



Review of the television production sector

Statement

Statement

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Section 1

Executive summary

Introduction

- 1.1 On 10 January 2006, Ofcom published a consultation document on its review of the television production sector¹ (“the TPSR Consultation”). The consultation period closed on 21 March 2006. Ofcom has now received and reviewed all responses to the consultation. This policy statement concludes the review, although further work will follow on the Codes of Practice governing the relationships between public service broadcasters and independent producers. Ofcom anticipates issuing a consultation document on changes to its guidance on the Codes of Practice before the end of the year.
- 1.2 Ofcom’s analysis has been informed by a substantial programme of evidence-gathering, quantitative analysis, discussions with stakeholders, and review of the formal responses received to the consultation. The data and analysis to support the review’s proposals and conclusions were set out in full in the TPSR Consultation, and are not reproduced in this statement – rather, this document reports the key issues raised in the consultation responses, alongside Ofcom’s final conclusions. This statement should therefore be read in conjunction with the TPSR Consultation.

Background to the review

- 1.3 The TPSR Consultation followed on from Ofcom’s review of public service television broadcasting (“the PSB Review”) carried out in 2004/5². The current review covers key aspects of the television production sector, which is considered to include programme-making activity both within the main broadcasters (in-house production) and externally through the use of qualifying and non-qualifying independent producers³. Ofcom’s focus has been on the key production quotas, the operation of the commissioning system between producers and broadcasters, and the Codes of Practice.
- 1.4 The last major review of the sector, the Programme Supply Review⁴, was conducted by the Independent Television Commission (“ITC”) in 2002. As well as reviewing existing quotas for independent production and production outside London, the ITC’s review recommended that Codes of Practice should be put in place between independent producers and the main terrestrial channels (BBC, ITV, Channel 4, Five, S4C). Each of those channels is a licensed public service channel for the purposes of the Communications Act 2003 (“the Act”) which came into force following the Programme Supply Review. Section 285 of the Act provides that the regulatory regime for such channels must include provisions requiring licensed public service channels to comply with Codes of Practices in their dealings with independent

¹ Ofcom, *Review of the television production sector: A consultation*. Published 10 January 2006.

² Ofcom, *Review of public service television broadcasting, Phase 3: Competition for Quality*. Published 8 February 2005.

³ In this document, Ofcom employs the terms “external producer” and “external production” to refer to all production that is not in-house – and so the terms refer to both qualifying independent producers, and other external producers. Ofcom also employs the terms “independent producer” and “independent production” where reference is made solely to qualifying independent producers.

⁴ Independent Television Commission, *Programme Supply Review*. Published November 2002.

producers. Codes of Practice have since been implemented by the broadcasters based on guidance issued by Ofcom in 2003⁵.

- 1.5 The timing of the current review has been driven in part by a need to conduct an initial assessment of the operation of the Codes of Practice. However, Ofcom has also used this opportunity to carry out a more comprehensive review of the operation of the production sector and regulatory intervention more generally.
- 1.6 To this end, the TPSR Consultation set out Ofcom's analysis and proposals in the following principal areas:
- **Objectives of television production.** Ofcom's overall regulatory objective is to secure the interests of viewers as both citizens and consumers. As such, Ofcom wishes to ensure that viewers receive the types of television content that meet their underlying interests, and Ofcom also believes that intervention should only take place if it is intended to secure benefits for viewers
 - **The rationale for intervention in TV production.** Three particular features of the TV production sector – namely the negotiating strength of the main terrestrial broadcasters, vertical integration between broadcasting and production, and geographic concentration of production – may prevent viewers' interests from being fully met. The existence of these factors has therefore driven the need for intervention in the sector
 - **Key developments in the sector.** The market for UK originated content has been growing, and stood at £2.6bn in 2004. Demand from outside the main terrestrial channels has been growing – particularly from commercial digital channels. However, the main terrestrial broadcasters remain the principal buyers of originated programming and are also the main customers of the external production sector. Geographically, production remains concentrated in London. On the basis of this analysis, Ofcom concluded that there is limited scope for the withdrawal of intervention in the near term. Negotiating strength, vertical integration and geographic concentration are likely to remain significant issues for the near future
 - **Independent production.** Ofcom's view is that the independent production quota remains an important source of certainty for the sector and therefore no change to the quota was proposed in the TPSR Consultation. Ofcom also welcomed the principle of the BBC's proposed Window of Creative Competition (WOCC), but suggested that more needs to be done in order to ensure meritocracy and proper monitoring of the operation of the WOCC
 - **Out of London production.** Without intervention, Ofcom does not consider that production outside London is likely to be self-sustaining in the longer term. Intervention will therefore continue to be needed to deliver the diversity benefits associated with out of London production. Ofcom recognises that an input-based quota for production outside London is a blunt instrument but appears to be a necessary intervention at the present time. The TPSR Consultation also proposed that the BBC should play a more significant role in ensuring a diversity of production outside London
 - **The key definitions.** In the TPSR Consultation, Ofcom proposed no change to the definitions of qualifying programmes and out of London productions, both of which were seen as working well. As regards the definition of a qualifying independent producer, Ofcom indicated in the TPSR Consultation that it was minded to

⁵ Ofcom, *Guidelines for broadcasters in drafting codes of practice for commissioning programmes from independent suppliers*. Published December 2003.

recommend no change to the definition. However, Ofcom stated that it would consider the issue further in the light of the consultation responses received

- **The Codes of Practice.** Ofcom's initial assessment suggested that the Codes of Practice are broadly working well. However, both producers and broadcasters had indicated that they felt there was a lack of clarity regarding the rights for exploitation of TV programmes on alternative distribution platforms ("new media rights"). In the TPSR Consultation, Ofcom suggested a possible alternative time-based (rather than platform-based) approach to rights exploitation. Ofcom also stated a clear preference that these issues should be resolved through commercial negotiation by industry parties. However, in the event that commercial agreement proved impossible, Ofcom indicated that it would have little choice but to intervene.

Key conclusions

- 1.7 This statement sets out Ofcom's final conclusions on the above issues. The TPSR Consultation proposed that there appeared to be no requirement for a major revision of regulatory intervention in the television production sector, although options for change were proposed in a small number of areas. These conclusions were reached on the basis of Ofcom's detailed analysis, which was reported in full in the TPSR Consultation with a view to developing the evidence base and informing debates in the industry.
- 1.8 Overall, therefore, the TPSR Consultation recommended that the status quo of regulatory intervention should largely remain intact. This position was broadly supported by responses to the consultation. Whilst many respondents raised issues with the detail of Ofcom's proposals, very few argued for a significant departure from Ofcom's position. Where such arguments were made, Ofcom has considered the responses and assessed any evidence provided. However, Ofcom considers that the arguments and evidence presented are not sufficiently convincing to warrant a significant change in Ofcom's position set out in the TPSR Consultation. This statement therefore broadly confirms the position stated by Ofcom in the TPSR Consultation. Where Ofcom has not followed arguments made by respondents to the TPSR Consultation, it has sought to clarify the reasons for its decision in this statement.

Objectives of television production

- 1.9 All respondents shared Ofcom's view that the focus in the television production sector should be on furthering the interests of viewers as consumers and UK citizens. However, opinion amongst respondents differed as to the appropriate understanding of the terms "citizen" and "consumer".
- 1.10 Ofcom recognises that there may be a variety of interpretations of consumer and citizen interests and agrees that seeking to apply a uniform definition of viewers' interests risks creating unnecessary complexity. Ofcom has therefore sought to define an overarching objective to secure viewers' interests. Ofcom confirms its view set out in the TPSR Consultation that the main objective of the television production sector is to further the interests of viewers as both citizens and consumers. Decisions reached on the policy issues considered in this statement have been developed in the light of this overarching objective.

- 1.11 Similarly, a variety of interpretations of the term “diversity” were put forward, although there was general agreement on the role of diversity as an important factor when considering viewer interests. There was also general agreement amongst respondents that viewers’ interests are furthered by diversity in its various forms, and that a mixed ecology of production is needed in order to deliver on diversity objectives. Ofcom will therefore continue to adopt this approach in relation to the production sector.

Rationale for intervention

- 1.12 The majority of respondents were in broad agreement with Ofcom’s overall analysis of the reasons why intervention has been warranted in the past – namely that negotiating strength, vertical integration, and geographic concentration are important factors that could run contrary to viewer interests.
- 1.13 However, opinion amongst respondents varied as to the extent to which the historical reasons for intervention remain valid today and in the future. For instance, there was general agreement that intervention remains necessary in order to support production outside London. In contrast, some argued that broadcasters’ negotiating strength has been diminishing and will continue to do so in future. Ofcom accepts that the broadcasters’ negotiating strength is likely to diminish over time and such a reduction may create the scope for the removal of regulation in this area. However, the main terrestrial broadcasters remain the principal buyers of originated content, and are likely to remain so in the medium term.
- 1.14 In addition, some suggested that the in-house bias associated with vertical integration is becoming of lesser importance since it would be self-defeating for a broadcaster to deny itself the best possible content. However, the majority of respondents argued that vertical integration remains a significant concern and expressed the view that intervention in this area will continue to be needed.
- 1.15 Overall, therefore, Ofcom recognises the arguments for change but remains of the view that intervention remains appropriate to protect the interests of viewers as consumers and citizens and that the prospects for a withdrawal of regulatory intervention are limited in the near to medium term.

