

10 December 2013

Alex Towers
BBC Trust
180 Great Portland Street
London
W1W 5QZ

STUART MCINTOSH

Group Director, Competition

Dear Alex,

BBC Trust Significance Test – Links between BBC public services and BBC Store

In accordance with the Terms of Reference of 29 October 2013 and the Addition to the Memorandum of Understanding¹ regarding significance tests, this letter sets out Ofcom's views on the potential impact on others ("others" being providers or potential providers of alternative products and services) of the BBC Executive's proposed changes to the BBC Online and iPlayer public services which arise as a result of the links between these services and the proposed new commercial service, BBC Store ('the Proposals').

Our views are provided in order to inform the Trust's decision on the significance of the Proposals. All aspects of the Proposals (including impact on users) are being considered by the Trust Unit and it is the Trust's decision as to whether the Proposals are considered significant for the purposes of Clause 25 of the BBC's Framework Agreement.

The Proposals relate to the launch of the BBC Store service by commercially-funded BBC Worldwide ('BBCW'), which will retail BBC content for consumers to download to own ('DTO')² across all platforms.³ Specifically we understand the Proposals are:

- to extend the search functionality on iPlayer and BBC Online to include results from both public service and commercially available BBC content;
- to include links to both BBC Store and other commercial outlets retailing BBC content, from both the iPlayer and BBC Online;⁴
- to create a 'seamless' purchasing experience, via pop-ups launched from iPlayer and BBC Online and the use of a single BBC account registration;
- storage of BBC Store purchased content via a 'cloud based digital locker' which will also contain any downloaded iPlayer catch-up content; and
- playback of BBC Store purchased content via the iPlayer.

Consideration of the broader public value of the BBC Store and the impact on users is a matter for the Trust and outside the scope of our input. However, it is likely that the BBC

¹ http://www.bbc.co.uk/bbctrust/assets/files/pdf/about/mou_addition_dec2011.pdf

² We note BBCW intends for the BBC Store to provide access to both TV and radio content but at launch only TV content will be available.

³ Although only PC, tablet and mobile platforms at launch.

⁴ In accordance with the BBC's Commercial Linking Principles and Fair Trading Guidelines. We note that links to other third party retailers of BBC content are already provided on BBC Online's programme pages.

Store and its proposed links to the BBC's public services will provide an attractive consumer proposition over time. By providing a route to market for the 93% of BBC archive content which is currently unavailable on either a public service or a commercial basis, consumer choice is likely to be increased.

Ofcom's approach to this assessment

We have reviewed the Proposals, information held by Ofcom⁵, and further information provided by the BBC at our request.⁶ We have not commissioned any additional market research, obtained any new information or data specifically for this work, or consulted with stakeholders – some of which may have particular views about the impacts of the Proposals.

The material provided by the BBC Executive included an assessment of its compliance with state aid and competition law requirements, including analysis of the appropriate transfer price for the BBC Store's use of public service capability, resources and assets and compliance with the BBC's Fair Trading guidelines.⁷ We have not made any assessment of these areas as this is the responsibility of the BBC Trust. We understand that the BBC Trust has carried out its own assessment in these areas and is content with the proposed approach.

We did, however, clarify with the Trust two specific issues related to Fair Trading which are relevant to our consideration of the impact on others. They were that:

- the rights for digitised BBC archive content will be made available on a non-exclusive basis to third party commercial providers; and
- the public service assets which the BBC Store will make use of (and which are paid for through the transfer pricing mechanism), including the iPlayer play-out technology, will also be available for other market players to use in line with the BBC's Fair Trading guidelines and using the established transfer price.

In our view this alleviates, in principle, any initial high-level concerns about distortionary effects on others.

Scope of the Proposals

At launch the BBC Store will only be made available on PCs, mobile and tablets and will only feature TV content, although playback of that content (using the digital storage locker) will potentially be possible through any platform capable of providing access via the Cloud. In future, however, the BBC Executive aims to make the service, and the linkages and purchase from iPlayer, accessible on multiple devices and platforms to ensure as wide an audience reach as possible and its aspiration is to extend the service to a select range of radio content.

⁵ Specifically, the Mediatique report *Implications of a change in the BBC's TV on-demand permissions*, 14 October 2013, the Decipher Mediabug Q3 2013 survey and the Ofcom Communications Market report 2013.

⁶ Specifically, information relating to the scope of the Proposals, the counterfactual, BBCW's DVD retail and distribution business, current use of external links from BBC Online, as well as iPlayer viewing figures and usage.

