BBC's policy on materiality should expand on the types of change that would likely merit such a consultation, as required by the new Framework Agreement. Indeed Ofcom should require the BBC to consult publicly in relation to this policy in order to ensure its assessment is appropriately robust. It is also appropriate for Ofcom to provide the BBC with some guidance over what such a policy would cover.

- 2.22 For example, one way of mitigating the risk that the BBC makes a number of small incremental and non-material changes to a service that cumulatively have a material impact on fair and effective competition would be to require the BBC to assess materiality against the service licence or proposal that was originally approved through a formal process, rather than against the service as it currently available. Such a procedure would also allow the BBC to set out when and how it will make stakeholders aware of future changes to its services that may impact on the market, thereby enabling stakeholders to raise concerns with the BBC and ultimately Ofcom *before* fair and effective competition is harmed.

Trials should be restricted

- 2.23 Ofcom is correct to highlight the risks posed by trials and expressly prohibit the BBC from applying a presumption of immateriality. There is a risk that BBC trials could significantly distort fair and effective competition if not properly supervised. Indeed Sky considers that Ofcom should go further and require all BBC trials to be time limited, followed by a period of review. This would prevent trials from becoming the de facto status quo, and facilitate consideration of the appropriate approval process whilst minimising any distortion of fair and effective competition.

Stakeholder engagement with BBC Public Interest Test

BBC assessments will be of limited use

- 2.24 Under the Framework Agreement, if the BBC wishes to make a material change to public service activities, it is required to carry out a public interest test on the proposed change, which includes an assessment of the impact on fair and effective competition.¹²
- 2.25 The BBC is also required by Ofcom to consult with interested parties.¹³ Ofcom makes the point that *'third parties will need to engage effectively [...] and third parties should not assume [Ofcom's] assessment of a proposal will provide a second opportunity to raise issues'*.¹⁴

¹² Clause 8(1) and (2) of the Framework Agreement.

¹³ Paragraph 4.15 of the Change Consultation.

¹⁴ Paragraph 4.17 of the Change Consultation.

- 2.26 While engagement with the BBC at this stage may well be appropriate at a high level, Sky and other stakeholders cannot be expected to submit any commercially sensitive confidential information to the BBC Board. Accordingly, the BBC's assessment will be incomplete and unlikely to accurately reflect the potential competition impact of the BBC's proposal. Ofcom should therefore be prepared to accept issues not previously raised with the BBC, and should rigorously examine the BBC's assessment, including, if appropriate, conducting its own information gathering exercise at this stage.
- 2.27 In this context, Ofcom should also give consideration to extending the time limit for third party comments to its own assessment beyond the two weeks it currently proposes.

Appropriate assessment procedure

- 2.28 The Change Consultation sets out certain circumstances where a shorter competition assessment (as opposed to a full competition assessment) may be appropriate.¹⁵ Sky considers that such instances should be the exception, and only available in very limited circumstances where it has been established by Ofcom that there would be no adverse consequences for fair and effective competition.
- 2.29 Ofcom highlights some specific scenarios which it describes as being "potentially appropriate" for a shorter competition assessment. Sky has a number of concerns with these:
- (a) *"Where we are not satisfied with the BBC's procedures in carrying out the public interest test"*: It is not clear to Sky why this scenario would merit a shorter assessment. If the BBC's procedures have been unsatisfactory, there can be no confidence in the outcome and a full BCA must ensue.
 - (b) *"Where large parts of the change proposal give little cause for concern but a limited element (e.g. a separable element of a proposal) requires consideration"*: The separable element may nonetheless merit a full assessment and this should be considered on the facts.
 - (c) *"Where the public interest test carried out by the BBC adequately addressed all (or most) issues"*: Ofcom should be wary of relying on the BBC's public interest test without carrying out further detailed review, in particular given the BBC's incentive to reach a positive conclusion (as noted by Ofcom at paragraph 4.36 of the consultation) as well as the risk of confirmation bias. Further, as explained at paragraph 2.26 above, the BBC's public interest assessment cannot be relied upon because it may be missing key, commercial sensitive information that third party stakeholders have been unwilling to disclose to the BBC Board.
- 2.30 The consultation document also lists a number of factors Ofcom may take into account when deciding whether to carry out a full competition assessment versus a shorter assessment. We are concerned that some of these factors appear ambiguous or superfluous. For example, Ofcom states that one factor which may prompt it to run only a shorter assessment is *"whether there is a real prospect of an outcome other than unconditional clearance"*.¹⁶ Ofcom gives no indication as to how it would reach a view on this – in reality, evaluating such a factor would itself require an assessment to be made of the merits of the case, including reaching preliminary views on the BBC's public value assessment and Ofcom's own view on market impact. Ofcom should seek to be more

¹⁵ See paragraphs 4.35 and 4.36 of the Change Consultation.

¹⁶ Paragraph 4.36 of the Change Consultation.

specific in the factors it will consider when deciding on the appropriate assessment to undertake.

- 2.31 More generally, we are concerned that BBC incentives to reach a positive conclusion may encourage ‘waiving through’ of changes without proper scrutiny or investigation, particularly in relation to new services. Experience has shown that the BBC has been either unwilling or unable to describe proposals in sufficient detail for stakeholders to engage fully, and this has resulted in inadequate analyses of both public value and impact on the market.¹⁷ Ofcom should therefore adopt a presumption that it will conduct a full BCA. Any decision to opt for a shorter assessment should be exceptional and supported by a detailed explanatory statement open for consultation to third parties prior to the decision being finalised. Failure to do so limits stakeholders’ ability to engage meaningfully in this process.

Analytical approach to public value

- 2.32 Sky broadly concurs with Ofcom’s guidance on its analytical approach outlined in section 5 of the Change Consultation, in particular the potential competition concerns identified.
- 2.33 However, we note that Ofcom’s assessment of the ‘public value’ of a particular proposal would be restricted to “*testing the analysis conducted by the BBC*”. Ofcom states that it would not conduct its own evaluation and would be unlikely to undertake its own research.¹⁸
- 2.34 It is crucial that Ofcom’s review of the BBC’s public value assessment is thorough, robust, and incorporates whatever measures are necessary (including further original research if required) in order that it may confidently fulfil its duty to protect fair and effective competition. If flaws in the BBC Board’s analysis are found then the matter should be remitted back to the Board to redo the assessment in line with Ofcom’s findings, however, there is every chance that flaws will not be found if Ofcom does not undertake its own independent research.