Key developments in the sector

- 1.16 The TPSR Consultation set out a detailed analysis of the current position of the television production sector, drawing on data collected from both producers and broadcasters. There was a broad consensus amongst consultation respondents that Ofcom’s representation of the current position of the television production sector accorded with the respondents’ own experience and understanding of the sector.
- 1.17 However, a minority of respondents expressed disagreement with some points of detail in Ofcom’s analysis⁶. In particular, concerns were raised that the survey produced by Ofcom was inaccurate in some places. Ofcom recognises the potential limitations of the survey in that producers were not obliged to respond to the survey, and hence the analysis was necessarily based on a partial sample. The results may therefore have been unrepresentative of the market as a whole in some instances – a point which was acknowledged in the TPSR Consultation. Nonetheless, Ofcom remains confident that its analysis painted a broadly accurate picture and the consultation responses received tend to support this position.

⁶ This analysis was set out in Section 4 of the TPSR Consultation.

- 1.18 The TPSR Consultation also set out Ofcom's analysis of possible future developments in the sector. In this area, responses expressed a variety of views regarding the likely pace and scale of future change in the sector although there was general agreement that growth in the sector will continue. It is not possible to reach firm conclusions on how the sector will develop going forward. However, Ofcom will continue to monitor developments in the market.

Independent production

- 1.19 There was consensus amongst respondents that the independent production quota should remain in place. Ofcom therefore confirms its proposal that the independent production quota should be held constant at current levels.
- 1.20 The majority of respondents agreed that the BBC's proposed WOCC will provide new opportunities for the external production sector through increased access to the BBC's commissioning base. Ofcom is not required to reach a decision on the WOCC, since this is matter for Government in the context of BBC Charter Review. Ofcom notes that the recent Charter Review White Paper confirmed Government's support for the WOCC and Ofcom welcomes the approach taken by Government on this issue.

Out of London production

- 1.21 There was broad agreement around Ofcom's analysis that, whilst the out of London quota is a blunt instrument, it remains a necessary intervention. Many respondents also agreed that further steps may be needed to secure out of London production for the future.
- 1.22 In particular, producers and production-related bodies based in the Nations and Regions generally argued that further intervention is needed to ensure the development of a sustainable and geographically diverse out of London production sector either in the form of higher out of London or Nation-specific quotas.
- 1.23 Amongst those respondents that expressed a view on the subject, there was support for the idea of moving a major channel out of London – those who responded to this question tended to argue that such a move would deliver benefits in terms of diversity of production, and would be practical to implement. There was, however, some concern amongst respondents in the Nations and some of the smaller English Regions that a channel move would deliver a geographic dispersal of production only to the area into which the channel were to move, and not across the UK as a whole. As such, there was a strong view that moving a channel would not in itself benefit other production centres greatly.
- 1.24 In the light of the analysis in the TPSR Consultation, and following a review of the consultation responses on this subject, Ofcom's conclusions are as follows:
- Intervention will continue to be needed to deliver the diversity benefits associated with out of London production, and further steps may be needed to secure production outside London in the future
 - An input-based quota for production outside London is a blunt instrument but is a necessary intervention, a view supported by responses to the consultation. Ofcom therefore proposes no immediate changes to out of London production quotas

- Ofcom recognises the arguments made by the BBC that its out of London strategy will enhance the BBC's role outside London. The BBC therefore argues that an increased quota is not appropriate. However, it seems likely that, if the BBC's out of London strategy is effective, the BBC's production outside London will increase over time. As such, Ofcom will continue a dialogue with the BBC and the BBC Trust on this subject to assess whether an increase in the out of London production quota would be appropriate to ensure diversity for the benefit of consumers and citizens
- As regards other measures proposed by respondents, Ofcom does not support the idea of introducing additional layers of production quotas – whether for the Nations, or for out of London production in particular genres – since these have the danger of creating additional bureaucracy and, particularly if divided too narrowly between areas, could mitigate against commissioning the best ideas. Moreover, Ofcom considers that such sub-quotas could be inimical to the development of a critical mass of production in the Nations and Regions of the United Kingdom
- Ofcom notes the comments of respondents regarding the move of a channel or of significant commissioning power outside London. Ofcom would not propose that the Government pursues such an option at this time, whether in relation to the BBC or any other broadcaster. Such a proposal would amount to a very significant intervention, but – as noted by some consultation responses – may not have significant benefits in terms of the dispersal of production around the United Kingdom, and it could simply create another centre in which television production was concentrated. Nonetheless, the consultation responses on this subject suggest that there are those in favour of such a move and Ofcom will consider the issue further as the market develops.

The definitions of qualifying programmes and out of London productions

- 1.25 There was broad agreement with the proposal in the TPSR Consultation for no change to the definition of qualifying programmes⁷. Ofcom therefore confirms that it will not be pursuing a change to this definition.
- 1.26 There was also general consensus amongst respondents that the definition of out of London productions⁸ was working well, although some respondents suggested that diversity is best achieved by producers based in the Nations and Regions rather than London-based producers making programmes outside London. These respondents therefore suggested that Ofcom should measure different categories of out of London production, for example by drawing a distinction between out of London production by London-based companies, and out of London production by producers with a substantial production base outside London.
- 1.27 Ofcom's overall view is that the definition of out of London production is working well, and therefore confirms its proposal set out in the TPSR Consultation for no change to the definition. Moreover, given the overall support for the current definition, and the fact that the current definition has only been in place since 2004, Ofcom does not consider it appropriate to measure different categories of out of London production. Ofcom is concerned that such measurement risks discouraging a wider pool of producers to make programmes outside the M25, as it could be seen to suggest that out of London production by London-based producers is less valuable than out of London production by producers based in the Nations and Regions. If so, then such

⁷ "Qualifying programmes" refers to those programming hours that can be used to count towards production quotas.

⁸ The definition of out of London productions refers to the hours that count towards quotas for production outside the M25.

criteria could be counter-productive as they may weaken, rather than strengthen, the critical mass of production outside London. Moreover, if the definition were revised to take account of such criteria, it may make it more difficult for the non vertically-integrated broadcasters to meet their out of London production quotas, due to the lack of critical mass of production in some areas of the UK.

The definition of an independent producer

1.28 The current definition of a qualifying independent producer⁹ excludes those production businesses that share significant common ownership (a 25% shareholding) with broadcasters. In response to the consultation, a number of parties made proposals for change to this definition. No option was suggested that would remove the restriction on common ownership between a UK broadcaster and qualifying independent producer entirely. Instead, all of the options were for a supplement to the current limitation on common ownership that, if the supplementary condition were met, would allow a producer with common ownership above the limit of 25% of shareholding to qualify as an independent producer when producing for another broadcaster. Four broad options were proposed:

- **Option 1: Introducing a test of economic independence** from the parent (or co-owned) broadcaster – so that a co-owned producer could qualify as an independent if only a small proportion of its revenue is sourced from the linked broadcaster. It was proposed in some consultation responses that the test of independence would be via a “double-lock” under which the proportion represented by the producer’s commissions from the broadcaster and the producer’s share of the broadcaster’s total commissions did not exceed a defined threshold. The threshold was suggested to be either 10% or 0% of commissions
- **Option 2: Changing the restriction on ownership** – so that a co-owned producer could qualify as an independent when supplying programming to any broadcaster other than the one with which ownership is shared. Some respondents proposed that the restriction on ownership could be changed so that it does not apply to either the production arms of the non-ITV plc owned Channel 3 licensees or, in a further proposal, to any vertically integrated producer when supplying programmes to any broadcaster other than the parent
- **Option 3: Revising the definitions of relevant broadcasters** – such that the ownership restriction only applies to, for example, English language or designated public service broadcasters (PSBs). One respondent proposed to exclude non-PSB broadcasters from the ownership restrictions, allowing production companies with common ownership with non-PSB broadcasters to qualify as independent
- **Option 4: Introducing a size dimension to the qualifying definition** – so that a producer with significant common ownership with a broadcaster could still meet the qualifying definition, provided that the broadcaster or production business concerned falls below a pre-defined size threshold. One respondent proposed that the size dimension would be based on an individual or group of commonly owned channels having less than a defined share of audience in all UK households. The share of audience was suggested to be less than 0.75% for a single channel, or less than 2% for a group of commonly owned channels.

1.29 Ofcom has assessed whether any of these options meet the following objectives (which were set out in the TPSR Consultation) better than the current definition:

⁹ A qualifying independent producer is one whose programming counts towards fulfilment of the independent production quota.

- Ensuring a diversity of production
 - Mitigating against the potential problems associated with vertical integration
 - Being consistent and readily applicable across the industry
 - Being practical to implement now and in the future.
- 1.30 Of the proposals made, Ofcom considers that Options 2, 3 and 4 do not meet the objectives for – and are therefore inferior to – the current definition:
- Option 2 – changing the restriction on ownership – could impair the diversity of production and incentivise vertical integration as it would allow large integrated producers to account for a high share of both in-house and external commissions
 - Option 3 – restricting the applicable broadcasters to the PSBs – may also incentivise vertical integration, and could create perverse incentives for some of the main terrestrial broadcasters to move away from PSB status
 - Option 4 – introducing a size dimension – could also promote vertical integration, and is likely to prove difficult to implement.
- 1.31 As such, Ofcom rejects Options 2, 3 and 4.
- 1.32 In contrast, Ofcom believes that Option 1 – the double-lock proposal – has more merit. It is the only option that may mitigate against vertical integration by creating incentives for a commonly owned broadcaster and producer to commission below a certain threshold of output from each other, which ensures that a diversity of programme supply is maintained. Once established, the thresholds would then be consistent and applicable to all producers who wanted to achieve qualifying status.
- 1.33 However, on the balance of the current evidence, Ofcom is concerned that the double-lock proposal may not increase the diversity of programme supply. In the longer term, the proposal would enable some integrated producers, who would be able to draw on considerable resources and industry expertise, to enter the market and compete for independent commissions from rival broadcasters. However, it would also have the immediate effect of ‘qualifying’ any ongoing commissions from integrated producers for other broadcasters, possibly at the expense of commissions to existing independent producers under the quota. Additionally, the current definition creates access for the diverse output of the large number of small independent companies in place of the output of larger vertically-integrated producers.
- 1.34 Ofcom has analysed the evidence relating to the potential impact of implementing Option 1. This analysis leads Ofcom to conclude that implementing the double-lock may allow a small number of integrated producers to qualify to compete for independent commissions. Its main merit is that it may also in time facilitate greater investment in the UK production sector. However, it is not yet clear how significant these benefits will be, and the time horizon in which they will be delivered. Moreover, there is significant risk that these potential benefits would be at the expense of an adverse impact on the diversity of production overall, particularly in commissions by ITV1 to smaller independent producers.
- 1.35 There is therefore a lack of clear evidence – and indeed a lack of consensus within the industry – that the benefits of the double-lock proposal would outweigh the costs. Ofcom is therefore not yet persuaded that a change to the definition would prove

superior to the current definition. As a result – while Ofcom recognises the merits of the case for change that has been made – it does not recommend a change to the definition to Government at this time.