⁷ In particular the use of the iPlayer technology and the value of the BBC brand.

Given that the information we were provided by the BBC Executive related primarily to the impact of the service at launch,⁸ and given the limited time available, we have not been able to fully consider the potential impact on others of these elements. We consider:

- it is plausible that there may be a wider range of considerations when assessing the impact of the Proposals on TV screen formats (such as smart TVs). For example, the scale of the difference between the user experience of a fully-linked BBC Store from iPlayer (in particular the potential for a more seamless user experience when purchasing content BBC Store compared to other commercial offerings) versus the alternatives may differ depending on the platform used. The range of commercial alternatives available to consumers may also differ by platform, which in turn could result in different degrees of impact. In particular, on a closed TV platform there may be fewer commercial alternatives for consumers to purchase the same BBC content, and therefore the Proposals may have a demonstrably greater impact on consumer behaviour in this case than they might on the open, online equivalent via PC or laptop. In turn this could lead to a different impact on platform operators and other content providers; and
- in our previous input to the radio DRM download significance test, we highlighted that there could be potential impacts resulting from extending the range of content available from iPlayer to include radio or audio – similar considerations would apply to the linkages from iPlayer to BBC Store radio content.⁹

The BBC should therefore consider the impact of these elements before they are approved or launched.

Finally, the BBC is considering wider strategic changes to BBC Online and iPlayer, including an extension of the catch-up window and improved customisation through 'My BBC'. Whilst these potential changes are not within scope of this assessment (and may be considered within separate assessments) the Trust may wish to consider whether there will be a cumulative impact on other operators resulting from the changes, when taken as a whole, which may not be captured when each change is considered on a stand-alone basis.

The Counterfactual

We have considered the proposed changes against the counterfactual of the Proposal as described by the BBC Executive a stand-alone BBC Store commercial service without any links from iPlayer or associated storage, purchase or playback functionality.¹⁰

The commercial case for the BBC Store, however, includes an assumption that over two thirds of its visitors and transactions will be click-throughs from iPlayer. We understand the BBC has not made an assessment of the counterfactual scenario in terms of the scale and

⁸ [3<]

⁹ See Ofcom's letter of 19 April 2013 on the BBC's radio DRM download proposal, available at: <http://stakeholders.ofcom.org.uk/binaries/research/tv-research/bbc-tests/radiodrm.pdf>

¹⁰ Although we note that the BBC will continue to provide links to third party retailers of BBC content (including the BBC Store) from the programme pages on BBC Online in line with its current approach.

impact of a stand-alone BBC Store service. Absent the Proposals, questions could be raised about the viability of a standalone BBC Store service and therefore about the modelling of such a counterfactual.¹¹ Alternatively, should a commercial proposition remain viable but substantially smaller, then the clause 25 assessment would need to assess the additional impact of BBC Store itself which would not have occurred absent the Proposals.

Impacts on others

The BBC's stated ambition for the BBC Store proposition – to more than capture the value from BBCW's current DVD sales (which currently delivers 30% of BBCW's returns to the BBC) – indicates that the impact may be sizable (albeit not necessarily negative). The BBC Executive identified that the Proposals could have an impact on:

- other public service broadcasters' ('PSB') catch-up services;
- retail supply of transactional video on demand ('tVOD') services including DTO and download to rent ('DTR'); and
- retail supply of DVDs and programme merchandise.

We consider there could also be wider impacts which were not included within the BBC Executive's assessment, including on:

- other VOD models (in particular subscription services – 'sVOD'); and
- linear TV channels (in particular those with a large proportion of BBC Archive content).

Our assessment assumes that there is unlikely to be additional growth in the time consumers spend watching long-form AV content (whether linear TV or VOD). It also assumes that the level of traditional TV viewing is likely to remain steady; the hours of TV watched per day has remained relatively stable over the last few years despite the growth in alternative viewing formats.¹² Therefore we consider it is likely that any growth in the time spent watching BBC content purchased on a DTO basis could be substitutional for other AV viewing. A proportion of this substitution is likely to be one type of BBC content for another (e.g. a consumer deciding to download to own a BBC series rather than buying the DVD of the same programme), so resulting in a lower net impact on others than the overall level of substitution might suggest.