Transitional arrangements

- 2.35 As noted above, Sky broadly supports Ofcom’s proposed approach to assessing material changes to BBC public services. Notwithstanding the concerns we highlight above, Ofcom’s proposals appear to be a substantial improvement on the previous procedures operated by the BBC Trust.
- 2.36 Given this, it is essential that no material changes to the BBC’s public services are permitted during the current transitional period – either through being assessed using the regime established under the previous Charter, or through adoption by the BBC Executive in the absence of any assessment at all.
- 2.37 For example, Sky notes the recent speech by Tony Hall outlined a variety of future changes to services that may well qualify as material (e.g. developments to BBC iPlayer).¹⁹ It is incumbent upon both Ofcom and the BBC, in line with their duties under the Charter, to

¹⁷ For example, the BBC Trust had to require additional information from the BBC Executive in relation to Project Canvas ([see press release of 04.06.09](#)), and the Trust’s Final conclusions on BBC on-demand noted that “*Some responses from industry stakeholders demonstrated a degree of confusion about what the BBC iPlayer will consist of and how it relates to the proposals being considered in this PVT.*” (Paragraph 3.12).

¹⁸ See paragraphs 5.21 and 5.22 of the Change Consultation . This approach contrasts with Ofcom’s proposed approach to the assessment of public value for the purposes of competition reviews, where Ofcom envisages carrying out its own work (see paragraph 4.28 of the Review Consultation).

¹⁹ See <http://www.bbc.co.uk/mediacentre/speeches/2017/tony-hall-ny-message>

subject these proposed changes to the requisite scrutiny before they are permitted to be implemented.

Ofcom's competition review

Phase 1: Deciding whether or not to initiate a BCR

- 2.38 Under the Framework Agreement Ofcom will have the power to carry out *ex post* competition reviews where Ofcom has reasonable ground to believe that the carrying out of a public service is having a significant adverse impact on fair and effective competition.²⁰
- 2.39 We welcome the fact that, under Ofcom's proposed operating framework, both third party requests and Ofcom itself would be able to trigger a competition review.²¹ However, investigations should not be limited to an exceptional event in response to major concerns (as might be inferred by Ofcom's language in the consultation document). Such an approach might unduly restrict access to the process, depriving stakeholders of an important means of redress against the BBC, particularly in circumstances where the impact on a single market player is significant, but may not be deemed to be material across the sector as a whole.
- 2.40 Ofcom's threshold of having "*reasonable grounds to believe that the carrying out of public service activities is having a significant adverse impact on fair and effective competition*" must therefore be assessed on the merits of each case, in light of all relevant circumstances of the complaint or issue.
- 2.41 There is also a case for more regular reviews of competition impacts, as part of the normal regulatory process (for example, in tandem with the operating licence reviews for each service). These regular reviews would create an opportunity for Ofcom to consider the actual impact of a service that has launched, and the cumulative impact of changes to services over time. They would also guard against the risk that Ofcom's threshold for competition reviews are set too high so as to never be triggered through a complaint or own initiative investigation.

Timelines

- 2.42 We note that the timelines for competition reviews appear more flexible than for competition assessments. While this is in line with the new Framework Agreement (which does not set a deadline for the completion of competition reviews), Ofcom should be mindful of the need to act swiftly where one or more third party (or Ofcom itself) has identified a potentially significant adverse impact on fair and effective competition.

SECTION 3: DISTRIBUTION

- 3.1 This section contains Sky's response to the Distribution Consultation.
- 3.2 Throughout the Charter renewal process, Sky has stressed the need for strong and active oversight of the BBC's approach to distribution. As noted, the BBC represents a significant intervention in the market with the ability to influence and condition what other parties in the value chain can achieve. In the case of distribution, the high value audiences place on the content the BBC is able to produce, and its ubiquity, may act as an important determinant of a platform's success. Specific regulatory oversight of this activity is a

²⁰ Clause 12(1) of the Framework Agreement

²¹ Paragraph 4.3 of the Review Consultation.

proportionate response to the potential impact such arrangements may have on the UK's broadcasting sector.

- 3.3 The interests of licence fee payers are clearly best served by an approach that facilitates widespread access to the content intended and paid for by them, on the platforms on which they choose to consume it. A more restrictive approach to content distribution would clearly act against such interests. It would also potentially impact on fair and effective competition, not least given the BBC's own extensive platform activities and stated strategies in this area.
- 3.4 Ofcom's regulatory framework for the distribution of BBC public services will therefore play a critical role in ensuring BBC content is widely available and that fair and effective competition is protected. Ofcom must be able to identify and address instances where the BBC acts in an obstructive manner, harming the ability of others to compete effectively and failing to deliver in line with its obligations.

The BBC and Ofcom's duties in relation to distribution

- 3.5 The new Framework Agreement confers a number of duties on both the BBC and Ofcom in relation to distribution of the UK public services.
- 3.6 Under clause 61 of the Framework Agreement, the BBC is required to do *"all that is reasonably practicable to ensure that viewers, listeners and other users (as the case may be) are able to access the UK Public Services that are intended for them, or elements of their content, in a range of convenient and cost effective ways which are available or might become available in the future"*.²² While the BBC may place *"reasonable conditions"* under which it will make its output and services available to third parties, these condition must not adversely impact fair and effective competition and must be fair, reasonable and non-discriminatory.²³
- 3.7 In the first instance, the BBC is required (under clause 62 of the Framework Agreement) to develop and publish a strategy and policy for the distribution of the UK public services, following consultation with Ofcom and the public.²⁴
- 3.8 Under clause 15 of the Framework Agreement, Ofcom is required establish a new Operating Framework which includes conditions that will protect fair and effective competition. *"The distribution of the UK public services"* is noted as a particular matter which may necessitate specific requirements being included in the Operating Framework in order to protect fair and effective competition.²⁵
- 3.9 Sky also notes the comments on distribution contained in the Government's 2016 White Paper. This stated that the BBC *"should look to maximise the opportunities it has to make its services and content as widely available as possible and it should only place reasonable conditions on how its content is distributed"*.²⁶ It also noted the absence of BBC video-on-demand content on a number of leading pay TV apps, stating that with more than half of all UK households now taking subscription based services, *"the BBC needs to consider how it*

²² Clause 61(1) of the Framework Agreement.

²³ Clause 61(3) of the Framework Agreement.

²⁴ Clause 62 of the Framework Agreement.

²⁵ Clause 15 of the Framework Agreement.

