

ITV plc response to Ofcom’s consultations on the BBC
“Assessing the impact of proposed changes to the BBC’s public service activities”; “The BBC’s commercial activities”; and “Assessing the impact of the BBC’s public service activities”

Introduction

ITV welcomes the new system of governance and regulation for the BBC. The introduction of a new unitary board to govern the BBC, and of Ofcom as its external regulator, underpinned by the new requirements set out in the Charter and Framework Agreement, collectively represent a significant step in the right direction, provided they are operated as intended. In our view the framework lays the groundwork for the BBC to demonstrate transparently that it is operating in a fair and effective way, maximizing benefits to UK citizens and consumers.

We appreciate the opportunity to provide feedback on the new regime at this critical point as Ofcom determines how it will operate in practice. There is an opportunity now to identify and resolve issues that have the potential to hinder the effectiveness of the new regime. One of the lessons of the last ten years is that it is harder to do this once the system has been up and running for a while.

With that in mind, there are a few things on which we would like to provide input in order to ensure that the result of these consultations is a system that works as well as it possibly can for the BBC, its suppliers, its partners, other broadcasters, for Ofcom, and above all for UK citizens and consumers.

We take as our starting point the fact that the BBC will now be governed in a way that more directly reflects any other company in a regulated industry. For the first time the BBC has a unitary board, but also an external regulator. As an organization that deals extensively with the BBC as competitor, partner and supplier we welcome this new clarity.

Our comments in this submission are based in part on the experience we have in operating within a governance and regulatory structure which has some similarities to ours, but also on our experience of negotiating with different BBC governance and regulatory regimes over the years.

General comments

Any external regulator will reduce the likelihood that it has to intervene later on by taking a clear and robust position at the outset

It is the case in any regulated industry that if the regulator makes clear at the outset that it will intervene, that it will have no hesitation in exercising all the powers available to it, and that it will monitor market participants closely, then regulated entities are much more likely to take seriously their regulatory requirements. On the other hand, if the regulator signals at the start that it has a low appetite for intervention, paradoxically it is more likely to have to intervene, since the regulated company has more incentives to take risks in compliance.

This is not a comment specific to the BBC but a broader point about corporate incentives. A key function of a regulator is to create incentives to abide by regulatory requirements that are sufficiently strong to outweigh other (potentially conflicting) considerations. In our view the most effective way to achieve this is by making it clear at the outset that monitoring and enforcement will be rigorous.

Clearly the changes in prospect here are very significant for the BBC (and indeed for Ofcom). Accordingly, we assume that there will need to be a change in culture and approach at the BBC given that it has not had a formal arms length regulator across its entire activities before. In our view the best way to support the BBC in making the transition is for Ofcom to set out its vision for rigorous oversight with the aim of avoiding the need for regular intervention.

The need for a firm stance at the outset is perhaps illustrated by aspects of the history of the BBC Trust. The BBC Trust took time to find its feet and to assert itself and by the time it did so it was arguably too late. The example of the BBC Trust and Fair Trading is salutary. By the time John Fingleton wrote his report in 2015, it was clear that there were real issues and a lack of trust in the regime in the market. However, by that point it was very difficult for the Trust to go back to first principles and re-engineer the regime and its application and enforcement from the bottom up, which is ultimately what the Fingleton report (and the related EY report on transfer pricing) could be read as suggesting was required. The question is whether the BBC will do this by itself, a development more likely if it is clear that Ofcom will intervene otherwise.

Against this backdrop, there are one or two places in Ofcom's consultation where we believe it would benefit all stakeholders if Ofcom's language were slightly stronger. For example, in the consultation on the BBC's commercial activities, Ofcom briefly sets out that the BBC may be required to provide and possibly publish additional information. At ITV, we operate under the licence condition that Ofcom may at any time require us to hand over a broad range of specific forms of information: "*documents, accounts, returns, estimates, reports, notices or other information as Ofcom may require for the purpose of exercising the function assigned to it by or under the 1990 Act, the 1996 Act, or the Communications Act*". We would suggest that a similar degree of specificity around Ofcom's information-gathering powers with regard to the BBC would be sensible.