We consider the most notable impacts are likely to arise from increases in iPlayer usage. Our assessment below therefore focuses first on how that could affect different types of viewing of AV content, including PSB VOD services, tVOD content, sVOD and linear TV. We then separately comment on other areas of potential impact, including the DVD market, digital

¹¹ [x]

¹² Ofcom's 2013 Communications Market Report ('CMR') indicates that TV viewing has been broadly stable over the last three years, with consumers viewing an average of four hours per day (Figure 2.56). We note this is consistent with the approach adopted in the Mediatique report prepared for the BBC on the extension of the on-demand window. Mediatique noted that total TV consumption is de facto subject to ultimate time constraints and the proportion of time that TV households can allocate to leisure (p.20).

content storage and revenues for the independent production sector.

Increase in iPlayer usage

The BBC Executive estimates that the Proposals are unlikely to drive much additional traffic to iPlayer.¹³ This assessment is partly based on evidence indicating that consumer usage of existing commercial links on the BBC Online programme pages is low¹⁴, and an assumption that the impact of the Proposals might be expected to be similarly modest given their evolutionary nature. In our view this assessment is likely to have underestimated the potential growth in usage of iPlayer as a result of the Proposals for a number of reasons.

Seamless user journey

The likelihood that users will choose to purchase content from the BBC Store rather than commercial competitors is in our view enhanced by the proposed seamless user journey from iPlayer to BBC Store. Consumers may end up remaining within the BBC environment given the low-friction purchasing experience – a single BBC ID, pop-up payment window, single storage locker and iPlayer playback – rather than looking elsewhere for content.¹⁵

We agree with the BBC Executive that the impact of this increased usage could be primarily limited to BBC content.¹⁶ However, we also consider that this impact could spread to other types of content if consumers spend more time in the BBC ecosystem and less time browsing content on other services. Given iPlayer's position in the market currently, and its forecast growth, we consider there is the potential for this impact to be substantial.¹⁷ It is inherently difficult, however, to accurately predict the extent to which the Proposals will lead to a change in user behaviour compared to the status quo.¹⁸ Therefore the magnitude of these affects across the different product types is uncertain. There is also a large range in the scale of the players in the VOD market and the implications of the Proposals are likely to be greater for the smaller players.

Improved content discovery portal

Evidence from the BBC suggests consumers are increasingly using iPlayer as a content discovery portal rather than somewhere only to catch up on a specific programme.¹⁹ The Proposals will deliver a much larger catalogue of content that is discoverable via the

¹³ [3<]

¹⁴ Overall volume of click-throughs on BBC Online programme pages were only an average of 10,000 per month in the first half of 2013 (across TV and radio content).

¹⁵ We note though the Executive's view that consumer stickiness is likely to lead to a large number of people sticking with their current services, such as iTunes.

¹⁶ In particular the links from iPlayer could mean that the impact would be more cannibalistic of BBC content than it would if it was operating on a standalone basis – because absent those links a higher percentage of users are likely to access the Store through general website searches rather than searching specifically for BBC content.

¹⁷ According to comScore MMX data, the unique audience of iPlayer on desktop and laptop computers was 7.6m in April 2013, compared to 2.8m for 4oD. Currently the BBC estimates there are 872m viewed hours on iPlayer, which Mediatique forecast to grow to 3.5bn in 2018.

¹⁸ In this respect we note that there is a risk that existing usage of commercial links on BBC Online is not be a good indication of likely consumer behaviour after the Proposals are implemented.

¹⁹ 40% of users now access iPlayer without a specific programme in mind – an increase from 20% in 2009. In addition, a similar proportion of users confirm that iPlayer has introduced them to programmes that might not otherwise have seen (BBC Survey data.)

iPlayer, making it a more compelling place to discover content. This could in turn increase the number of people using iPlayer as a starting place for discovering content and increase the likelihood that they would find something to watch, whether paid or free, resulting in some growth in usage.

An improved iPlayer product

The BBC's own research evidence indicated that, after being shown the BBC Store proposition, 66% of participants said they were either much more likely or slightly more likely to use the iPlayer.²⁰

The integrated search functionality in particular is likely to have an impact, dramatically reducing the number of 'dead' searches²¹ currently experienced by users. The largest number of complaints received about iPlayer are about programmes which are no longer available due to the 7 day window.²² The linked search functionality will mean that a far greater proportion of these 'dead' or unsatisfactory searches are likely to result in positive results. This will both improve functionality of the iPlayer and so improve the overall user experience. This could in turn potentially lead to greater consumption of content from BBC Store than in the counterfactual.