²⁶ *"A BBC for the future: a broadcaster of distinction"*, p.69, available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/579638/DCMS_A_BBC_for_the_future_linked_rev1_1.pdf.

can continue to make services and content available to viewers who use other platforms and applications to watch content”.

- 3.10 These specific requirements (and preceding comments) emphasise the importance of an appropriate regulatory framework for the BBC’s distribution arrangements. Taken together, the responsibilities of Ofcom and the BBC are to establish a permissive approach to distribution that results in wide availability of BBC content, contributing to fair and effective competition in the broadcasting market.

Ofcom’s framework must be able to address instances where the BBC’s approach to distribution has been unduly restrictive

- 3.11 As a platform operator whose UK viewers are also all licence fee payers, Sky has frequently engaged with the BBC in efforts to bring BBC content to viewers via our services. We are therefore well placed to be able to assess the BBC’s approach to distribution and its negotiations with third parties.
- 3.12 [REDACTED].
- 3.13 [REDACTED]. The challenge for Ofcom is to establish a regulatory framework that can be used to identify and rectify instances where the BBC acts in an unduly restrictive manner by placing unreasonable restrictions or conditions on distribution.
- 3.14 [REDACTED].
- 3.15 [REDACTED].
- 3.16 [REDACTED], the BBC’s approach appears to be guided by a strategic preference for delivering its content exclusively via the so-called ‘standardised syndicated iPlayer experience’, (where the licence fee payer is restricted to viewing BBC content in a BBC controlled walled-garden) rather than being open to alternative delivery, distribution and promotion arrangements.
- 3.17 The indications are that this strategic preference will only strengthen in the coming years. The BBC put forward a number of new proposals in its September 2015 publication “*The BBC’s programmes and services in the next Charter*”, the most material being a proposed new scope for the iPlayer, repositioning it as a content aggregator that brings together programming from the BBC with content from other UK broadcasters.²⁷
- 3.18 More recently, Tony Hall set out an ambitious aspiration for the iPlayer in a speech to staff in January, speaking of the need to ‘reinvent’ the service:

“we need it to make the leap from a catch-up service to a must-visit destination in its own right... Our goal, even in the face of rapid growth by our competitors, is for iPlayer to be the number one online TV service in the UK. That will mean doubling our reach, and quadrupling the time each person spends on it every week. And we want do it by 2020.”²⁸

- 3.19 This is clearly a significant objective, and one which may raise questions as to the incentives it creates in relation to the BBC’s distribution strategy, as well as the competitive impact it might have on other providers and distributors.

²⁷ See Section 4, “*British Bold Creative: the BBC’s programmes and services in the next Charter*”, available at: <https://downloads.bbc.co.uk/aboutthebbc/reports/pdf/futureofthebbc2015.pdf>.

²⁸ See <http://www.bbc.co.uk/mediacentre/speeches/2017/tony-hall-ny-message>.

- 3.20 Sky notes that Ofcom has previously addressed the issue of the incentives facing vertically integrated owners of 'key content' in its wholesale must offer (WMO) regulation. Ofcom defined key content as content "*that is capable of influencing the choice of pay TV provider for a significant number of consumers.*"²⁹ The equivalent in relation to content that is provided on a free to air basis would be content that is capable of influencing the choice of platform for a significant number of consumers. Plainly, a great deal of content provided by the BBC would meet this definition.
- 3.21 The concern at the heart of the previous WMO obligation was that vertically integrated owners of key content may withhold that content from rivals in order to induce consumers to choose to receive content via their own downstream business. The BBC is vertically integrated between its platform provision (i.e. the iPlayer) and its programming. Accordingly, it potentially faces incentives to induce consumers to view its content via platforms and services in which it has an interest, rather than those operated by third parties.
- 3.22 The litmus test of Ofcom's regulation of the BBC's distribution activities will be whether the processes and assessments set out in the consultation will allow Ofcom to resolve this kind of restrictive practice in the manner best suited to meeting the needs of licence fee payers.

Sky welcomes Ofcom's distribution proposals as a necessary step, but some concerns remain

- 3.23 Sky broadly supports Ofcom's proposed requirements and guidance on distribution. The inclusion of specific requirements on distribution in the Operating Framework is, itself, an important step in holding the BBC to account (both to licence fee payers and the wider market) in relation to one of its critical activities.
- 3.24 Beyond that, many of Ofcom's proposals appear reasonable and appropriate. However, Sky has a number of concerns and comments in relation to specific aspects of the regulatory framework being proposed. In summary:
- (a) *Ofcom's proposed distribution requirements:* The BBC should be required to supply all reasonable requests for supply of its content. The BBC should not be allowed to objectively justify non-supply where such a request is reasonable.
 - (b) *Enforcement:* Given Sky's concerns over the BBC's current distribution policy and the potential for a significant delay until a third party complaint on this matter may be investigated under the new procedures, Ofcom should give the BBC a clear indication of its expectations, and if not acted upon, prioritise an own initiative investigation into the BBC's compliance with the requirements under the Operating Framework in relation to distribution once implemented.
 - (c) *Factors for assessment:* Ofcom's illustrative factors are relevant considerations in assessing the BBC's approach to distribution – but Ofcom should not view these factors as 'conditions' the BBC must be able to impose on third parties in order to secure a distribution agreement.
- 3.25 We expand on these concerns below.

²⁹ See for example, Paragraph 4.1 of Ofcom's statement dated 19 November 2015 "*Review of the pay TV wholesale must-offer obligation*".