Another example where we can see the benefit of a change in tone from Ofcom is in the Commercial Activities consultation which says that Ofcom may review the BBC's work in setting a rate of return "*in extreme circumstances*"¹. Clearly our hope and expectation is that the BBC's own analysis will be sufficiently robust to not require regulatory intervention and again we emphasise that it is not in ITV's or anyone else's interests for the BBC to fall short of its requirements and to prompt regulatory intervention. However, we believe that if Ofcom indicates that it is willing ready to intervene systematically where there is justification, the BBC will work harder to ensure it is not necessary.

¹ The BBC's Commercial Activities, p.18

Greater transparency in general is critical to the success of the new regime

One of the historical challenges that third parties have faced in their interactions with the BBC is that there has often been little transparency around the way the BBC operates, particularly in terms of the relationships between BBC Public Service and the various BBC commercial entities.

The perceived lack of clarity was one of John Fingleton's key findings in his review of BBC Fair Trading:

"In general, the Executive appears to publish the minimum amount of information required by law. It is not clear to us that this level of information is sufficient to demonstrate publicly that the Executive meets the Trust's requirements on separation, and our interviews with third parties suggest this level of information is not sufficient to ensure they are confident the relationships between the BBC's Public Service divisions and its commercial subsidiaries are compliant with State Aid law.

*Given the widespread lack of trust in the arrangements between the BBC and its commercial subsidiaries expressed to us by third parties, we consider the Executive could do more to demonstrate these relationships are compliant with the Fair Trading Obligation."*²

We would note that if greater transparency was required as part of the old governance and regulatory regime, the need for greater transparency is even higher now. Many of Ofcom's proposals for implementing the new system rely on the BBC being much more transparent than before.

For example, in Ofcom's consultation on assessing the impact of proposed changes to the BBC's public service activities, it notes that the situation in which the BBC has not published a material change to activities will be avoided in part by the BBC publishing an annual plan and work plan that will:

"give third parties a good understanding of the areas where important strategic thinking is taking place, in sufficient detail to enable comment and debate."

The current BBC Work Plan does not set out detailed descriptions of emerging proposals that are likely to amount to material changes in the future. Rather, it contains high-level one or two page summaries for each service setting out the overall vision for the service, and with a handful of bullet points along the lines of:

*"Radio 1 will continue to look for innovative and engaging ways to involve its audience in conversations via Social Media, including a fresh look to its page on Tumblr"*³.

² Ibid, p.39

³ BBC Work Plan, 2015/16

The BBC has historically focused on making public only such proposals as have been agreed on internally, and even then only at a very high level. The scale of the cultural change required for the BBC to instead publish proposals that are still at an early stage and on which they still have a genuinely open mind, and to be transparent about the details and implications such that third parties can meaningfully provide feedback, should not be underestimated.

The requirement throughout these proposals for the BBC to be more transparent represents a significant cultural change at the BBC and will require a fundamental rethink of many ways of working across the organization. In our view, the more Ofcom can do to acknowledge the scale of the change and to support the BBC in facing it, the more likely it is that the change will be achieved.

Ofcom Consultation on assessing the impact of proposed changes to the BBC's public service activities

Ofcom's role

One of the great advantages of the new governance and regulatory system for the BBC is that the roles and responsibilities of the different parts of the system are far clearer. The BBC is governed by its new unitary board, but regulated by Ofcom as the external regulator.

Clearly, it is the duty of any board, and perhaps particularly the BBC unitary board given the substantial responsibilities that come with public funding, to ensure the organization is fully compliant with all regulatory requirements. It is not the primary duty of a board to operate (and interact with others in the market) as if it were a quasi-regulator itself. That was exactly the problem of the old system.

With that in mind, we are concerned that paragraph 4.17 of Ofcom's consultation sets out a process that is in direct conflict with this clear new position. Ofcom appears to put the onus on third parties to *"engage effectively"* with the BBC and *"should not assume our assessment of a proposal will provide a second opportunity to raise issues"*.

Of course, the BBC needs to ensure active compliance with the Charter, Agreement and relevant related obligations and this will require it to actively engage with the industry and with licence fee payers. It absolutely must try to get broad consent for its approach and its proposals but that is something that any board would seek to do with its relevant stakeholders. However, it can't be right for Ofcom to suggest that it might not perform its role fully if stakeholders haven't, regardless of the reason, engaged on a particular issue with an organization that may be its closest commercial rival and/or key customer.