All of these changes may result in an overall increase in the use of iPlayer and a corresponding reduction in time spent viewing TV or AV content (whether paid or free) elsewhere.²³ Services which could potentially be impacted include:

Other PSB VOD services:

An increase in usage of the iPlayer as a consequence of the Proposals could be to the detriment of other PSB VOD services if consumers substitute their use of these services with the iPlayer and/or BBC Store. Survey evidence indicates that browsing through VOD menus is the most common way for consumers to find VOD content (both paid and free),²⁴ which as set out above indicates that a wider range of content being made accessible through iPlayer could lead to more content discovery taking place there, at the expense of other VOD services.

tVOD services:

²⁰ Optimisa Research, Project Barcelona, August 2012 – QG3. In total, 33% said it would make no difference to their usage of iPlayer, 42% said it would make them slightly more likely to use the iPlayer and 24% said it would make them much more likely to use the iPlayer. We note, nevertheless, that this type of stated preference could potentially lead to some optimism bias.

²¹ i.e. searches that return a 'no programmes found' result.

²² Material provided by the BBC Executive said that around 30% of all searches on iPlayer currently are for BBC programmes that are not available on the service and return no results at all. The Executive also noted that there may be a far higher number of searches that do not register as 'dead' as they do return a result but not the one desired by the user.

²³ In terms of the substitutability of free and paid content, we note the Competition Commission previously took the view that these services competed with one another within a market for all-TV, which includes VOD. (Competition Commission, Acquisition by BSkyB Group plc of 17.9% of the share in ITV plc (2007)).

²⁴ Decipher Media Bug, Q3 2013 found that 61% of online VOD users found free content through browsing the website and 36% found paid content in the same way. However, 40% of paid VOD users also said they did not know where to find paid for content. The Media Bug survey is conducted online amongst a panel of respondents. As such, the survey data may slightly over-represent consumers who are more proficient with communications technology

As noted by the BBC Executive, the tVOD market is relatively nascent, with a variety of delivery mechanisms and business models being tested.²⁵ As a consequence, it is difficult to be certain on how the Proposals will impact these services. There could be both positive and negative impacts:

- the emergence of a BBC Store, and the potential advantage that the Store will have over competitors as a result of the Proposals (in particular the seamless user journey from iPlayer which will not be present for other competitors, despite links to their content) could mean that new emerging players, particularly those of a smaller scale, find it difficult to match the user experience offered by the BBC; but
- this is a growth market²⁶ and the Proposals may encourage competition, expanding the consumption of archive TV viewing and purchasing of digital TV content (whether on a DTO basis or DTR). The inclusion of links to other commercial retailers of VOD content in iPlayer could also facilitate this growth, as well as the wider availability of digitised BBC Archive content.²⁷

Either of these scenarios are plausible although the scale of the impact is not clear in either case.

Subscription VOD:

The BBC Executive did not include sVOD services within its assessment because it considers the degree of substitution for these services is limited.²⁸ We recognise that they may involve different business models and different purchasing decisions by consumers. However, we disagree with exclusion of these services from those that could potentially be impacted. Our comments above about the finite amount of TV viewing time available mean that some consumers could move away from their sVOD services, even if only for a matter of months, if they spend more time using iPlayer. In addition, given the prominence of TV 'box-set' series being promoted on sVOD services, the argument that there are limited overlapping content types appears questionable.

Linear TV:

There is likely to be a significant overlap between the content available through BBC Store and that used on linear TV channels such as Dave (and other UKTV channels). However, live television remains the main way of watching programmes and is forecast to remain so

²⁵ Current estimates of the size of this market vary significantly, Futuresource estimate it was £25m in 2012, whereas Screen Digest estimate it at £91m in the same year.

²⁶ Digital video sales increased by 20% from 2011-2012 according to the Electronic Retailers Association 2013 Yearbook. In addition reported consumer usage increased from 19% in 2012 to 32% in 2013 (Decipher Mediabug Q3 2013 survey).

²⁷ In this respect we understand the BBC Executive has developed a set of 'Commercial Linking principles' and that the Fair Trading guidelines will mean that BBC Store links will have equal prominence with other supplier links. We note that BBC is still refining how this will be applied in practice.

²⁸ This was on the basis that the Mediatique report excluded these substitution effects in considering the impact of an extension of the iPlayer catch-up window. Mediatique noted that subscription VOD services provide access to a range of movies, US series and independent content and that the Competition Commission had previously concluded that there was unlikely to be a material overlap between BBC catch-up content and the majority of content retailed by subscription VOD services.

for the foreseeable future.²⁹ Only 10% of all TV viewing is time-shifted, despite the growth in on-demand viewing and the iPlayer still only accounts for 2% of all TV viewing.³⁰ The continuing popularity of linear TV demonstrates viewer's preference for watching TV as it is broadcast. Therefore we consider DTO BBC Archive content is likely to be a limited substitute and is unlikely to have a material impact on linear TV channels.