Potential competition concerns and requirements for the BBC

- 3.26 Section 3 of the Distribution Consultation sets out the potential competition concerns that Ofcom considers may arise over this Charter period, and the subsequent requirements it proposes to impose on the BBC to protect fair and effective competition.
- 3.27 Sky agrees with the potential competition concerns Ofcom identifies of discriminatory supply, overly restrictive terms and declining of reasonable requests for supply from third parties.³⁰ Each of these practices would risk a material impact on fair and effective competition. As noted, the BBC may be incentivised to act in this way, withholding or restricting access to its content in order to drive audiences to its own platforms, primarily iPlayer.
- 3.28 Sky would also highlight the potential for the BBC's distribution activities to impact fair and effective competition in relation other content providers. If the BBC's approach serves to drive audiences to the iPlayer at the expense of platforms which provide access to content from a variety of broadcasters, this could have a potentially exclusionary effect. If viewers find themselves in a BBC-only environment, the likelihood is that this will have a negative impact in terms of viewing on other broadcasters.
- 3.29 Sky is concerned that Ofcom's subsequent requirements, while well intentioned, are not robust enough to hold the BBC to account.
- 3.30 Ofcom states that the 'starting point' should be that the BBC should supply its public services where it receives a 'reasonable request' to do so. The effect of this would be that the BBC would be compelled to act with a presumption of supply – an appropriate requirement given the BBC's obligations and duties, as well as its incentives and previous behaviour.
- 3.31 But Ofcom undermines this approach by permitting the BBC to not supply if there is an 'objective justification' for not doing so – even if the third party request was 'reasonable'. This means that in the event of a platform operator proposing an arrangement that complied with all of the BBC's asks, it would still be open to the BBC to refuse to supply its content, so long as it could devise an 'objective justification' for doing so.
- 3.32 Sky recognises that there will be aspects of any distribution agreement that the BBC will need to secure as legitimate matters of principle – for example around brand attribution, commercial exploitation or costs of provisioning. But in Sky's view, any third party offer that did not offer assurances to the BBC in these areas would clearly not constitute a 'reasonable request' for supply.
- 3.33 Ofcom should not include any sort of exception in its final requirements. Rather than citing an objective justification for refusing a reasonable request, the BBC should be required to demonstrate that the request itself is unreasonable in order to refuse to supply to a third party.
- 3.34 Ofcom should also consider giving guidance to the BBC as to what constitutes a 'reasonable request', or highlight specific practices that should or should not be considered as 'unreasonable'. In particular, given the BBC's clear preference for an 'iPlayer first' strategy, Ofcom should move to clarify that platform providers not acquiescing to this approach are not acting in an 'unreasonable' manner.

³⁰ Paragraphs 3.16-3.21 of the Distribution Consultation

Enforcement procedures

- 3.35 In section 4 of the Distribution Consultation, Ofcom sets out its proposed enforcement procedures. It notes that the Framework Agreement provides for the BBC to develop and publish a distribution policy, and that complaints from third parties on distribution matters should go first to the BBC. Ofcom states that it will 'generally' only consider distribution arrangements where it receives a complaint from a third party following the exhaustion of commercial negotiations and the BBC being unable to resolve the complaint satisfactorily.
- 3.36 Sky acknowledges that the Framework Agreement envisages complaints being brought to the BBC in the first instance. However, we are concerned at the potential damage to fair and effective competition that may arise because of long timescales associated with enforcement and Ofcom's proposed involvement.
- 3.37 Under Ofcom's proposals, it will only be able to examine whether the BBC's distribution activities have an impact on fair and effective competition after two processes have run their course:
- (a) The BBC Board – expected to be constituted in April 2017 – will be required to develop, consult on, and then publish a distribution strategy and policy. This process might optimistically be expected to take six months.
 - (b) An aggrieved third party complainant would then be required to bring a complaint to the BBC Board. Assessing and ruling on this complaint might in turn be expected to take a further three months. The BBC Board may also be incentivised to reject initial complaints on the basis that the distribution strategy and policy would have only been in place very recently.
- 3.38 Following this, the Ofcom process itself might also be expected to take a further three months. This suggests that the *earliest possible* date for an Ofcom ruling on distribution matters would be April 2018.
- 3.39 [REDACTED].³¹ [REDACTED].
- 3.40 Sky notes that the Framework Agreement grants Ofcom significant 'step in' powers in relation to the BBC. Specifically, clause 58 states that Ofcom may carry out such investigations "as they consider appropriate to determine compliance with a specific requirement". Clause 59 clarifies that the specified requirements include any requirement imposed on the BBC in the Operating Framework, which incorporates the distribution requirement.
- 3.41 Notwithstanding this, the Framework Agreement also gives Ofcom a role in the setting of the BBC's distribution policy, albeit only on a consultative basis. Ofcom should ensure that it provides the BBC with detailed guidance as to aspects of a policy that it considers would protect to fair and effective competition – including with reference to specific agreements and deals that have or have not been struck.
- 3.42 [REDACTED].

³¹ Sky also notes that BBC on-demand content was first available on Sky from October 2012: over 5 years after its availability on other platforms. Similarly, Sky Go launched in July 2011, yet users have never been able to use it to watch BBC content.

Factors for assessment

- 3.43 Ofcom sets out a non-exhaustive list of factors which could be relevant to determining whether it is necessary to intervene in relation to complaints. Ofcom frames these factors as ‘*particularly relevant to points the BBC may raise to justify its position*’.³²
- 3.44 Sky broadly accepts Ofcom’s illustrative factors as relevant considerations in assessing whether the BBC’s distribution activities may adversely impact fair and effective competition. But we would caution Ofcom against viewing these factors as ‘conditions’ the BBC must be able to impose on third parties in order to secure a distribution agreement. It is crucial that each complaint is dealt with on a case by case basis, with these (and other) factors assessed with an open mind.
- 3.45 We provide specific comments on each illustrative factor below.

Platform compatibility

- 3.46 Sky acknowledges that different platforms have different technical capabilities, and that may have a bearing on their ability to carry the BBC’s content. Consideration of this factor may be useful in assessing whether the BBC has acted in a particularly discriminatory manner (i.e. by supplying to one provider but not another in similar circumstances).
- 3.47 However, Sky is concerned that this factor, as currently presented, might give the BBC scope to adopt a very narrow approach to distribution. In particular, Ofcom indicates that it will consider “*whether the complainant has technology capable of supporting the public services or whether the BBC would need to provide a degree of customisation*”.³³ This language risks being interpreted as tacit approval for the BBC refusing to distribute its content to those platforms that do not offer the exact technical specifications, and adopting a rigid ‘standard iPlayer only’ approach.
- 3.48 Platforms differ significantly in their technical capabilities and in the manner in which they present content to viewers, which may require varying levels of customisation to support innovative and novel means of accessing content. For instance, provision of BBC content to Sky has in the main required some level of customisation necessary to provide a holistic and consistent consumer experience – in particular, enabling content from many providers to be discovered and accessed in a consistent way by viewers. In such instances, there is no justification for platform compatibility to be considered an obstacle to the supply of BBC content.

Costs of distribution

- 3.49 Sky agrees that this is a relevant factor for assessment where the costs of distribution may be abnormal or unreasonable. [X]

Consumer experience

- 3.50 Ofcom notes that this factor encompasses a wide range of issues, including prominence, picture quality and brand attribution. Sky considers that these are reasonable considerations. However, as with platform compatibility, Ofcom must ensure that it does not view these matters simply as conditions that the BBC is allowed to place on prospective partners, with a refusal to supply if they are not met precisely to the BBC’s liking.

³² Paragraph 4.9 of the Distribution Consultation.