- 1.36 However, Ofcom considers that the situation should be kept under review. This is for two principal reasons:
- Structural changes in the industry may well lead to more interest in shared ownership and operation of production and distribution of programmes across a number of platforms. If the current definition frustrates such investment, then further clearer evidence of the need for change may well be forthcoming
 - As the market for programme commissions evolves, both the independent production quota and definition may well be of diminishing significance. This was suggested by a number of consultation responses, which highlighted the BBC's WOCC, the growth in programme commissions outside of the PSBs and the increasing fragmentation of and competition for audiences as key drivers of change. These are likely to mitigate the negotiating strength of particular broadcasters, and increase the strength and stature of independent producers with valuable programming. Under this scenario, the importance and effectiveness of intervention in creating diversity of suppliers will be reduced. A further review of intervention in this area may therefore be appropriate.
- 1.37 As such, Ofcom believes that stronger arguments may arise in favour of a change to the definition in the future, if clearer evidence of the benefits of change (or of the disbenefits of the current definition) emerges. Ofcom therefore proposes that this issue is considered again during the next PSB Review, or earlier if clearer evidence emerges.

The Codes of Practice and new media rights

- 1.38 The consultation questions on the Codes of Practice drew responses from a wide range of respondents including: representatives of independent producers; individual producers; the PSBs; other commercial broadcasters; mobile operators; and new media service providers. The range of respondents indicates the importance of these issues to the industry as a whole.
- 1.39 In relation to the operation of the Codes of Practice, which set out the principles that PSBs apply in commissioning from independent producers, there was broad agreement from a number of respondents that the framework put in place by the Codes of Practice was working well. For instance, responses generally agreed that the Codes had brought significant change and opportunity to the external production sector and were helping to underpin growth in the sector. It was felt that the Codes had had the effect of stimulating investment in original production and encouraging competition and growth. Comments also suggested that the Codes had been key in terms of creating an environment that: encouraged risk-taking; attracted and retained the best talent; and had been important in relation to UK companies' ability to compete globally.
- 1.40 A specific concern was expressed by the Satellite and Cable Broadcasters Group (SCBG) on behalf of non-PSB owned commercial broadcasters that the Codes of Practice had failed to stimulate a fair and competitive market for the secondary (non-primary) rights to exploitation of programmes in the UK. It was argued that the launch by PSBs of portfolios of digital channels had had the dual effect of restricting

secondary channels' access to content originally commissioned by the PSBs and had also made PSBs reluctant to allow producers to raise co-production funding from the secondary channels. The SCBG argued that the potential for the secondary market to bring new finance to UK production had not yet been fully realised: they felt that it was simply too early in the new Code of Practice cycle to make such judgements. Ofcom will continue to monitor the situation.

- 1.41 Some concerns were also expressed in relation to the issue of pricing. However, none of the responses on this particular issue have caused Ofcom to change its view as expressed in the TPSR Consultation. Specifically, Ofcom concludes that the position needs to be kept under review as part of the regular monitoring of the operation of the Codes of Practice. However, Ofcom will not take any action at this point in time.
- 1.42 In relation to new media rights, there was broad agreement with the objectives which Ofcom had set down in relation to the development of new media issues. There was also a general acceptance that a move to a “windowing approach” would provide a more suitable framework for dealing with new media rights issues going forward. Against that background, there was also broad agreement that it would be preferable to agree the detail of a new framework through commercial negotiation rather than through Ofcom intervention (although there was some scepticism whether a commercial agreement was in fact possible). A more detailed summary of the consultation responses in this area is set out in Section 4 of this statement.
- 1.43 The consultation set the PSBs and the representatives of independent producers the challenge to reach new agreements covering new media rights through commercial negotiation. In fact, agreement on Heads of Terms was reached between PACT and the BBC, ITV1 and Channel 4 in the early part of the summer; at the time of writing, negotiations between PACT and Five are still ongoing. On that basis, Ofcom does not consider that there is a need for it to intervene to resolve this issue.
- 1.44 In order to accommodate the new Terms of Trade, Ofcom is conscious that there may be a need for some modifications to broadcasters' existing Codes of Practice. Ofcom further recognises that the existing guidance on the Codes of Practice is likely to require amendment. In drawing up new guidance for consultation, Ofcom will take into account the range of issues that have been raised in the course of this consultation process as far as it is able to within the requirements of section 285 of the Act. That consultation is likely to be launched before the end of the year.
- 1.45 Once the guidance has been updated, broadcasters can then make any necessary changes to their Codes to bring them into line with the revised guidance, and submit the Codes to Ofcom for formal approval. As part of Ofcom's approval process, Ofcom would need to take into account not just the requirements under section 285 of the Act but also its wider duties under section 3 of the Act.
- 1.46 Given the agreement on new terms of trade, Ofcom would anticipate that the process of consulting on new guidance and updating Codes of Practice could largely run in parallel so that this process should not cause any unnecessary delay in implementing the new commercial arrangements.

Section 2

Review of policy issues

- 2.1 This section sets out Ofcom's conclusions on a number of key policy issues addressed in the TPSR Consultation – namely the objectives of the TV production sector, the rationale for intervention, key developments in the sector, independent production, out of London production, and the definitions of qualifying programmes and out of London productions. This section does not address the definition of a qualifying independent producer and the Codes of Practice – these issues are each addressed in subsequent sections of this statement.
- 2.2 For each issue covered in this section, Ofcom summarises the position set out in the TPSR Consultation and provide a summary of the consultation responses received before setting out its policy conclusions. Before addressing the key issues, Ofcom notes that the TPSR Consultation indicated that Ofcom did not consider that there was a need for major revisions to existing regulatory intervention in the television production sector but proposed options for change in a small number of areas. This conclusion was reached on the basis of detailed analysis set out in full in the TPSR Consultation with a view to developing the evidence base and informing debates in the industry.
- 2.3 Overall, the TPSR Consultation recommended that the status quo of regulatory intervention should be maintained. This position was broadly supported by responses to the consultation. Whilst many respondents raised issues with the detail of Ofcom's proposals, very few argued for a radical departure from Ofcom's position. Where such arguments were made, due consideration was given to the responses and any evidence provided was closely assessed. However, Ofcom has concluded that the arguments and evidence presented were not sufficiently convincing to warrant a significant change in its position as set out in the TPSR Consultation. This statement therefore broadly confirms the position stated by Ofcom in the TPSR Consultation. Where Ofcom has not followed arguments made by respondents to the TPSR Consultation, it has sought to clarify the reasons for its decision in this statement.

Key principles and objectives of television production

Ofcom's position in the TPSR Consultation

Ofcom's starting point in this review is the interest of viewers. In defining what Ofcom means by viewers, two perspectives are considered:

- Viewers as consumers, who enjoy television as an entertainment medium
- Viewers as UK citizens, who are affected by television at a social level – relating to the viewing habits of all UK citizens, as well as their own.

Ofcom's objective is to ensure that viewers as consumers and UK citizens receive the types of television content that meet their underlying interests. Importantly, Ofcom believes that intervention should only take place if it is intended to secure benefits for viewers.

This approach requires Ofcom to define the types of content expected by viewers:

- Ofcom’s audience research has firmly established that viewers as consumers see entertainment as a key purpose of television
- However, viewers as UK citizens are also aware of the impact of television on society – it is therefore important that this perspective is also considered in this review, and that Ofcom is clear about the link between the production sector and public service broadcasting (PSB)
- A healthy production sector is one that promotes and encourages creativity and innovation – its analysis in this area suggests that there is no one model that delivers creativity and innovation, and that both broadcasters and producers have an important role to play.

Relevant consultation questions

Question 1. Do you share the view that Ofcom’s focus in the TV production sector should be on furthering the interests of viewers as consumers and UK citizens?