Other potential impacts

Hastening decline of the DVD market for TV content

It is widely recognised that this market is in decline.³¹ However, it remains sizeable³² and new business models are being developed such as combined physical/digital products.³³ It is therefore important not to underestimate any impact – in particular there is plausibly potential for the Proposals to accelerate the decline in DVD sales by changing consumer consumption patterns and choosing DTO content rather than purchasing DVDs.

This would mean the scale of the impact could extend beyond BBC specific content.³⁴ In particular this could have a binary effect on the availability of DVDs more generally – for example prompting a retailer to pull out of this market.³⁵ Nevertheless, we note there may not be complete substitution between digital and physical content, as some consumers may prefer physical copies for gifts, or have concerns about digital storage (see below).

Storage lockers

There is evidence of concern amongst consumers about the security and storage of digital content.³⁶ Some consumers may wish to have a single digital locker for all their digital content. There are currently different standards in the market for such lockers.³⁷ The adoption by the BBC of one particular storage locker standard for all their digital content could have an impact on players in this area (both in how they develop those standards and in the commercial success of those offerings). Any potential impact is mitigated to some extent, however, by the BBC's confirmation that iPlayer technology will be available to other market players as noted above.

Increasing revenues for the independent production sector

²⁹ Ofcom, 2013 CMR, p.144. Figure 2.20. Enders Analysis forecast that in 2020, live TV viewing will still make up 80% of all TV viewing (*The rise of connected TV*, January 2013).

³⁰ Ofcom, 2013 CMR, pp.137 & 152, Figure 2.21. Based on BBC data.

³¹ [§<]

³² DVD/Bluray sales were worth £1543m in 2012 (Electronic Retailers Association 2013 yearbook) and Futuresource estimate the market will still be worth £900m in 2015.

³³ For example Ultraviolet (through Flixster.com) provides consumers with the option to download a digital copy of a DVD they have purchased using a code provided with the physical copy: <http://www.uvvu.com/>

³⁴ Mediaticque estimate that the BBC has 8.5% of the TV DVD market

³⁵ An example of this is that Sainsbury's have recently announced they will stop selling DVDs online:

<http://www.nme.com/news/various-artists/74019>

³⁶ Decipher Media Bug, Q3 2013 survey found that of users who had heard of EST (electronic sell through – same as DTO) but not used it, 21% said it was because a physical DVD was more secure, 10% said they were worried about losing the file and 15% said it took up too much space on their hard drive.

³⁷ Including the UltraViolet system which is being deployed by a consortium of movie studios and the system from Apple based on iTunes / iCloud. [§<].

We agree that the non-exclusive licensing of DTO rights is likely to encourage competition in the sale of this content and should deliver additional revenue streams to independent producers. The Proposals may increase these potential revenue streams further.

Conclusion

Overall we consider that the potential impacts on others extend beyond those identified by the Executive in its assessment, including sVOD and linear TV providers.

The impact of extending the linking and purchase elements of the Proposals to other platforms, notably smart TV services and closed TV platforms, may result in different competitive impacts which have not been assessed. Similarly, offering radio or audio products may also result in different impacts, which again have not been assessed.

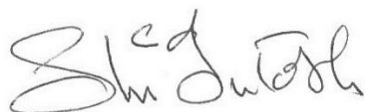
It is not clear that the appropriate counterfactual has been used, although this does not necessarily result in a far greater impact than the Executive's initial assessment.

The Proposals may result in positive impacts (for example, growing the DTO market and increasing revenues to the independent sector). However, the use of iPlayer is also likely to increase, due to the seamless user experience and increase in the potential to access a greater amount of content, at the expense of alternative products (including the BBC's own).

It has not been possible in the time available to reach a firm view on the precise scale of the impacts on others. Whilst there is the potential for the impact to be substantial, it is unclear to what extent the Proposals will lead to changes in user behaviour towards the iPlayer compared to the counterfactual. Some of the product substitutions will also be between BBC products rather than between third party offers and BBC content, so reducing the net impact on others. Any impact is likely to be spread across a range of markets and players.

The Trust may wish to consider these potential impacts, as well as our comments above relating to the counterfactual scenario, when making its overall decision on whether the Proposals are significant.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Stuart McIntosh', written in a cursive style.

Stuart McIntosh