³³ Paragraph 4.11.2 of the Distribution Consultation.

- 3.51 In particular, both Ofcom and the BBC should acknowledge the changing dynamics of the UK content sector in relation to content discoverability. Viewers are using new and ever changing methods of finding and accessing content, and platform providers are frequently innovating in order to better serve their customers in this regard. Ofcom should ensure that any assessment it makes under this factor does not require platform operators to restrict or stifle this innovation in order to secure supply of BBC content.
- 3.52 Ofcom provides a more detailed description of the prominence principle – ‘*finding the public services and accessing them quickly and easily*’.³⁴ Sky considers that this is an appropriate consideration, so long as it is not taken to mean that the BBC can demand disproportionate positions in what is an ever-evolving consumer journey.
- 3.53 Sky lists the BBC at the top of its linear EPG and – even though it is not required to by regulation – at the top of sub menus listing catch-up services. [REDACTED].
- 3.54 Sky also has reservations about the inclusion of ‘brand attribution’ as a component consideration of the consumer experience. Again, on the face of it this is a relevant factor, and a reasonable aspect for the BBC to seek to secure. However, it should not be used as justification for BBC content to be confined to the ‘walled garden’ of the ‘standardised iPlayer experience’.
- 3.55 [REDACTED]. It is patently possible to deliver the requisite brand attribution to BBC content outside of the iPlayer – through, for example, clear channel attribution wherever a piece of content is viewed and accessed.
- 3.56 Sky also notes that the BBC currently accepts a wide range of alternative arrangements in relation to its linear and on-demand audio content, which is widely available across the BBC’s websites as well as from podcast and audio aggregation services. These arrangements demonstrate that the iPlayer is not analogous to the BBC’s TV or radio channels,³⁵ which are curated and scheduled. In fact, the iPlayer is merely one ‘shop window’ in which the BBC’s linear and on-demand content can be made available. Licence fee payers and the BBC have derived considerable public value from such disaggregated arrangements in respect of BBC audio content.³⁶ It is unclear why BBC video content should not simultaneously benefit – it is clear there is no risk to brand attribution from doing so.

Editorial control

- 3.57 Sky agrees that this is a legitimate factor for Ofcom to consider in its assessment. [REDACTED].

Curation of the public services

- 3.58 Sky recognises that it is legitimate for the BBC to seek to promote and direct audiences towards its content. [REDACTED].³⁷

³⁴ Paragraph 4.14.2 of the Distribution Consultation.

³⁵ As the BBC Trust noted in its decision approving the BBC’s on-demand proposals, “*the BBC iPlayer is not the service offering in itself but is an interface through which a number of services will be provided*”. See http://downloads.bbc.co.uk/bbctrust/assets/files/pdf/consult/decisions/on_demand/decision.pdf.

³⁶ For example, in the week beginning 13th February 2017, 26 of the top 100 iTunes podcasts were from BBC radio shows. See <http://www.itunescharts.net/uk/charts/podcasts/>.

³⁷ [REDACTED].

- 3.59 When assessing this factor as part of its analysis, Ofcom should consider whether the BBC's preferences in this area may act to unduly harm other market players. [3<]. Ofcom should include explicit consideration of this point in its final guidance.

Technical and service innovation

- 3.60 Sky notes that the BBC is an important component of third party platforms' ability to deliver innovative services. Our own experience tells us that, given the high value audiences place on the BBC's content, it is challenging to launch new and innovative services without content from the BBC being available from the start.
- 3.61 Where the BBC acts restrictively, therefore, it not only poses a potential risk to fair and effective competition – it may also call into question the BBC's fulfilment of its duty to promote technical innovation. An insistence that a platform adopts the BBC's preferred user interface journey could negatively impact attempts at implementing innovative approaches. Consequently, Sky welcomes Ofcom's consideration of technical and service innovation as a relevant factor.

Market norms

- 3.62 In Sky's view, this is likely to be a critical and instructive factor for Ofcom to assess under its new regulatory framework. As noted, the BBC's unique position means that it is not subject to the same level of competitive pressure as commercial broadcasters when dealing with third party providers on distribution. An appropriate benchmark for the reasonableness or otherwise of a complainant's position would be the arrangements that platform operators have been able to agree with other broadcasters (public service or otherwise).
- 3.63 For example, the commercial PSBs – ITV, C4 and Five – would be expected to have similar content distribution strategies to the BBC, in that all are incentivised to seek mass audiences through free-to-air broadcast, and add to that reach through standalone catch-up players. Yet that has not prevented these broadcasters from reaching agreements with Sky for the full integration of their content into platforms chosen by the very many Sky households – including on Sky Go and Sky Q. Sky further notes that other pay TV platforms (in particular Virgin Media) have been able to strike similar deals.
- 3.64 Simply put, there is no compelling rationale for the BBC to diverge significantly from the practices and agreements struck by ITV, C4 and Five. Indeed, given that the BBC has a specific obligation to secure the wide availability of its content in order to serve licence fee payers, it should be *more* permissive in its approach to content distribution than the commercial PSBs. Consequently, Sky welcomes the inclusion of market norms as a relevant factor for assessment, and considers that Ofcom should place significant weight on its analysis of comparable market practices.

Openness and transparency

- 3.65 Sky agrees that appropriate transparency of the BBC's strategic approach is a relevant factor for assessment, given its role as a significant intervention in the market.

SECTION 4: COMMERCIAL ACTIVITIES

- 4.1 This section contains Sky's response to the Commercial Consultation.
- 4.2 As with other BBC activities, Sky both competes and collaborates with the BBC's commercial subsidiaries across a range of activities. In particular, we distribute some of the BBC's services (such as UKTV pay channels, and certain BBC content made available by

BBC Worldwide) on a commercial basis, while Sky Vision competes directly with BBC Worldwide (and, in future, a newly privatised BBC Studios) in content production and distribution.

- 4.3 Ofcom's regulatory framework for the BBC's commercial services will play a critical role in ensuring that its impact on the wider market is effectively scrutinised and controlled. It is therefore essential that Ofcom's procedures and guidance in relation to such assessments are clear and robust.