- 2.4 All respondents to the TPSR Consultation shared Ofcom’s view that the focus in the production sector should be on furthering the interests of viewers as consumers and UK citizens. However, opinion carried amongst respondents as to the appropriate understanding of the terms “citizen” and “consumer”. A certain number of additional proposals on Ofcom’s approach and priorities were also made by respondents.
- 2.5 It was submitted by one respondent that the interests of the citizen and consumer do not always coincide and that Ofcom should lean towards the citizen rather than the consumer if choices have to be made. In contrast, certain respondents considered that the interests of the consumer and the citizen are often interlinked and in many cases competition in the market for consumers breeds innovation and diversity resulting in public service value to the citizen.
- 2.6 Many respondents made submissions on the link between competition and viewers’ interests, with several respondents arguing that viewers’ interests will only be served through a truly competitive marketplace. For instance, one respondent urged Ofcom to challenge excess market power and anti-competitive behaviour, and to create the conditions for more investment in original content.
- 2.7 Similarly, another respondent agreed that viewers’ interests should be the priority, but that greater emphasis should be placed on the obligation to stimulate competition and plurality. The respondent argued that Ofcom was focusing only on the viability of the terrestrial broadcasters rather than acknowledging the wider impact of the Codes of Practice on the whole industry. If the main terrestrial broadcasters exploit a strong market position, this could be detrimental to consumer choice. Another respondent additionally argued that regulatory intervention to promote public policy objectives must be carefully designed and implemented to minimise the risk of competitive distortion in relevant markets, and that customer demand and satisfaction should be at the heart of the regulatory approach.
- 2.8 In terms of the focus of Ofcom’s approach, some respondents argued that Ofcom was correct to avoid a focus on industrial policy, and that the economic and industrial policy arguments can be separated from a focus on viewers. In addition, another respondent argued that the value of TV production was not felt directly through the viewing of programmes, but indirectly through the economic and infrastructural impact of production activity in a given place.

Conclusions on objectives of television production

- 2.9 Ofcom recognises that a variety of interpretations of consumer and citizen interests exists and agrees that seeking to apply a uniform definition of viewers' interests risks creating unnecessary complexity. Ofcom has therefore sought to define an overarching objective to secure viewers' interests. Ofcom confirms its view set out in the TPSR Consultation that the main objective of the TV production sector is to further the interests of viewers as both citizens and consumers. The policy issues considered in this statement have been developed in the context of this overarching objective.
- 2.10 In relation to the link between competition and viewers' interests, Ofcom notes its principal duty, under section 3 of the Act, to further the interests of consumers in relevant markets for which it has responsibility, where appropriate by promoting competition. Ofcom considers that it has fulfilled this duty in relation to the policy issues addressed in this statement, and will continue to do so going forward.

The role of diversity

Ofcom's position in the TPSR Consultation

A mixed ecology of production is important in delivering diversity in programming – which is important for viewers as consumers and UK citizens. Diversity is important not just in programming output, but also as an input to the production of programmes. As an input, diversity in production has several aspects, whether:

- Diversity of social, cultural and geographic perspectives
- Diversity of corporate scale and structure (in-house or external, large or small)
- Diversity through a plurality of players in the market
- Diversity of channels
- Diversity of commissioning within channels.

It is important to note that Ofcom does not seek diversity, in its variety of forms, for its own sake. Rather, Ofcom is concerned with the contribution of each of the above characteristics to the commissioning and production of a range and variety of programme types that deliver on viewer interests. Moreover, its objectives are not to further industrial policy goals, although Ofcom recognises that some existing policy tools may have developed in response to industrial policy concerns. Ofcom believes that diversity in production is a means to the end of meeting the needs and interests of viewers.

It is important to be clear that this does not necessarily mean that more and more diversity is desirable. For example, whilst the location of production may be critical in delivering a diversity of perspectives, this does not necessarily mean that the distribution of production around the UK should be purely equitable. For instance, spreading production around the UK in proportion to population distribution may dilute the talent base in the production sector – a lack of critical mass in production centres would create a danger that ever-increasing dispersal could compromise overall programme quality.

Thus, whilst Ofcom believes in general that the production sector should function in such a way as to ensure that diversity is delivered, Ofcom recognises that too much emphasis on

promoting diversity in the production sector could ultimately act against viewer interests. A delicate balance needs to be struck.

Relevant consultation questions

Question 2. Do you agree that Ofcom's assessment of the role of diversity in its different forms is an appropriate framework within which to think about the link between viewer interests and diversity of production?

- 2.11 There was general agreement amongst respondents that the role of diversity is an important factor in determining viewer interests although a variety of interpretations of the term “diversity” were put forward.
- 2.12 Several responses focused on the link between diversity and specific parts of the UK, often calling for an industrial policy based approach. It was argued by some respondents that diversity underlined the importance of building a skills base in Scotland and that this industrial policy approach was one which should be adopted by Ofcom. Similarly, another respondent argued that diversity in UK broadcasting could only be achieved through the existence of a number of production centres across the UK. In particular, Scotland would be better reflected through high quality programmes across all genres that are commissioned and produced by a thriving indigenous production industry. In addition, it was suggested by other respondents that the location of supply was essential, that the geographic location of production centres must be desirable to feed into the creative process, and that programmes made in London did not guarantee quality.
- 2.13 Other respondents submitted that much of the value of diversified production was indirect and not immediately obvious from the viewer perspective. In Northern Ireland, for instance, it was argued that the direct economic contribution of production is important, as is its role as a “tent pole” for the creative industries.
- 2.14 Some respondents argued that diversity of supply is necessary to ensure diversity in content and that diversity was a means to the end of meeting audience needs and should therefore be regarded as a guiding principle rather than a measurement framework. Another agreed that no single model or approach can be put forward as the ideal way of providing a range of diversity of production. In contrast, some argued that Ofcom could withdraw regulations on the location of production. If Ofcom were reluctant to remove quotas, this would suggest that it continues to have an interest in industrial policy.
- 2.15 Whilst largely in agreement with Ofcom, a further respondent argued that diversity in production could only deliver benefits to viewers if it were matched by diversity in other parts of the content value chain. One respondent argued that having a healthy number of competitive companies in the external production sector was key to ensuring diversity of supply, and that a broadening of the issue of diversity in areas other than geographic location would be a positive step.
- 2.16 One respondent disagreed with Ofcom's assessment of the role of diversity, considering that the link between diversity of supply and viewers' interests was not proved. It was submitted that there was a strong viewer interest in sustaining a critical mass of in-house production in the broadcasting sector as this guaranteed range, quality and diversity of output.

Conclusions on the role of diversity

- 2.17 As set out in the TPSR Consultation, Ofcom believes that there are a number of aspects to diversity, a view confirmed by the variety of approaches taken by respondents on this issue.
- 2.18 On the role of diversity in television production, the majority of responses confirmed the approach taken in the TPSR Consultation, namely that viewers' interests are furthered by diversity in its various forms, and that a mixed ecology of production is needed in order to deliver on diversity objectives. Ofcom will therefore continue this approach in relation to the production sector.
- 2.19 However, Ofcom does not consider that it should adopt a more industrial policy-based approach in relation to diversity issues. Ofcom has not been granted powers to adopt an interventionist industrial policy approach under the relevant statutes and does not consider it appropriate to do so. Ofcom's powers to set quotas for out of London production derive from sections 286 to 288 of the Act which do not include powers to consider industrial policy objectives when setting those quotas. Therefore, Ofcom continues to believe that diversity in production is a means to the end of meeting the needs and interests of viewers, rather than an end in itself.

The rationale for intervention

Ofcom's position in the TPSR Consultation

Three particular features of the television production sector – related to its market structure and the conduct of programme-buyers – may prevent viewers' interests from being met. This may mean that, as well as intervening at the broadcast level for PSB and competition concerns, intervention is also needed at the production level. The following factors have been identified as driving the need for intervention in television production:

- **Negotiating strength:** there is a relatively small number of buyers of originated programming, but a very large number of producers. This imbalance is likely to provide broadcasters with a relatively strong negotiating position with producers. While this may deliver savings that can be passed on to viewers, the extent to which broadcasters take advantage of this position may be at the cost of producers and potentially viewers. Given the current market structure, it may not be possible to rely on effective competition to ensure broadcasters are incentivised always to use their negotiating strength in the interests of viewers – they may therefore damage the quality, diversity and plurality of external production
- **Vertical integration:** some broadcasters (notably the BBC and Channel 3) are considered vertically-integrated broadcaster-producers, in that they have in-house production units. Vertical integration is not usually considered a problem by competition authorities and regulators unless it is combined with market power. Without market power, broadcasters would be incentivised to serve the interests of viewers and therefore commission programmes that offer the best value for money. However, and as discussed above, the current market structure may not provide this incentive – and could therefore lead to a diminution in programme quality. For example, broadcasters may use the option to commission in-house in order to enhance their bargaining position with external producers. Moreover, given the limitations of effective competition between broadcasters and the existence of potential synergies – and therefore efficiencies – in producing in-house, there may be a natural tendency for vertically-integrated

broadcasters to commission in-house. Whilst this may be commercially rational, it may ultimately damage the diversity and plurality of television production

- **Geographic concentration:** television production, commissioning and broadcasting tend to be concentrated in London – this may be the outcome of well-functioning market forces, but it may have a damaging impact on the diversity of content available. It could therefore be undesirable from the perspective of viewers.

Relevant consultation questions

Question 3. Do you agree with Ofcom's understanding of the reasons why intervention has been warranted – namely negotiating strength, vertical integration and geographic concentration?

- 2.20 The majority of respondents were in broad agreement with Ofcom's overall analysis of the reasons for intervention in the past, although opinion varied as to the extent to which the historical reasons for intervention remain valid today, particularly in the spheres of negotiating strength and vertical integration. This is explored further below.
- 2.21 A small number of respondents disagreed with Ofcom's understanding of the reasons for intervention in the sector. Some argued that the framework of public service broadcasters receiving privileged access to scarce spectrum is the real underlying reason why intervention has occurred and that the interventions have been applied to the public service broadcasters (PSBs) mainly because the regulator has had the ability to apply them. A number of linked arguments were also made, with respondents arguing both for and against the idea that one of the key objectives for intervention in the television production sector should be to ensure that the main terrestrial broadcasters continue to be able to meet their PSB obligations.