ITV welcomes the opportunity to engage constructively with the BBC over future proposals, and we believe that a positive and open dialogue can often result in better outcomes for all involved. In general, we would intend to engage with the BBC on its proposals where we can. However, it is perfectly possible that there will be good commercial or relationship reasons why we would not be comfortable taking up certain issues with the BBC instead of

with Ofcom, or objections that could only be evidenced with commercially sensitive information.

Alternatively, it may be the case that we have not been provided with sufficient information by the BBC for us to wholly understand the proposal and identify grounds to object: this is a key issue that was identified by Fingleton and one that has been a longstanding challenge for the commercial sector.

We believe that Ofcom should be clear that while it expects the industry would wish to engage with the BBC where appropriate (and vice versa) this will not be a substitute for the proper discharge by Ofcom of its role.

Ofcom's use of the BBC's own assessments as opposed to its own independent analysis

Ofcom states on p.30 of the consultation that:

*"the starting point for our analysis will generally be the BBC's public interest test. Where the BBC's analysis is reasonable, complete and objective, there will be less need for us to conduct further analysis"*⁴

It is important to be realistic about the extent to which any company or organization can be expected to be truly objective about its assessment of a new proposal or initiative, particularly where such proposals are part of a broader corporate plan or strategy. There are potential conflicts inherent in this that necessitate external regulation. This appears to us a critical part of the rationale for introducing Ofcom as the BBC's external regulator in the first place. To be clear, this is not a criticism of the BBC at all – indeed our preference is for a single BBC Board with a single view of a proposal but subject to effective external oversight.

Indeed, we note that Ofcom itself recognizes in the same document the inherent bias that the BBC will naturally have in terms of reaching a positive outcome in its self-assessments:

*"If the standard of the BBC's own work is such that we consider full assessment to be duplicative this would be a factor in deciding to conduct a more limited, shorter assessment. **We take into account, however, that the BBC has an incentive to reach a positive conclusion from its public interest test and would be looking to see evidence that work is appropriately balanced and robust.**"*⁵ [emphasis ours]

Given that Ofcom acknowledges the fact that the BBC clearly has an incentive to approve its own proposals, Ofcom should take a cautious approach to the BBC's own self assessment as part of its regulatory process and always do its own work and analysis.

Again, this is by no means a criticism of the BBC. It is simply based on an observation from experience that at many companies or organizations, the strategy comes first, and the

⁴ Ofcom, Assessing the impact of proposed changes to the BBC's public service activities, p.30

⁵ Ibid, p.20

approvals and regulatory processes follows. Clearly good strategy formation should take some account of the possible regulatory hurdles, but in reality the incentive to execution for any organization is strong.

In the case of the BBC, as the Ofcom consultation acknowledges, relevant strategies will have been announced in its annual report or work plan and have been put into the public domain. In the case of larger planned changes, the BBC may have announced the proposal as part of a major speech by the Director General with significant press coverage (as is sometimes the case). In order to believe that the subsequent internal approvals process run by the BBC would be truly objective, one would have to believe that it is just as likely as not that the BBC would then, after public announcement, conclude that the public value has turned out to be too low and that the proposal will be shelved. That is why it is critical that Ofcom takes its own independent view.

The visibility of the pipeline

The proposed new regulatory system for the BBC sketched out by the new BBC Agreement relies on Ofcom and third parties having high visibility of potential material changes, long in advance. As set out above, clearly the BBC's annual work plan could offer forward visibility in these areas, though that will require significant change since that document is not currently aimed at providing anything like that level of visibility.

For different reasons, it is also important that there is appropriate visibility of the marginal decisions where the BBC decides not to initiate a formal regulatory or approval process and no one knows that a decision has even been taken. Although it is right that the BBC should be able to exercise its discretion in some areas, it would not hinder the smooth operation of the BBC if it were to be required to simply notify Ofcom when it has exercised its discretion, and/or departed from the norm. This would give the market some reassurance that Ofcom was across decisions the BBC was making behind closed doors, and, indeed, there seems no particularly legitimate reason why such decisions shouldn't be made public too.