Ofcom's duties in relation to commercial services

- 4.4 The new BBC Royal Charter confers a number of duties on Ofcom in relation to commercial activities, notably that in exercising its functions in relation to the commercial activities the BBC "*must ensure that its commercial activities do not, as a result of their relationship with the UK Public Services, non-service activities or trading activities, distort the market or gain an unfair competitive advantage*".³⁸
- 4.5 Under clauses 23-27 of the Framework Agreement, Ofcom is required to set requirements in the Operating Framework to protect fair and effective competition in the UK in relation to material changes proposed by the BBC in relation to its commercial services. As with competition assessments, where the BBC publishes a proposed change, Ofcom must first determine whether this change is material. If it concludes the change is material, it must then assess whether it is likely to distort the market or create an unfair competitive advantage.
- 4.6 Furthermore, under clause 28 of the Framework Agreement, Ofcom is required to set out trading and separation requirements on the BBC to ensure that commercial activities do not distort the market or gain an unfair competitive advantage as a result of their relationship with the Public Service.
- 4.7 Specifically, these rules may include requirements to ensure that:
- (a) relationships between the BBC Public Service and the commercial subsidiaries operate at arms-length;
 - (b) commercial activities are carried out in accordance with normal market principles, including making a commercial rate of return; and
 - (c) the relationship between the BBC Public Service and the commercial subsidiaries is appropriately transparent, including providing Ofcom with financial reports and the publication of information.
- 4.8 These duties bear significant similarities to those conferred on the BBC Trust under the previous Charter. While the Trust handled only a small number of appeals on fair trading and commercial activities, this is largely reflective of a lack of clarity and confidence in the framework it established.
- 4.9 In particular, Sky would note the concern (identified by Fingleton Associates in its Trust commissioned review) at "*the lack of formal mechanism through which to express views on the impact of the BBC's activity on the market*".³⁹ The review also noted that

³⁸ Article 18 of the Charter.

³⁹ *Fair Trading Policy Review*, Fingleton Associates, p.3. Available at: http://www.fingletonassociates.com/wp-content/uploads/2015/07/FingletonAssociates_BBCTrustFairTradingPolicyReview_July2015.pdf.

implementation was heavily reliant on self-assessment by the Executive and that the Trust had not conducted any “own initiative” investigations on fair trading matters.

- 4.10 Ofcom’s challenge therefore is to create a regulatory framework that is more effective in providing appropriate scrutiny and transparency of the BBC’s activities in this area than was achieved under the Trust.

Ofcom’s proposed trading and separation arrangements are not robust enough to mitigate the competition concerns it identifies

- 4.11 Section 3 of the Commercial Consultation sets out the potential competition concerns that Ofcom considers may arise over this Charter period, and the subsequent trading and separation requirements it proposes to impose on the BBC in order to protect fair and effective competition.

- 4.12 Sky agrees with the potential competition concerns Ofcom identifies - that the BBC’s commercial subsidiaries might enjoy preferential access to BBC public service assets, and that they may distort markets by offering products at a price below cost. In addition, given the significant market presence the BBC commercial subsidiaries have – in particular BBC Worldwide, the biggest content distributor outside the US studios – Ofcom should also have regard to general competition law, including state aid law, in scrutinising the BBC’s commercial activities.

- 4.13 However, Sky is concerned that, as with the previous regulatory regime, Ofcom’s proposals fall far short of measures sufficient to enable proper scrutiny of the BBC’s commercial activities and therefore provide no guarantee that the BBC is trading fairly. In particular, Sky is alarmed that Ofcom appears to broadly accept the BBC commercial subsidiaries may have non-standard relationships or interactions with the UK Public Service, and the lack of explicit guidance Ofcom provides in combatting this.

- 4.14 In summary:

- (a) *Operational separation requirements:* Ofcom should remove the proposed ‘exceptions’ in its requirements, whereby BBC subsidiaries would be permitted to share information and employees with the UK Public Service.
- (b) *Supply of goods and services requirements:* Ofcom should require the BBC Public Services to adopt a market-based approach as standard to its goods and services, only contracting with BBC subsidiaries if they are successful in a competitive open market process.
- (c) *Transfer pricing requirements:* Absent a market-based approach, Sky is concerned that the BBC will seek to rely excessively on a cost-based approach to transfer pricing. Ofcom should only permit this where the BBC can actively demonstrate that the supply of goods and services would be expected to be priced effectively at cost even in an open market.

- 4.15 We expand on these concerns below.

Operational separation requirements

- 4.16 Ofcom proposes operational separation requirements in relation to two broad activities – the exchange of information between the BBC’s public services and its commercial subsidiaries, and governance arrangements of the commercial subsidiaries. In both cases, Sky is concerned that the ‘exceptions’ Ofcom allows for in these requirements risk rendering regulation in this area ineffective.

- 4.17 First, Ofcom proposes that the BBC must ensure that commercial subsidiaries do not “normally” have access to information relating to the UK public services that is not available to the wider market. It goes on to state that, where this does occur, the BBC must put in place mechanisms to ensure that such information is only used “for the specific purpose for which it was obtained”.⁴⁰
- 4.18 No guidance is given by Ofcom as to the ‘abnormal’ circumstances under which the commercial subsidiaries would be permitted access to such information, beyond a very wide description of ensuring that “*the activities of the BBC’s commercial subsidiaries fit with the Mission and Public Purposes*” or in relation to “*the fulfilment of any existing commercial relationship*”. Moreover, Ofcom does not indicate what mechanisms would in its view be appropriate in ensuring the information was only used for a specific purpose.
- 4.19 Second, Ofcom’s requirements on governance appear strong in the first instance – with commercial subsidiaries required to be run by Directors who are “*distinct and separate from the BBC Board and its executive committee*”. But this requirement is undermined by subsequent wide exceptions. In particular, Ofcom specifically allows for Directors to serve on the board of a BBC public service *and* a commercial subsidiary, so long as “*appropriate measures*” are in place to identify, record and address any conflicts of interest.⁴¹ Again, Ofcom provides no indication as to the kind of measures it would view as appropriate.
- 4.20 These requirements do not in themselves give Sky confidence that the BBC’s commercial activities will be conducted at arm’s length from publicly funded services. The exceptions Ofcom envisage would, in reality, allow for little to no separation at all between the BBC Public Service and its commercial subsidiaries.
- 4.21 In order to be more robust, Ofcom’s requirements should be far more definitive. It should remove the exceptions it allows in both exchanges of information and governance arrangements – for example, with an amended list of requirements such as:
- (a) “The BBC must ensure that commercial subsidiaries do not normally have access to information about the BBC Public Service’s strategy, priorities and activities that is not available to the wider market, other than ~~that strictly required to ensure the activities of the BBC’s commercial subsidiaries fit with the Mission and Public Purposes~~ or for the fulfilment of any existing commercial relationship.”
 - (b) “The BBC must ensure that BBC commercial subsidiaries are run by boards and executive committees of Directors which are distinct and separate from the BBC Board and its executive committees. ~~They should also consist of an appropriate number of directors with an emphasis on those who are separate from the BBC Board and its executive committees.~~”

Supply of goods and services requirements

- 4.22 Sky supports Ofcom’s proposals to require the BBC to ensure that any arrangements entered into between the BBC Public Service and commercial subsidiaries are made on arm’s length commercial terms. Such an approach is clearly necessary in order to guard against potential competition concerns arising.
- 4.23 Ofcom also requires that the BBC Public Service make its assets available to third parties on equivalent terms and prices to those offered to its commercial subsidiaries. However, this requirement only applies in instances where the BBC Public Service actually supplies

⁴⁰ Paragraph 3.21 of the Commercial Consultation.