Negotiating Strength

- 2.22 The majority of respondents agreed that the main terrestrial broadcasters continue to have negotiating strength relative to external producers – citing alleged warehousing, netting-off and holdback of programming as evidence for this. However, some argued that Ofcom had underestimated the extent to which the negotiating strength of the broadcasters is already diminishing, suggesting that creative power is shifting or, in some genres, has already shifted in the direction of independent producers.
- 2.23 Some respondents also suggested that the importance of negotiating strength differs between broadcasters based, for instance, on the size of the broadcaster or on the extent of vertical integration at the organisation in question.

Vertical Integration

- 2.24 Whilst there was broad agreement with Ofcom's analysis on this issue, a number of further issues were raised by respondents. For instance, some respondents suggested that Ofcom had underestimated the benefits of in-house production. One respondent argued that Ofcom had not presented compelling evidence that further intervention against vertical integration was justified, and that Ofcom underestimates the importance of in-house production to the sector overall.
- 2.25 Another respondent, while agreeing with the historical reasons for intervention in the form of the independent production quota, made the point that vertical integration does not in itself prevent diversity or plurality and that Ofcom has underestimated the

benefits that in-house production brings to the industry as a whole. Ofcom also received responses expressing the opposite view, namely that Ofcom had overestimated the potential benefits of in-house production.

Geographic Concentration

- 2.26 Consultation responses indicated that there was significant acceptance of the reasons why intervention has been necessary in this respect, namely that geographic concentration of production can prevent the delivery of the diversity benefits of production. However, one respondent noted that the out of London quota is a comparatively recent tool, while another suggested that the out of London investment strategy of the broadcaster (including both investment in programming and investment in other production and broadcasting facilities outside London) is more important than input-based quotas.
- 2.27 Several respondents suggested that Ofcom does not place sufficient emphasis on the potential economic and industrial benefits of an out of London quota, and that industrial policy should not be entirely set aside by the regulator.

Conclusions on the rationale for intervention

- 2.28 The consultation responses on this issue have helped to further the debate on the rationale for intervention in the TV production sector. Whilst Ofcom recognises the concerns expressed by certain respondents to the consultation, the majority of responses call for continued intervention in the production sector in respect of the two issues set out above. Having considered the responses received, Ofcom remains of the view that intervention is required in the production sector in order to protect the interests of consumers and citizens, notably by maintaining diversity within the sector. The rationale for intervention is primarily prompted by the following factors, as set out in the TPSR Consultation:
- The responses to the TPSR Consultation have confirmed that the negotiating strength of the main terrestrial broadcasters remains a concern. This concern has driven the development of the Codes of Practice that govern the relationships between these broadcasters and independent producers. Ofcom accepts that the nature and extent of negotiating strength may differ by broadcaster, and indeed this is one of the reasons why each broadcaster has been allowed to develop a Code of Practice specific to its circumstances. Ofcom recognises that the negotiating strength of the main terrestrial broadcasters may diminish over time with the development of larger independent producers and the expansion of new media markets and may, over time, create the scope for the removal of regulation in this area. However, Ofcom does not consider that, at the present time, those developments have had a significant effect on the negotiating strength of the principal broadcasters. In particular, the main terrestrial broadcasters remain the main buyers of originated content, and are likely to remain so in the medium term. As a result, Ofcom remains of the view that intervention is still required in order to address the imbalance in negotiating strength between the main terrestrial broadcasters and independent producers, and that the Codes of Practice are a useful tool in achieving this objective. Ofcom shall, however, continue to monitor developments in this area
 - In highlighting the role of vertical integration as part of the rationale for intervention, Ofcom also recognises that in-house production delivers significant viewer benefits. As a result, and as highlighted in the TPSR Consultation, Ofcom supports the idea

of a mixed ecology of production. However, consultation responses indicated that the incentives for vertically-integrated broadcasters to source production in-house identified in the TPSR Consultation remain and therefore a reduction of diversity and plurality in production to the detriment of citizens and consumers may result from the lifting of the independent production quota

- As regards geographic concentration, Ofcom has not received any responses adopting a contrary position to that set out in the TPSR Consultation, namely that a highly concentrated production base would not deliver the diversity benefits of production. Ofcom does not consider that, as suggested by certain respondents, the adoption of a more interventionist policy in this area based on industrial policy would be appropriate. As set out above in relation to diversity, Ofcom has not been granted powers to adopt the approach sought. Moreover, and as noted in relation to out of London production, Ofcom does not consider such an approach to be warranted
- Finally, Ofcom does not consider that one of the key objectives for intervention in the television production sector should be to ensure that the main terrestrial broadcasters continue to be able to meet their PSB obligations. Whilst Ofcom recognises that there are some areas of overlap, Ofcom believes that regulation for broadcasters' delivery of PSB purposes and characteristics should be kept separate from intervention in the television production sector wherever possible. If intervention in television production were directed towards preserving PSB delivery in broadcasting, then this would not be consistent with the goal of addressing concerns over broadcasters' negotiating strength.

Current position of the Television Production Sector

Ofcom's position in the TPSR Consultation

In relation to the production sector as a whole, and the importance of vertical integration, Ofcom's key findings include the following:

- UK channels spent £4.7bn on programming in 2004. Excluding rights, programming spend has increased by 3% per year since 1999
- Total UK spend on originated programming has grown by 4% per year over the past five years, and amounted to £2.6bn in 2004
- Across the five main terrestrial channels, 56% of 2004 originations spend was in-house. Channel 4 and Five were the largest external commissioners in terms of hours.

Data on the size of external producers and the demand for external production provide insights into the relative negotiating strengths of broadcasters and producers:

- Demand for commissions from digital channels has increased. Excluding BBC digital services, spend by multichannel services has grown by 19% per year over the period. In 2004, multichannel spend accounted for £123m of total originations spend
- Nonetheless, the main terrestrial channels accounted for 87% of spend on first run originations in 2004
- Out of 200 respondents to the Ofcom/PACT Producer Census, accounting for £1.1bn of external production market turnover, 58 companies reported turnover of less than £1m. 25 companies reported total turnover of over £12m

- Based on Ofcom's analysis of producer and broadcaster data, larger production companies, with turnover in excess of £12m, accounted for approximately 50% and 63% of external commissions for the BBC and ITV1 respectively
- Primary TV rights remain the largest source of revenue for external producers, accounting for 79% of total reported production turnover. £118m was reported as TV-related distribution and rights exploitation turnover, and 44% of this was accounted for by international sales. Interactive media production accounted for 18% of £72m of reported non-TV production turnover.

Ofcom's analysis also focused specifically on understanding the position with regard to production outside London. On this issue, the key findings included:

- In 2004, £941m of production was commissioned outside London, 77% of which was for network programming. On the main terrestrial channels, the value of out of London network production has grown by 8% per year since 2002 while out of London hours of production have grown at a slower rate of 4% over the same period
- Outside London, the BBC and ITV1 accounted for 80% of all network commissions in 2004. Channel 4 and the BBC were the largest commissioners of out of London external production, accounting for 40% and 35% of total out of London network external commissions value respectively
- 54% of £216m of non-network production for the Nations and Regions was accounted for by in-house commissions. Of the remaining 46% of external non-network production, 22% were commissions for S4C and 24% were other external commissions. S4C functions as a discrete network and Welsh language producers in Wales operate in a distinct "micro market"
- A total of £24m of external non-network production was reported in the census, representing 2% of total turnover reported. £1.6m of external non-network production was reported in the English Regions
- 85% of the reported external production sector turnover was accounted for by London-based production companies. Only 9 companies based outside London reported turnover greater than £4m.

In summary, Ofcom's survey suggests that the current size of the market for UK-originated TV production is £2.6bn. 56% of the market, representing £1.5bn, is accounted for by in-house production, while 44% or £1.1bn comprises external production. 63% of all originated production, or £1.6bn, is based in London and divided relatively equally between in-house and external production companies at 55% and 45% of the total respectively. Out of London, 58% of production is accounted for by in-house production companies.

Relevant consultation questions

Question 4. Does the representation of the current position of the television production sector accord with your experience and understanding of the sector?

- 2.29 There was a broad consensus that Ofcom's representation of the current position of the television production sector accorded with the respondents' own experience and understanding of the sector. However, a number of specific points were raised.

- 2.30 Some respondents argued that Ofcom's analysis underestimated the importance of broadcasters, particularly the extent to which they created value for the whole production sector by taking the initial risk on ideas. A number of respondents also expressed the view that the power of independent producers in the market was now considerable and would continue to grow and consolidate over the next five to ten years.
- 2.31 In contrast, others argued that the main terrestrial broadcasters continue to dominate the programme supply market and that, despite any recent changes, the overall structure of the industry remained one where there was a small number of buyers and a large number of sellers.
- 2.32 One respondent expressed concern that the data suggested that only a small number of production companies accounted for the bulk of turnover, a finding which might imply that the sector was not competitive or dynamic. As highlighted in the *Broadcast Independent Survey* (published in March 2006), the biggest growth as a percentage of the overall market in 2005 was amongst smaller companies and the highest relative growth came from the mid-sized companies. In contrast, the share of the top 10 companies has remained flat over the last 4 years.
- 2.33 A small number of the national and regional respondents expressed disappointment with specific data for their respective Nation or Region, suggesting the information distorted or gave an overly positive representation of production activity in the area.