The definition of public value

Ofcom's consultation includes a consideration of what could be considered a "reasonable view of what constitutes public value":

"People may benefit from using the service offered by the BBC. Additionally, where people use the BBC's public services, they may also change their attitudes and behavior in ways that benefit those around them. For example, providing impartial news could foster active and informed participation in the democratic process that improves the lives of fellow citizens. These wider benefits to citizens are reflected in the BBC's Public Purposes."⁶

One of the most significant changes that has arisen from the latest Charter review is the new overriding responsibility on the BBC to be distinctive. The new governance and

⁶ Ibid, p.32

regulatory regime clearly recognizes that the distinctiveness of the BBC's services is a key part of the value that it provides to UK citizens and consumers. This is reflected in the new licence conditions for services in the Framework Agreement around levels of risk-taking, innovation, challenge, creative ambition, etc – all of which are at the heart of the public value that the BBC delivers. It must be right therefore that these considerations are core to the assessment of what constitutes public value, and we would hope to see that clearly set out by both Ofcom and the BBC.

Furthermore, the first sentence from the extract above would seem to suggest that the sheer number of people using a service is a key consideration in the assessment of public value. Although it is one factor in the assessment, our concern is that without greater clarity and emphasis on the other elements of public value, a proposal could receive a positive assessment simply by increasing reach or share. This is particularly the case given that audience numbers are considered as part of the BCA process (both audience growth and audience substitution⁷), creating a risk that if a proposal simply results in an increase in reach or share that could outweigh other considerations such as a lack of distinctiveness in the proposal.

Following on from this, we note that Ofcom references the cost of the proposal to the BBC licence fee payer as a consideration in the assessment of public value. We agree that this is an important point since, as Ofcom says, the potential costs of a proposal may outweigh the benefits. We would only add to this the point that when any company considers an investment it is not just the absolute cost of the change that is considered, but the opportunity cost – i.e. would this money generate better outcomes if it were spent in another part of the business. This applies to the BBC as much as any other company, and we would expect it to be reflected in the consideration of cost and public value.

Information requests

We have one final point to make regarding this consultation: in paragraph 4.53, Ofcom states that in general, information it seeks via an information request should be provided within 5-10 working days, depending on the complexity of the request.⁸ Our concern is that this may well be impracticable. ITV is a large organization but a very lean one, and information requests often require critical input from just 1 or 2 people who may not be immediately available at the point the request is received. We have no desire to unduly delay proceedings and would make our best efforts to respond swiftly, but with our level of resource we would seek recognition that it may take us more time.

Ofcom consultation on the BBC's commercial activities

Commercial rates of return

⁷ Ibid, p.29

⁸ Ibid, p.24

We agree that the introduction of regulation around commercial rates of return is wholly appropriate for the BBC. Indeed, this simply mirrors the level of accountability that commercial players have always faced: these companies are held accountable by their shareholders for the rates of return they deliver, and there is a very strong mechanism for accountability – ultimately, shareholders have the ability to replace the management team should they feel they are not delivering adequate returns. This forces a relentless focus on efficiency and return at commercial businesses. Where an organization operating in a commercial market is not subject to this pressure, it will distort competition by competing unfairly (potentially via uneconomic pricing) given the advantage of a lower obligation to make a return on capital. Accordingly we welcome Ofcom’s proposals which we agree will help to ensure that licence fee payers’ money is not used to finance commercial activities which make market returns below those of their competitors.

The detail of this new mechanism will determine the extent to which it achieves its aims. We suggest that there are three elements that will be critical to getting this right.

Firstly, the definition of a line of business, for each of which a rate of return must be set, is key. As Ofcom acknowledges, a return at the level of a commercial subsidiary as a whole would not be sufficient. We agree that it would also be unhelpful to set the obligation at a level that is too low to be meaningful, but finding the balance will clearly be critical.

Secondly, the definition of a ‘credible business plan’⁹ must take into account historical performance, since it is possible to have several different iterations of a business plan, each of which may appear credible on its own merits, but if the proposal has failed each time then that is an important factor to consider in determining the credibility of any new iteration.

Finally, we note Ofcom’s comment that, although it expects every activity to be profitable over an appropriate period, *“in some circumstances an investment in one activity 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”*¹⁰. Although we do not object to this on principle, we would highlight that it is critical for this to be analysed very carefully to ensure that there is no unfair cross-subsidy within the BBC group.