⁴¹ Paragraph 3.24 of the Commercial Consultation.

these assets to the wider market, with Ofcom appearing to give the BBC complete discretion in this regard. Under the proposed requirements, it would appear to be perfectly permissible for the BBC to *never* supply Public Service goods and assets to the wider market, so long as it had arrangements in place to ensure that direct relationships between the Public Service and commercial subsidiaries could be said to be conducted on an arm's length basis.

- 4.24 Sky is concerned that such a permissive approach may embed existing practices that threaten an adverse impact on fair and effective competition, as well as acting against licence fee payers' interests more generally.
- 4.25 The BBC Public Service already enters into a number of arrangements with its commercial subsidiaries. Most notably, BBC Worldwide has a 'first-look' agreement, under which it receives first refusal to invest in the majority of co-production deals the BBC's public service enters into. Arrangements such as this prevent a competitive market emerging for BBC assets, despite other players being active in this part of the value chain.
- 4.26 Sky has long-standing concerns with regard to the preferred partnership between the BBC and BBC Worldwide. These include:
- (a) Whether BBC Worldwide is incentivised to maximise the exploitation of BBC content. In particular, Sky notes that BBC Worldwide is able to 'warehouse' rights acquired from the BBC rather than exploit them, with no condition that rights must be exploited when the BBC transacts with BBC Worldwide.
 - (b) Whether BBC Worldwide's exclusivity results in inefficiencies and distortion of competition through licensing policies and agreements. [X].
 - (c) Whether the BBC – and by extension the licence fee payer – is missing out on important revenue streams as a result of these practices.
 - (d) An ongoing lack of transparency as to the relationships between the BBC and BBC Worldwide.
 - (e) Preferential treatment of BBC Worldwide through discriminatory cross-promotion of BBC Worldwide services from public services, for example BBC Store's prominence and promotion within BBC iPlayer. We provide examples of this in Annex 2.
- 4.27 So long as a preferential agreement between the BBC and BBC Worldwide remains (and other market players are unable to present counter offers), these concerns are likely to persist.
- 4.28 In Sky's view, therefore, the presumptive approach for all BBC activities that require interaction with commercial players (whether subsidiaries or otherwise) should instead be one of market competition. Greater competition drives efficiency, value for money and better on screen outcomes, as well as strengthening the wider UK content sector by providing further growth opportunities for other market players. It is also the only way to truly test the market in terms of prices and terms and conditions, and is therefore crucial in providing relevant benchmarks for transfer pricing (see below).
- 4.29 Ofcom should amend its proposed requirements to ensure that in the first instance the BBC makes all public service goods and services available to wider market as standard. For example:

- (a) “Goods and services supplied by the BBC Public Service should be sold on the open market by being made available to third parties on equivalent terms and prices to those offered to its commercial subsidiaries.”
 - (b) “Where the BBC Public Service provides goods and services solely to its commercial subsidiaries, the BBC must ensure that arrangements are made on arm’s length commercial terms.”
- 4.30 Implementing a transparent market-based approach as standard which provides competitors with the opportunity to participate in the market would be critical step in ensuring that the BBC’s commercial trading processes are adequate.

Transfer pricing requirements

- 4.31 Ofcom proposes a number of requirements in relation to transfer pricing. The BBC is required to set prices for goods and services “as if they were sold on the open market”, using prevailing market practices as benchmarks “wherever possible”.⁴² Cost-based approaches to pricing are permitted if the BBC can demonstrate that no relevant market benchmarks are available.
- 4.32 Sky supports Ofcom’s clear preference for benchmarking, which is the most effective way for an organisation to gauge an appropriate transfer price. This is particularly true in the broadcasting sector since the value of rights may differ significantly by purchaser.
- 4.33 As noted above, Sky considers that one benefit of subjecting more of the BBC’s supply activities to open bidding processes would be that this would establish clear and verifiable market benchmarks for subsequent transfer prices to be based on. Adoption of an open market approach across the BBC’s activities would enable the BBC to undertake benchmarking in the vast majority of cases.
- 4.34 Without the comprehensive benchmarking that a market based approach allows, the danger is that the BBC seeks to rely more usually on a cost-based approach. Such an approach risks undervaluing significantly the benefit to the BBC’s commercial subsidiaries, as it bears no relation to what those services would have to pay in the market. As noted, this is particularly relevant to content rights which may be valued very differently by different players.
- 4.35 Under Ofcom’s proposals, the BBC is required to adopt a cost-based approach only where it can demonstrate that no market benchmarks are available. So long as the BBC retains discretion over which of its Public Service goods and services are made available on the open market, this could become something of a self-fulfilling prophecy – no benchmarks are available (and therefore a cost-based approach is permitted) precisely because the BBC opts to strike a an agreement with its commercial subsidiaries without inviting other offers. This raises a clear risk of adversely impacting on fair and effective competition, and emphasises again the criticality in ensuring a market based approach is followed as standard.
- 4.36 Consequently, it is not sufficient for the BBC merely to demonstrate that no benchmarks are available. Ofcom should only permit a cost-based approach to pricing where the BBC can actively demonstrate that the supply of goods and services would be expected to be priced effectively at cost even in an open market. This may for example be the case where the BBC Public Service offers goods and services that are widely available from other providers.

⁴² Paragraph 3.33 of the Commercial Consultation.

- 4.37 Sky also has an ongoing concern with the general lack of transparency in relation to transfer pricing and valuation. In our experience we have little information or understanding as to the approach taken by the BBC Executive, resulting in an inability to challenge assessments or make alternative offers. This is particularly the case in terms of payments made by BBC Worldwide for use of the BBC brand.
- 4.38 In this context, Sky supports Ofcom's later requirements to publish the methodologies the BBC uses to establish transfer prices and to value the BBC brands.