Conclusions on the current position of the sector

- 2.34 Overall, Ofcom remains confident that its quantitative analysis of the production sector in the TPSR Consultation painted as accurate a picture as possible. This review has been informed by a comprehensive assessment of the sector, combining broadcaster data supplied to Ofcom with a producer. However, Ofcom recognises the potential limitations of its survey: producers were not obliged to respond to the survey, and hence the analysis was necessarily based on a partial sample. This is particularly relevant in relation to areas of the country where gaps in producer responses can have a significant impact on the overall conclusions drawn from the data.
- 2.35 As a result, Ofcom acknowledged in the TPSR Consultation that the results may in some instances have been unrepresentative of the market as a whole. Ofcom has no power to compel producers to provide information to it. Nonetheless, Ofcom encourages producer surveys of this kind, and hopes that the accuracy of future surveys can be improved further through greater participation from production companies across the UK.

Future developments in the TV Production Sector

Ofcom's position in the TPSR Consultation

Ofcom's forward-looking analysis suggested the following:

- The sources of demand for external productions are growing – mainly from digital channels, but also some emerging demand from international markets and new distribution platforms. However, the main terrestrial broadcasters are likely to remain the main buyers of originated programming going forward – and so their negotiating strength will only be ameliorated to a limited extent

- The external production sector is likely to continue its growth, but Ofcom has found no evidence to suggest that external producers will grow to exceed the size of in-house production in the near future
- Growth and consolidation in the independent production sector are likely to be of particular benefit to the large producers often referred to as “super-indies”. Ofcom does not consider that this is a cause for concern – such producers are likely to bring to bear the benefits of scale and commercial experience. However, while Ofcom expects entry barriers to remain low, it recognises that it may need to monitor whether – in the medium term – the rise of the super-indie could have any adverse impact on the prospects for entry into the production sector
- There is little evidence that significant levels of production outside London would be provided by the market. Ofcom has analysed the factors that would be required to create sustainable production clusters outside London – and its analysis suggests that production would become even more concentrated in London if quotas were removed. As a result, intervention is still needed to deliver the diversity benefits associated with out of London production. 85% of the reported external production sector turnover was accounted for by London-based production companies. Only 9 companies based outside London reported turnover greater than £4m.

Relevant consultation questions

Question 5. Do you agree with Ofcom’s understanding of the likely future developments in the sector? Are there any other relevant developments that Ofcom should consider?

2.36 Consultation responses raised a number of alternative possibilities for the future developments in the TV production sector. For instance, it was variously argued that:

- Future growth of external producers will be driven by exploitation of drama programming – as this genre provides a long shelf life, and international sales offer a long-term revenue stream
- Proper self-sustaining regional production can only be achieved by focussing on regional centres – as critical mass is required to keep the support businesses viable. A move by the BBC to Manchester alone will not be enough. There is a need to move the decision making and commissioning power of the channel to change the view that all decisions are made in London
- Given the pace and scale of change in the sector, the current scope of regulatory intervention will need to be kept under review
- The consolidation of the independent sector will create regulatory issues for Ofcom to consider. For instance, Ofcom should monitor the growth of “super-indies” and the impact these could have on broadcasters and other producers
- Independent producers will be biased towards safe, sellable formats – which will undermine their contribution to diversity; and independents are able to pay more at the high end and could poach staff from in-house producers
- Video on Demand (VoD) services may contribute to the fragmentation of terrestrial TV audiences, but nonetheless are likely to increase the size of the market. VoD will not threaten the existing financing model, as it will add to the size of the sector
- The availability of high quality content is key to the introduction of new services on broadband, and the rapid deployment of such content will limit piracy

- New media business models will rely on secondary (rather than originally commissioned) content, much of which will have been funded, commissioned or marketed by PSBs
- The growth of new platforms will be important, but the growth cannot be taken for granted. The main broadcasters will remain dominant, and there is a risk they might stifle growth from secondary markets.

Conclusions on future developments in the sector

- 2.37 As the above summary of consultation responses suggests, there appears to be a commonly-held view that growth in the production sector will continue. Nonetheless, there is significant uncertainty about the direction of future development, especially around the growth of independent producers and the development of new media services.
- 2.38 It is not possible to reach firm conclusions on how the sector will develop going forward – uncertainty remains. As noted in the TPSR Consultation, Ofcom will continue to monitor developments in the sector. In particular, Ofcom will monitor whether, in the medium term, the rise of the “super-indie” could have any adverse impact on the prospects for entry into the production sector and will consider at the appropriate time whether changes to the regulatory framework are required.

Prospects for the withdrawal of intervention

Ofcom’s position in the TPSR Consultation

On the basis of the forward-looking analysis summarised above, Ofcom has concluded that the prospects for withdrawal from intervention are limited in the near term:

- There would need to be much more significant growth and diversification of the sources of demand before broadcasters’ relative negotiating strength weakens as an issue
- Vertical integration between broadcasting and production remains a significant issue – as long as this is the case, the independent production quota and associated definitions of qualifying independent producers are likely to remain necessary
- The market is unlikely to deliver much out of London production unless a significant amount of commissioning power and funds were moved away from London. Under current market conditions, therefore, Ofcom believes that intervention to secure out of London production will continue to be required.

Relevant consultation questions

Question 6. Do you agree that the rationale for intervention – in terms of the negotiating strength, vertical integration and geographic concentration – remains valid? Do you have a view about the circumstances that would lead to the withdrawal of intervention?

- 2.39 A variety of views and arguments were put forward by respondents on this issue. While there was broad (although not unanimous) agreement around the proposition that intervention to secure geographic dispersal will continue to be necessary for the foreseeable future, there was less of a consensus around the issues of negotiating strength and vertical integration.
- 2.40 Some respondents suggested that Ofcom should only intervene where necessary, and argued that quotas and the focus of intervention on the PSBs could be viewed as

being inappropriate in the digital world. It was suggested that the case for intervention, in particular in terms of negotiating strength and vertical integration, is less clear cut than it was in the past.

- 2.41 Other respondents argued that the historical reasons for intervention remain in place today and that there is no case for its withdrawal in the immediate future.

Negotiating strength

- 2.42 A number of parties suggested that Ofcom is underplaying the impact of existing developments on the production market, arguing that the negotiating strength of the PSBs is being eroded by increased competition for audiences, the growth of digital channels, and the consolidation of the independent sector. Those respondents considered that the negotiating position between PSBs and independent producers is already more even – with broadcasters having less negotiating strength than in the past.
- 2.43 However, other respondents argued that broadcasters will continue to have significant negotiating strength which will continue to require intervention. One respondent suggested that negotiating strength might be a particularly difficult hurdle for producers based outside London to overcome, while another suggested that consolidation among broadcasters has reduced the number of potential outlets for independent producers, and actually increased the buyer power of PSBs.
- 2.44 A further respondent argued that the vitality and competitiveness of the secondary market is being threatened by the PSBs ability to leverage rights from independent producers for their own digital services, and that there is a need for Ofcom to intervene on this issue in future. Moreover, it was suggested that the existing Terms of Trade threaten to restrict the level of competition, particularly due to the continued existence of holdbacks on secondary exploitation.

Vertical Integration

- 2.45 Several respondents argued that the independent production sector as a whole remains smaller than the in-house production capability of the BBC and ITV combined. In-house production capacity and influence will continue to be significant and therefore intervention in the form of the independent production quota will continue to be needed.
- 2.46 However, it was also suggested that concerns over the impact of vertical integration no longer apply as it would be self-defeating for any UK channel to deny itself the best possible content. Therefore, no broadcaster would favour a poor quality in-house programme over a high quality external one.

Out of London production

- 2.47 The majority of respondents agreed that production would tend to concentrate further in London if intervention in the form of the out of London production quota were removed, and that intervention would continue to be necessary for the foreseeable future.
- 2.48 However, arguments were made for refocusing the out of London quota on particular broadcasters and genres. Some respondents cautioned against Ofcom putting all its faith in such a blunt instrument, arguing that investment and developing production

centres outside London was the key objective. A delicate balance needs to be struck, it was argued, between maintaining value for money and increasing geographical spread, a balance that would require flexible intervention in the future.

Prospects for Withdrawal

- 2.49 Some respondents attempted to define the circumstances that would allow the withdrawal of intervention. For instance, it was suggested that withdrawal of the out of London production quota could take place when producers based in the Nations and Regions are winning 70% of qualifying out of London commissions and 50% of productions of scale and long running series are being made from bases outside the capital.
- 2.50 Another respondent suggested that Ofcom should not cast the conditions for withdrawal of intervention on the grounds of negotiating strength and vertical integration in structural terms (e.g. scale of in-house relative to independent producers). Instead the key criterion for withdrawal should be effective competition for audiences across the terrestrial and digital channels, which would – it was suggested – be achieved in the near future.

Conclusions on the prospects for withdrawal of intervention

- 2.51 Whilst Ofcom recognises the pace of change in the production market, it continues to believe that the prospects for withdrawal of intervention are limited in the near term. Negotiating strength, vertical integration and geographic concentration are significant issues, and are likely to remain so for the near future.
- 2.52 Specifically, Ofcom's position is as follows:
- Ofcom continues to believe that there would need to be significant growth and diversification of the sources of demand before PSBs relative negotiating strength weakens. Ofcom recognises that the negotiating strength of the PSBs may diminish over time, but the analysis suggests that they will remain the main commissioners of originated content for the foreseeable future and their negotiating strength will only be reduced to a limited extent
 - Ofcom believes that vertical integration between broadcasting and production remains a significant issue. For as long as this remains the case, the independent production quota and associated definitions of qualifying independent producer are likely to remain necessary. Although some respondents argued that concerns over vertical integration no longer apply, Ofcom notes that vertically-integrated producer-broadcasters still commission the majority of their programming from in-house sources, and (as noted by other respondents) the independent production sector as a whole remains smaller than the in-house production divisions of BBC and ITV taken together
 - Ofcom believes that the market is unlikely to deliver much out of London production unless a significant amount of commissioning power and funds were moved away from London, a point with which respondents tended to agree. Ofcom's further conclusions on the future of intervention to secure out of London production are discussed later in this section
 - Ofcom has also notes the points made regarding defining the circumstances that would allow a withdrawal of intervention. Ofcom does not consider that the market has yet developed sufficiently to be able to define the precise triggers for withdrawal.