Burden of proof

The draft guidelines suggest that it will be for the complainant to demonstrate how the BBC’s arrangements are outside of market norms and how they impact competition:

“When deciding whether to open an investigation, we will consider whether there is evidence that the BBC’s arrangements are outside the market norms for the relevant line of business and if the BBC’s commercial activities are likely to distort competition

⁹ The BBC’s Commercial Activities, p.18

¹⁰ Ibid, p.18

in the UK. We would not expect to consider distortion to competition in international markets. We would therefore expect complainants to clearly demonstrate how the BBC's arrangements are outside of market norms and in particular how they are likely to impact UK competition.¹¹

Although we appreciate the challenge of determining when a claim merits a full investigation, the difficulty with this proposal is that it is very hard to begin to provide evidence of potential breaches of the rules without far greater visibility as to what is going on, particularly as between the BBC and its commercial subsidiaries. Citing a lack of complaints as evidence of compliance where there is virtually no external visibility of what is going on is not sustainable. The market has very little visibility as to the approach of the BBC to transfer pricing for example.

The recent EY review of current transfer pricing practice in the BBC also illustrated some of these difficulties. For example, it identified the fact that the BBC does not have a list of all transfer pricing relationships, as the BBC's Fair Trading team does not track information in this way. As such, there is no one even within the BBC who was able to state how many transfer pricing arrangements there are, or review a complete list of their details. The EY report further noted that there is no annual monitoring report on the agreements between the BBC and its commercial subsidiaries, such that third parties can identify any key changes or review the BBC's assessment of how they are in line with the fair trading guidelines. And in one of the EY case studies, a brand agreement between BBC PS and BBC S&PP, neither party was able to locate a copy of the brand licence agreement nor any of the underlying data that went into the method for determining the fee.

In a context where it appears to be challenging even within the BBC to find details of transfer pricing agreements, it is very difficult to see how third parties could be in a position to provide evidence to support their concerns. There must be a recognition that if there is a concern, the burden of proof must be on the BBC to demonstrate how it is compliant, not on the third parties who have no access to data to do so.

Transparency around transfer pricing

We agree with Ofcom that

"greater transparency in relation to transfer prices could improve confidence in the regulatory framework around the BBC's commercial activities"¹²,

However, we feel that this would be best achieved by Ofcom requiring the BBC to publish actual transfer prices. The reports by both John Fingleton and EY have illustrated real issues around transparency, as set out above, and publication of actual prices is the best possible way to ensure prices are fair, since the market would be able to identify and flag any clear discrepancies. Given that the BBC's content is funded by a mandatory fee collected by law, the BBC is in a very different position to the commercial market and should be more

¹¹ Ibid, p.5

¹² Ibid, p.20

transparent, if only to reassure licence fee payers that it is achieving a justifiable and competitive price from its commercial subsidiaries.

If there is no publication of transfer prices we agree with Ofcom that it is critical for the BBC to publish the detailed methodologies chosen for each transfer price. Here we would suggest that simply listing the type of approach and the sorts of factors that were taken into account is not sufficient to provide meaningful transparency: the BBC should publish specifics such as what dataset was used, from which source, how the final transfer price may differ from the market data, etc. Clearly such an approach would help to illustrate where irregular approaches have been used.

Finally, in cases where the BBC has used its discretion in setting the transfer price, there should be a requirement to flag to Ofcom that it has done so. This is not to suggest that Ofcom should be in any way continually involved in the day-to-day operations of the BBC, but simply to ensure that Ofcom is made aware when the BBC has departed from its guidance (such as to use a market benchmark approach whenever possible, and to only use an alternative approach when justified).

Ultimately, however, experience suggests that in circumstances where publicly funded assets are in play, competitive tendering is usually the best way of establishing a market price.

Ofcom consultation on assessing the impact of the BBC's public service activities

Many of our comments above in relation to Ofcom's consultation on assessing the impact of proposed changes to the BBC's public service activities apply equally to the proposals within this consultation: particularly our comments around Ofcom's role and use of BBC analysis, the definition of public value, and on information requests.

In addition, we note that Ofcom says that one of the factors that will determine whether or not they initiate a BCR is:

"The resources required to conduct a BCR and the comparative benefits of using those resources in other ways. We are particularly aware in this context of projects drawing on similar resources such as other ongoing BCRs and BCAs"¹³

We appreciate that Ofcom has finite resources, and similarly we appreciate that if there are competing priorities then a BCR may be scheduled but put on hold until the appropriate resources are available. However, we would be surprised if Ofcom were to ignore genuine grounds for concern over a competition issue because staff were committed elsewhere at the time. We would appreciate any clarification from Ofcom that the availability of resource may impact the relative prioritization of a BCR, but not the decision to initiate one.

¹³ Assessing the impact of the BBC's public service activities, p.15