Ofcom's assessment of material changes to commercial activities

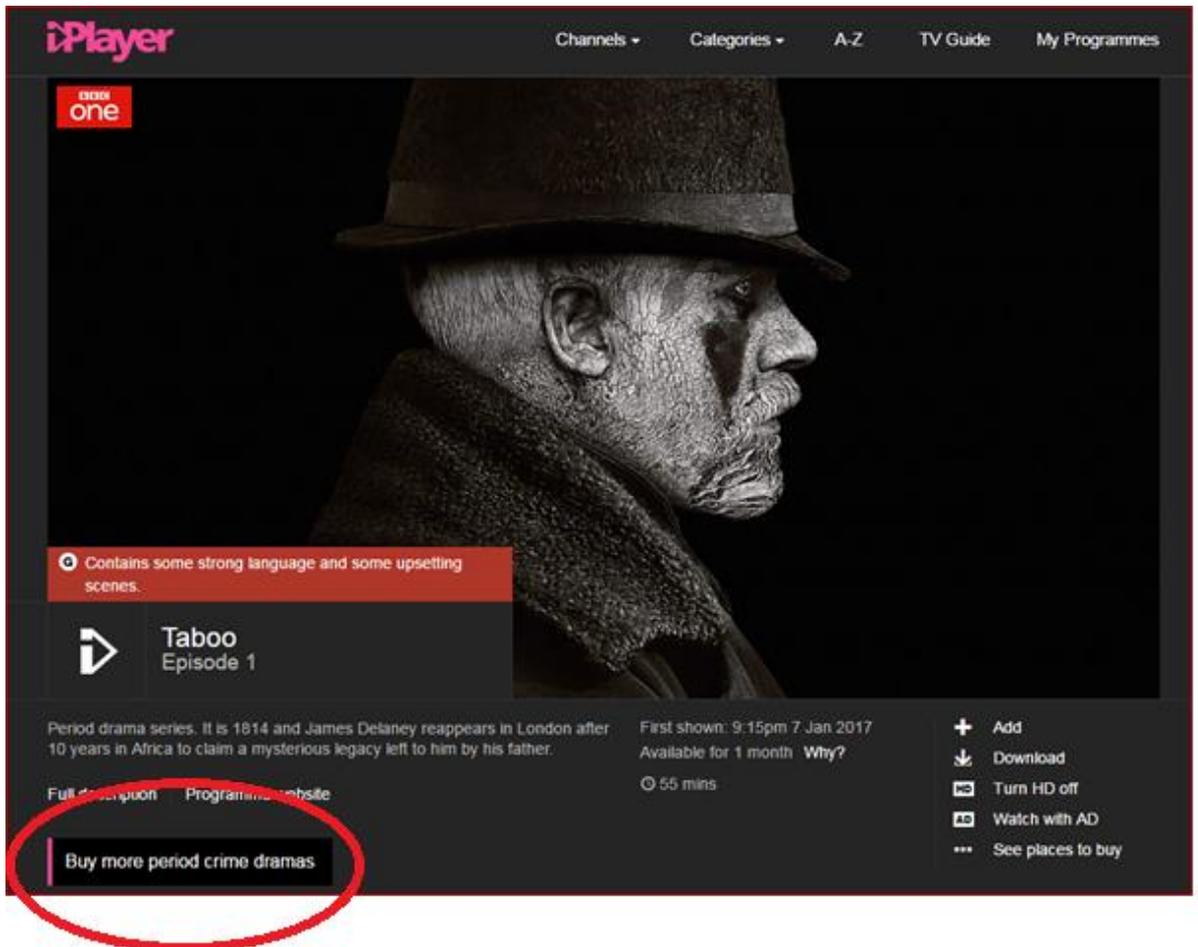
- 4.39 Sky broadly supports Ofcom's proposed approach to *ex ante* assessments of material changes to BBC commercial activities.
- 4.40 Ofcom's suggested process bears similarities to its proposed competition assessment process. Many of Sky's comments outlined above also therefore apply in this case, including:
- (a) *BBC materiality assessment*: Ofcom should go further and provide for the BBC to take a precautionary approach to its materiality assessment, and limit the use of trials to allow for proper consideration of their impact;
 - (b) *Appropriate assessment procedure*: Ofcom should minimise its reliance on the BBC's assessment, should adopt a presumption that any change deemed as material will be assessed under a full trading and separation assessment, rather than any shorter assessment. This is necessary given BBC incentives to reach a positive conclusion, this may encourage 'waiving through' of changes without proper scrutiny or investigation, particularly in relation to new services.
 - (c) *Transitional arrangements*: It is essential that no material changes to the BBC's commercial services are permitted to pass during the current transitional period. For example, BBC Worldwide and ITV have launched Britbox, an OTT pay TV service, in the US. Sky understands that the BBC Trust is currently considering proposals to launch the service in the UK. Given the new procedures and obligations set out in the Charter and Agreement providing increased scrutiny over such commercial services, it would be of significant concern were the Trust to authorise a new commercial service before Ofcom takes over regulatory responsibility. Such a matter would appear to fall squarely within Paragraph 2(2) of the Schedule to the Charter covering transitional arrangements as a function that the Trust ought to refrain from exercising on the ground that it would be more appropriate for the Board to deal with the matter in question on or after 3 April 2017.

ANNEX 1: SKY'S RELATIONSHIP WITH THE BBC

[REDACTED]

ANNEX 2: EXAMPLE OF PREFERENTIAL TREATMENT OF BBCWW (BBC STORE/IPLAYER)

1. [Public service content location with “Buy more period crime dramas” promotion:](#)



2. [Link through from "Buy more period crime drama"](#)

The screenshot shows the iPlayer website interface for the show 'Peaky Blinders'. At the top, there is a navigation bar with the iPlayer logo and links for Channels, Categories, A-Z, TV Guide, and My Programmes. Below the navigation, the show title 'Peaky Blinders' is displayed in pink, followed by a description: 'An epic gangster drama set in the lawless streets of 1920s Birmingham.' There are two buttons: 'NOT AVAILABLE IN CATCH-UP' and 'Programme website'. A section titled 'Places to buy' is highlighted with a red circle. It contains an information icon, a text block explaining that the show is not available in catch-up but can be bought, a 'Find out more' link, a small image of the show's cast, and two buttons: 'BBC Store' (with a description of the store) and 'Other suppliers'. At the bottom of the page, there is a footer message: 'Looking for something you've already bought? Go to My Programmes to see your purchases.'