The Window of Creative Competition

Ofcom's position in the TPSR Consultation

Ofcom welcomes the principle of the Window of Creative Competition (WOCC) and supports the BBC's intention to enhance creative competition and create a more level playing field for external producers. However, Ofcom believes that more work is still needed in order to ensure that the WOCC works effectively in practice.

Specifically, it is important that the BBC's proposals ensure the commissioning process provides a sound platform for competition for the WOCC to thrive. For instance, the BBC and the Government may need to give further consideration to the separation of roles of BBC commissioning and production. In addition, more information is needed on how the operation of the WOCC will be monitored. The Government will finalise the details of the WOCC in the context of the BBC's new Charter and Agreement. Ofcom therefore makes the following recommendations to Government:

- There should be more clarity on how the BBC's commissioning structure will work to ensure a level playing field in competition between in-house and external producers
- The nature and scope of the review of the operation of the WOCC should be finalised and made public, along with the criteria that would define success for the WOCC
- Given that there will be some overlap of responsibilities between Ofcom and the BBC Trust in relation to production quotas, Ofcom believes that it should be asked to work with the Trust to define the terms of the review of the operation of the WOCC; and that Ofcom should be asked to conduct the review jointly with the Trust
- Ofcom also considers that the Government should clarify what will be the backstop response if the WOCC does not achieve its aims. If the WOCC does not work, the Government should revisit the option of increasing the BBC's independent production quota. But Ofcom recognises that the WOCC may need time to bed down before it is possible to reach a conclusion about its success.

Relevant consultation questions

Question 14. What do you see as the key issues in relation to the operation of the BBC's proposed WOCC?

- 2.53 The principle of the WOCC was welcomed by almost all respondents as providing new opportunities for the external production sector, and consequently strengthening the sector overall. However, a number of respondents called for more clarity or detail on exactly how the WOCC will operate.
- 2.54 Overwhelmingly, it was argued that the WOCC should be transparent and effective, although there was some disagreement as to whether the BBC Trust or Ofcom would be best placed to monitor and assess its operation. Several respondents argued that the WOCC should be applied across all genres and timeslots, that it should be measured by value as well as volume, and that it should be made to work outside London as well as in the capital. On the latter point, it was suggested that the WOCC should also be applied to the BBC's regional programmes.

- 2.55 It was often argued that the separation of commissioning and production continues to be an important issue which will affect the operation of the WOCC in practice, particularly in relation to access for smaller producers and producers based in the Nations and Regions.
- 2.56 Some respondents proposed changes to the structure of the WOCC arguing, for instance, that there should be a 50% ceiling on the BBC's in-house production in order to ensure that the WOCC is not dominated by in-house commissions. Others were sceptical as to whether the WOCC would be of sufficient value to non-qualifying external producers, suggesting that these might be squeezed between in-house and qualifying independent commissions.
- 2.57 A small number of respondents called into question the principle of the WOCC, arguing that the WOCC was potentially harmful to the BBC in terms of undermining critical mass and training, and risks “hollowing out” the BBC as a creative organisation.

Conclusions on the WOCC

- 2.58 Ofcom is not required to reach a decision on the WOCC, since this is a matter for Government in the context of BBC Charter Review. Ofcom has, however, noted the above comments and welcomes the Government's overall approach to the WOCC set out in the recent Charter Review White Paper¹⁰:
- The Government confirmed its support for the BBC's proposed WOCC, and, in line with Ofcom's recommendations in the TPSR Consultation, highlighted the need for proper (operational) separation between the BBC's commissioning and production functions
 - The Government also confirmed that the operation of the WOCC must be reviewed regularly by the BBC Trust. The Trust may draw on external expertise – including that of Ofcom – if needed.

The independent production quota

Ofcom's position in the TPSR Consultation

In terms of the independent production quota more generally, Ofcom heard no strong case for a general variation in the level of the quota – whether an increase or a decrease. Ofcom considers that vertical integration remains a significant issue and therefore the independent production quota remains needed. Similarly, the position of Channel 4 as a publisher-broadcaster continues to provide an important balance to the sector.

In Ofcom's view, regulatory certainty in this case is more important than regulatory withdrawal. Ofcom therefore considers that the independent production quota should be held constant at current levels for all broadcasters.

Relevant consultation questions

Question 15. What are your views on the options for the future of the independent production quota?

¹⁰ DCMS, *A public service for all: the BBC in the digital age*. Published 14 March 2006

- 2.59 Where commented on, there was a consensus across the board from respondents that the independent production quota should remain in place, although some argued that the conditions under which such intervention should be revisited are closer than stated in the TPSR Consultation.
- 2.60 Some respondents argued that the option should be retained to increase the independent production quota to 50% if the vertically-integrated producer-broadcasters do not reduce their reliance on in-house production. Moreover, another respondent argued that, if the WOCC fails to establish greater creative competition by the BBC Trust's second biennial review, a 50% quota, defined in value terms, should be imposed.

Conclusions on the independent production quota

- 2.61 Ofcom confirms the view expressed in the TPSR Consultation that the independent production quota should be held constant at current levels for all broadcasters. In line with the comments made in the TPSR Consultation, Ofcom has heard no strong case for a general variation in the level of the quota, whether an increase or a decrease. Ofcom believes that vertical integration remains a significant issue and therefore the independent production quota is still needed. Similarly, the position of Channel 4 as a publisher-broadcaster continues to provide an important balance to the sector.
- 2.62 In Ofcom's view, regulatory certainty in this case is more important than regulatory withdrawal. Ofcom therefore concludes that there should neither be an increase nor decrease in the quota, although Ofcom continues to believe that this issue should be revisited if the WOCC does not achieve its aims.

Out of London production

Ofcom's position in the TPSR Consultation

Without intervention, Ofcom does not believe that much production outside London is likely to be self-sustaining in the longer term. In its view, intervention will continue to be needed to deliver the diversity benefits associated with out of London production. Ofcom recognises that an input-based quota for production outside London is a blunt instrument, but it appears to be a necessary intervention. In particular, Ofcom considers that intervention solely at the broadcasting level would not be practical or effective, given the difficulties in measuring the diversity of broadcasting output.

Ofcom's analysis also suggests, however, that the prospects for production outside London – particularly from external producers – may become more challenging in the future. This raises the question of whether additional measures will be needed to secure out of London production.

Ofcom believes that the BBC should play a more significant role in ensuring a diversity of production outside London, given the BBC's privileged access to public funding. Whilst Ofcom welcomes the BBC's Out of London review, it would also recommend that Government should ensure that the BBC's plans work to secure production outside London for the future. In particular:

- Ofcom reiterates its view expressed in Phase 3 of the PSB Review, that it is reasonable to expect the BBC to increase its out of London commissioning of network programming. Ofcom considers that the BBC should aspire to reach a similar position to ITV1 over time, by setting a target for 50% of network production by volume and value produced

outside London. This target should not necessarily be seen as a short-term objective, but one that could be achieved over time

- At the same time, Ofcom would propose that Government should put measures in place to ensure that the BBC's commissioning of out of London external production is maintained at least at current levels and, ideally, the BBC's role in this area should increase over time.

Ofcom recognises that the BBC's out of London strategy is seeking to enhance the BBC's role outside the M25 area through, for instance, a commitment to increase the BBC's spend and staff numbers outside London, increases in the BBC's Regional Development Fund, and increased commissioning power outside London. Ofcom therefore notes that the BBC's current plans may indeed achieve the aims set out above. As such, it will closely follow the BBC's actions in this area, and will seek a continuing dialogue with the BBC on these issues.

Relevant consultation questions

Question 16. What are your views on the options for the future intervention to secure production outside London?

- 2.63 There was broad agreement around Ofcom's analysis that, while the out of London production quota is a blunt instrument, it remains a necessary intervention.
- 2.64 Most agreed that the quota has an important role in terms of delivering a diverse output that reflects the different cultures of the UK. A number of respondents also suggested that the quota supports the development of healthy regional production bases, underlining the importance of broadcasters investing in a range of such production centres across a range of genres. Some respondents suggested that, in emphasising the importance of geographical diversity of output, Ofcom may have underestimated the importance of the role the quotas play in achieving structural change and sustainability of production centres outside London.
- 2.65 Although some respondents suggested that the out of London quotas are too intrusive, the majority of respondents either felt that the out of London quotas should be maintained at current levels or that Ofcom should consider increasing the quotas over time.

The BBC outside London

- 2.66 There was broad support for Ofcom's hypothesis that the BBC will have an increasingly important role outside London in the future and should aspire to achieve 50% of network production in the Nations and Regions over time. The BBC acknowledged its increasingly important role but argued that an increased quota is not the best means of achieving its objectives for out of London production.
- 2.67 A number of respondents agreed with Ofcom's suggestion that the BBC's commissioning of out of London external production should be maintained and ideally increased over time in order to ensure a mixed ecology of supply. One respondent disagreed on this point, arguing that the need to build and preserve critical mass outside London means that the emphasis should be on in-house production.
- 2.68 Most respondents welcomed the BBC's plans to move departments to Manchester. However, a number of respondents raised concerns over the perceived slowness of the move, the specialist nature of the genres that are involved, and the issue of how much (or how little) other Regions and Nations are likely to benefit from the move.

