

A1. Proposed modifications to trading and separation requirements and guidance

Schedule

Part 1: Definitions and Interpretation

1. In this Schedule -

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

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

“BBC Studios” means BBC Studios Group Limited which consolidates BBC Studios Limited and BBC Worldwide Limited;

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

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

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

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

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

“Current Year Figures” means, in relation to any set of the reports published or provided by the BBC under these Requirements, the amounts relating to the Financial Year to which the reports relate;

“Distribution Activities” means all activities associated with sales of formats, content and consumer products which are carried out both domestically and abroad;

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

“Financial Year” means 1 April to 31 March;

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

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

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

“Prior Year Comparatives” means, in relation to any set of the reports published or provided by the BBC under these Requirements, the amounts relating to the Financial Year immediately preceding the Financial Year to which the reports relate, re-evaluated if necessary to ensure that such figures are comparable to the Current Year Figures;

“Production Activities” means all activities associated with production of content which are carried out both domestically and abroad;

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

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

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

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

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

2. Except in so far as the context otherwise requires:
 - a) words or expressions shall have the meaning assigned to them in paragraph 1 of Part 1 of this Schedule, and otherwise any word or expression shall have the same meaning as it has in the Charter and/or the Agreement; and
 - b) words in the singular shall include the plural and, in the plural, shall include the singular.
3. A reference to a statute or statutory provision is a reference to it as amended, extended or re-enacted from time to time.

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

4. The Interpretation Act 1978 (c. 30) shall apply as if this Schedule were an Act of Parliament.
5. Headings and titles shall be disregarded.
6. Expressions which cognate with those referred to in this Schedule shall be construed accordingly.

Part 2: Requirements and Guidance

C. Commercial rate of return

Requirements

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

- c) The BBC must include the following information in respect of each proposed change in a notification made under Requirement C.5(b):
 - i) a description of each change;
 - ii) the BBC's reasons and justification for making each change; and
 - iii) an explanation of the impact of each change on the information reported by the BBC under these Requirements.
- d) The BBC may implement a proposed change set out in a notification made under Requirement C.5(b) except where one or more of the following applies:
 - i) the BBC has not complied with Requirement C.5(b);
 - ii) the BBC has not complied with Requirement C.5(c);
 - iii) Ofcom has directed the BBC not to proceed with that change.

Guidance

Appropriate commercial rate of return

- C.6 Requirements C.1 to C.5 inclusive help to ensure that:
- a) BBC public funding is not used to finance Commercial Activities other than on a commercial basis; and
 - b) Commercial Activities are undertaken on an arm's length basis and in accordance with normal market principles.
- C.7 A key aspect of the return earned by a Commercial Activity will be the price the Commercial Subsidiary or the line of business in question has paid for its inputs. We do not focus on the rate of return in isolation and in each case, we will usually consider a Commercial Activity's rate of return in combination with transfer pricing to assess whether the relationship between the Public Service and a Commercial Activity has had an unfair competitive advantage or a market distorting effect. We also consider that it would not be appropriate to focus on a single, universal measure of rate of return but rather to use the rate of return metric that is most relevant to the market or line of business in question.²
- C.8 The BBC is required to assess what an appropriate commercial rate of return is for Commercial Activities at the Commercial Subsidiary level and the line of business level. However, the BBC is not required to carry out such an analysis at the level of individual goods and/or services or specific activities (e.g. individual book titles).
- C.9 In assessing whether the commercial rate of return of a Commercial Subsidiary and each line of business within that Commercial Subsidiary is appropriate, we would consider, amongst other things, whether a rational private investor would invest in that Commercial Subsidiary and/or that line of business.
- C.10 In using this approach, it is important to recognise:

² For example, rates of return can be measured in terms of: return on capital employed; return on sales; return on investment etc.

- a) A Commercial Subsidiary and/or line of business need not generate a profit every year, particularly if it is a new activity. For example, a business plan may project a loss in the early years of a new activity as the business grows. However, the plan must forecast that it will achieve a commercial rate of return over an appropriate period of time;
- b) Requirement C.1 provides that Commercial Activities at the Commercial Subsidiary level and at the line of business level must earn a commercial rate of return over an appropriate time period. However, in some circumstances an investment in one line of business could generate indirect returns elsewhere, and a rational investor may accept low returns on a specific investment if this investment produces high returns for the same investor from other assets. Where this is the case, we would expect the BBC to be able to demonstrate how low returns on one line of business supported higher returns elsewhere, in order to show that the low returns nevertheless represent appropriate commercial rates of return; and
- c) The actual (ex-post) return could be very different (higher or lower) than the estimated return at the time the investment is made.

C.11 What constitutes a commercial rate of return will depend on the specific market circumstances. The Requirements do not specify rates of return. Instead, the BBC must monitor and research the markets in which Commercial Subsidiaries and the lines of business operate, including using benchmark rates of return, to ensure that the returns generated by their Commercial Activities are in line with commercial rates of return.

C.12 Given that Commercial Activities must be separate from the delivery of the Public Purposes and are only required to fit with the BBC's Mission and Public Purposes, a non-commercial rate of return cannot be justified on the grounds of assisting the delivery of the BBC's Mission and Public Purposes. However, in considering whether to (i) investigate a potential breach of Requirements C.1 to C.5, and (ii) impose a penalty in the event that a breach is found, we will take into consideration, among other factors set out in our Enforcement Procedures, any link between the Commercial Activity in question and the other activities carried out by the BBC which are subject to the regulatory regimes established by the Operating Framework.

C.13 The BBC may of course set additional rate of return benchmarks either for its own internal investment appraisal purposes or in terms of setting performance targets for existing Commercial Activities. For instance, the BBC may set specific targets for its Commercial Activities which are intended to be more challenging than simply earning a commercial rate of return.

Suspected failure to achieve an appropriate commercial rate of return

C.14 We recognise that there may be situations where returns are low, particularly in the short term. For example, unexpected changes to market or economic conditions may cause performance to deviate from expectations.

C.15 However, if the BBC considers that an activity is not likely to earn a commercial rate of return over an appropriate period of time, under Requirement C.4 the BBC is obliged to follow the specified process and take remedial steps. In reviewing performance and implementing any necessary steps to move to earning a commercial rate of return, the BBC must decide whether the line of business should be modified, scaled back, stopped, or divested.

- C.16 Where we are concerned that the BBC has not complied with one or more of Requirements C.1 to C.5, we will consider whether to launch an investigation. If, following such an investigation, we find that the BBC has failed to comply with the Requirements, we may direct the BBC to take action to ensure that the Commercial Subsidiary and/or the line of business earn an appropriate commercial rate of return within an appropriate time period or do anything else we consider appropriate to remedy the breach. In considering whether to open an investigation and whether to impose a penalty in the event that a breach is found, we will take into account, among other factors set out in the Enforcement Procedures, the extent of any risk of market distortion, or the Commercial Activity in question gaining an unfair competitive advantage, as a result of its relationship with the Public Service.
- C.17 For the avoidance of doubt, where a Commercial Subsidiary has entered into a Joint Venture, the Commercial Subsidiary's share of revenues and costs associated with this Joint Venture must be included in the relevant lines of business.

Reporting requirements for Section C

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

D. Monitoring, reporting and transparency

Requirements

Commercial rate of return

Publication of reports on financial performance

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

Provision of Target Rates of Return information to Ofcom

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

- D.12 The information required under Requirement D.11 must be provided for all the future Financial Years included in the period for which the BBC has prepared its budgets and/or business plans.
- D.13 In the event that the Target Rates of Return for any Commercial Subsidiary or any line of business within a Commercial Subsidiary fall below the BBC's assessment of the commercial rate of return, the BBC must provide to Ofcom as soon as practicable the following information:
- a) explanation of the steps the BBC is planning to take for the Commercial Subsidiary or the line of business in question to reach a commercial rate of return;
 - b) the period of time after which the BBC expects that that commercial rate of return will be reached and the reasons why the BBC considers that period of time to be appropriate; and
 - c) any business planning and budgeting information necessary to support the information provided under D.13(a) and (b).

Provision of achieved rates of return information to Ofcom

- D.14 The BBC must provide to Ofcom the following information for each Commercial Subsidiary and each line of business within each Commercial Subsidiary:
- a) the achieved rate of return, setting out the revenues, costs, assets, liabilities, capital employed and cash flows used in the calculation of those rates of return, each split into key categories together with a description of those key categories;
 - b) Budgeted Figures for the key categories of the revenues, costs, assets, liabilities, capital employed and cash flows, and an explanation of any differences between the actual figures and the Budgeted Figures;
 - c) explanations of cost attribution methods applied to common costs in the calculation of the rates of return;
 - d) a breakdown of total revenues and costs used in the calculation of the rates of return of each Commercial Subsidiary pursuant to Requirement D.14(a) and a breakdown of total revenues used in the calculation of the rate of return for each lines of business within each Commercial Subsidiary pursuant to Requirement D.14(a). Each breakdown must be split into the following:
 - i) those which relate to the Public Service;
 - ii) those which relate to other Commercial Subsidiaries;
 - iii) those which relate to other lines of business within the same Commercial Subsidiary; and
 - iv) those which relate to third parties;
 - e) the total amount of revenues which have been allocated:
 - (i) from the Production Activities to the Distribution Activities; and
 - (ii) from the Distribution Activities to the Production Activities;

in the Financial Year to which the achieved rates of return relate;

- f) a breakdown of the total amount of allocated revenues referred to in Requirement D.14(e) split by each individual title;
- g) an explanation of any material change in the total amount of allocated revenues referred to in Requirement D.14(e) which are comprised in the Current Year Figures, as compared to the total amount of allocated revenues which were comprised in the Prior Year Comparatives; and
- h) a copy of the most recent management accounts for the Financial Year prepared by BBC Studios for the purpose of internal monitoring of performance of different activities within the lines of business comprised in BBC Studios.

D.15 The information must be provided pursuant to Requirement D.14:

- a) for the first half of the Financial Year, no later than three months after the end of the first half of the Financial Year;
- b) for the whole of the Financial Year, at the same time as the BBC Annual Report for that Financial Year is published; and
- c) in relation to Requirements D.14(e), D.14(f), D.14(g) and D.14(h) only, the information required under these Requirements must be provided once every Financial Year at the same time as the BBC Annual Report for that Financial Year is published.

D.16 In the event that a rate of return achieved by a Commercial Subsidiary and/or a line of business within that Commercial Subsidiary is lower than the target rate of return for the relevant period, the BBC must inform Ofcom as soon as practicable, after providing the specified information pursuant to Requirement D.14, of the following:

- a) the reasons for the difference between the target rate of return and the achieved rate of return; and
- b) in the event that the achieved rate of return is lower than a commercial rate of return, explanation of the steps that the BBC has already taken, and/or is intending to take, in order to achieve a commercial rate of return.

Other requirements

D.17 In addition to Requirements D.13 and D.16, if at any other point in time the BBC identifies that a Commercial Subsidiary and/or a line of business within a Commercial Subsidiary is not expected to earn a commercial rate of return over an appropriate period of time, the BBC must provide to Ofcom as soon as practicable the following information:

- a) explanation of the steps the BBC is planning to take in relation to the Commercial Subsidiary and/or the line or business in question;
- b) if the BBC decides to take steps to ensure the Commercial Subsidiary and/or the line of business in question reaches a commercial rate of return, the period of time after which the BBC expects that that commercial rate of return will be reached and the reasons why the BBC considers that period of time to be appropriate; and

- c) any business planning and budgeting information necessary to support the information provided under D.17(a) and D.17(b).

General

- D.18 Subject to Requirement D.19, the information published or provided pursuant to Requirements D.1 to D.17 must include information in relation to all Commercial Subsidiaries and all Joint Ventures in which the Commercial Subsidiaries may participate.
- D.19 Where information relating to a Commercial Subsidiary (the “Consolidated Commercial Subsidiary”) or a Joint Venture referred to in Requirements D.1 to D.17 has been consolidated into reports and accounts for a parent Commercial Subsidiary which is a trading company subject to these Requirements, the BBC is not required to publish or provide separate reports and accounts for the Consolidated Commercial Subsidiary or that Joint Venture under these Requirements.
- D.20 The BBC must include and/or take account of all material items of information in complying with Requirements D.1 to D.17. A material item of information is one which is reasonably expected to affect the views of a competent user of the publications and submissions which BBC is required to make under Requirements D.1 to D.17.
- D.21 Requirement D.5(c) applies to all transactions between the Public Service and the Commercial Subsidiaries, including transactions which are subject to the Commissioning Requirements.
- D.22 The information provided or published (as applicable) pursuant to Requirements D.5(b), D.5(c), D.7(a), D.8(a), D.8(b), D.11, D.12 and D.14 must be prepared, as a minimum, as to form and content in the manner set out in Part 3 of this Schedule.
- D.23 Any information published under Requirements D.1 to D.17 must be effected by the BBC by placing a copy of the information in a prominent place on the relevant publicly available website operated or controlled by the BBC.
- D.24 The BBC must maintain accounting records, including but not limited to relevant correspondence, contracts and invoices, for a period of six years from the date on which each record was created and ensure that those records are sufficient to provide an adequate explanation of how the BBC has complied with each of the Requirements, including an adequate explanation of the information published and provided to Ofcom (as applicable) pursuant to Requirements D.1 to D.17.

Guidance

Purpose of publication and provision of information to us

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

Reporting of information concerning supply of goods and/or services

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

Reporting of commercial rate of return information

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

Part 3: Reporting templates

The proposed template in respect of proposed Requirements D.14(e), D.14(f) and D.14(g).

TEMPLATE 9					
Requirements D.14(e), D.14(f) and D.14(g)					
Revenue allocation between distribution and production activities					
Commercial Subsidiary: ...					
Financial Year ended: ...					
Line of business	Production name	Reference	Year of production	BBC Classification	Allocation £000's
Line of business 1	x	x	x	x	x
Line of business 1	x	x	x	x	x
Line of business 1	x	x	x	x	x
Line of business 2	x	x	x	x	x
...	x	x	x	x	x
Total					<hr/> <hr/>
Notes: BBC Classification is defined as either new BBC Studios productions, returning series or archive.					
New BBC Studios productions: New non-returning series that were developed and produced post since BBC Studios became a commercial entity.					
Returning series: New series of established returning series that are being made by BBC Studios since it became a commercial entity.					
Archive: Series produced before BBC Studios became a commercial entity.					