Some respondents based in the Nations and the smaller English Regions felt that the BBC's move to Manchester risked "creating another London" which would build the North West as a substantial production sector, but might actually lead to there being less regional production elsewhere in the UK.

Channel 4 and Five

- 2.69 Some respondents argued that Ofcom should consider increasing the out of London quotas on other PSB channels, as well as the BBC. For instance, it was suggested that Five's quota should be increased to be more in line with the channel's actual delivery outside London, and that Channel 4's quota should be raised (to 40 or 50%) or that it might be made to apply across its digital channels. Respondents argued that such increases would contribute towards building sustainable production centres outside London and lead to a more equitable distribution of production that was more closely aligned with population distribution.
- 2.70 Some respondents disagreed with Ofcom's suggestion that the BBC is better placed than Channel 4 or Five to manage any increase out of London quota, arguing instead that not having an in-house capacity could make a channel more adaptable and more able to change reasonably quickly. In contrast, others suggested that a higher out of London production quota is more practicable for broadcasters with significant in-house production bases.

Dispersal

- 2.71 A significant number of respondents believe that the dispersal of production around the United Kingdom is a key issue. Several parties suggested various means of ensuring a "more equitable" dispersal of production around the country, particularly to the Nations. These included:
- Measuring the out of London quota by Region in England rather than by macro region, to better identify those Regions which are less well represented
 - Ensuring that ITV's Regional Production Fund delivers better dispersal and lobbying government to make sure the BBC also achieved better dispersal
 - Raising ITV's target for the Nations (set at 8% in the PSB review) to be more in line with the BBC's self imposed target of 17% for network production in the Nations
 - Introducing similar targets for Channel 4 and Five in the Nations
 - Introducing a formal "out of England" quota for the Nations.
- 2.72 Some respondents favoured the introduction of a formal quota for the Nations, arguing that the current quotas have not delivered sufficient production in the Nations and that a new approach is necessary. However, others argued that sub quotas – either for the Nations or for specific genres – would prove over-intrusive.

Ofcom's position in the TPSR Consultation

Its view is that the objective of any further measures should be to maximise the net benefit of production outside London, and that any measures should be implemented in as unintrusive a way as possible. Ofcom welcomes Channel 4's strategy for production out of London, and recognise the impact of the recent increase in ITV1's out of London quota. Ofcom also raises a consultation question about the idea of requiring a major broadcaster or channel to move

out of London – Ofcom welcomes views about whether there are strong arguments for such a proposal, or alternatively whether this might be too intrusive.

Relevant consultation questions

Question 17. Would the move of a channel or significant commissioning power outside London be desirable and practical and would it create the circumstances to allow a withdrawal from intervention in out of London production?

- 2.73 Ofcom notes that many respondents did not express an opinion on this issue. Amongst those respondents that did answer this question, the majority argued that such a move was desirable.

Desirability

- 2.74 There was support amongst a number of respondents – including some based in London as well as several based in the Nations and Regions – for moving a major channel outside London.
- 2.75 The main arguments put forward in favour included “balancing the metropolitan bias”, the potential diversity benefits to viewers from having a channel with an out of London “cultural attitude”, creating a “magnet” for producers to cluster around in order to build critical mass outside the capital, and diluting the concentration of commissioning power that exists in London.
- 2.76 However, some respondents argued that it would not be desirable to move a major channel outside the M25 as it would “create a second London”, rather than dispersing production activity or commissioning power more evenly around the UK.

Withdrawal of intervention

- 2.77 A number of respondents doubted whether moving a channel outside the M25 would create the conditions that would allow for a withdrawal of intervention. The out of London quota would still be required, it was argued, in order to ensure range and dispersal beyond the location of the channel.

Which channel?

- 2.78 Amongst those respondents that offered a view on which channel would be best moved outside London, a variety of opinions were expressed:
- Many suggested that a BBC channel (e.g. BBC 2 or 3) would be the most likely candidate to move
 - Some argued that only the publicly-owned PSBs – the BBC and Channel 4 – should be considered
 - Others simply suggested that the best candidate would be a generalist, mainstream channel offering a range of genres.

Practicality

- 2.79 On the issue of practicality, it was suggested by some that moving a channel outside London would not be as complex, costly or time consuming as, for example, moving a major production department outside London because of the relatively small

numbers of people involved. Whilst it was generally acknowledged that such a move would be a significant intervention, respondents generally argued that it would be an achievable option.

Commissioning Power

- 2.80 On the issue of moving commissioning power out of London, the responses received were generally in favour of some expansion of commissioning power into the Nations and Regions.
- 2.81 However, some respondents – whilst recognising the possible cultural value of the proposition – voiced reservations about dispersing commissioning power too widely for reasons of practicality. Others argued strongly that achieving critical mass of production was more important than moving either channels or commissioners.

Conclusions on the future of out of London production

- 2.82 Ofcom believes that intervention will continue to be needed to deliver the diversity benefits associated with out of London production, and that further steps may be needed to secure production outside London for the future. Ofcom's specific conclusions are as follows:
- Ofcom continues to believe that an input-based quota for production outside London is a blunt instrument but is a necessary intervention – this view has been supported by responses to the consultation. Ofcom therefore proposes no immediate changes to out of London production quotas
 - Ofcom recognises the arguments made by the BBC that its out of London strategy will enhance the BBC's role outside London. The BBC therefore argues that an increased quota is not appropriate. However, it seems likely that, if the BBC's out of London strategy works effectively, the BBC's production outside London will increase over time. As such, Ofcom will continue a dialogue with the BBC and the BBC Trust on this subject to assess whether an increase in the out of London production quota would be appropriate to ensure diversity for the benefit of consumers and citizens
 - As regards other possible measures suggested by respondents, Ofcom does not support the idea of introducing additional layers of production quotas – whether for the Nations, or for out of London production in particular genres – since these have the danger of creating additional bureaucracy and, particularly if divided too narrowly between regions, could mitigate against commissioning the best ideas. Moreover, Ofcom considers that such sub-quotas could be inimical to the development of a critical mass of production in the Nations and Regions of the UK
 - Ofcom notes the comments made regarding the move of a channel or significant commissioning power outside London. However, Ofcom does not propose that the Government pursues such an option at this time, whether in relation to the BBC or for any other broadcaster. It would be a very significant intervention, but – as noted by some consultation responses – may not have significant benefits in terms of the dispersal of production around the UK. Nonetheless, the consultation responses on this subject suggest that there may be some appetite for such a move. Ofcom will therefore consider this issue further as the market develops.

Definitions of qualifying programmes and out of London productions

Ofcom's position in the TPSR Consultation

The definition of qualifying programmes has been drawn relatively widely, so as to capture as much origination as possible. Ofcom has had no representations from stakeholders on this subject, and so does not propose a change to the definition of qualifying programmes.

New definitions of out of London production were introduced in 2004. The general view is that the new definitions are working well. As such, Ofcom does not propose any change in this area.

Relevant consultation questions

Question 20. Do you agree with the proposals for no change to the definitions to qualifying programmes and out of London productions?

Qualifying programmes

- 2.83 Ofcom received broad agreement from respondents with the proposal for no change to the definition of qualifying programmes, with only one respondent suggesting a modest change to the definition.

Conclusions on the definition of qualifying programmes

- 2.84 Ofcom continues to believe that the definition of qualifying programmes is working well, and, in the absence of argument to the contrary, Ofcom confirms that it will not be pursuing a change to this definition.

Definition of out of London productions

- 2.85 Again there was a reasonably broad consensus that the definition of out of London productions is working well. However, a number of respondents suggested various changes – some arguing for a tightening of the definition, and others for a relaxation – and one respondent made the point that it was too early to judge whether the definition is effective or not.
- 2.86 Two respondents suggested that diversity is best achieved by indigenous out of London producers, and that while London-based producers have a necessary role in terms of the investment they bring to the Nations and Regions, Ofcom should consider making a requirement for a substantial base outside London mandatory for qualifying out of London production.
- 2.87 Another respondent developed this idea further by suggesting that Ofcom should measure and publish data showing the balance of indigenous Nations and Regions production relative to production by London-based companies that qualifies under the definition. Whilst it was agreed that London-based producers have an important role to play, concern was raised that if broadcasters rely too heavily on London based producers, then the growth of sustainable regional production clusters and the diversity of output might be undermined. It was suggested that a 50:50 split would be a reasonable starting point, increasing to 70:30 (in favour of regionally based indigenous producers) by 2010.

Conclusions on the definition of out of London productions

- 2.88 Ofcom's overall view is that the definition of out of London production is working well, and therefore confirms its proposal for no change to the definition. The review of consultation responses and discussions with industry stakeholders have demonstrated that the balance of opinion is that the definition has brought the prospect of an increased volume of production activity in the Nations and Regions, and that this development should help in delivering a critical mass of production.
- 2.89 Given these overall views (and given that the out of London definition has only been in place since 2004, and indeed only fully comes into force in 2006), Ofcom does not consider it appropriate to measure different categories of out of London production (e.g. drawing a distinction between out of London production by London-based companies, and that by producers with a substantial production base outside London). Such measurement has been proposed by parties concerned about the increasing amount of out of London production carried out by London-based companies. However, Ofcom is concerned that such measurement risks discouraging a wider pool of producers to make programmes outside the M25. If so, then this kind of measurement activity could be counter-productive as it may weaken, rather than strengthen, the critical mass of production outside London. Moreover, if the definition were revised in line with this measurement approach, it could make it more difficult for the non vertically-integrated broadcasters to meet their out of London production quotas, due to the lack of critical mass of production in some areas of the UK.
- 2.90 Ofcom therefore concludes that, not only should the current definition of out of London production be retained, but Ofcom's approach to monitoring the quota should also remain unchanged.

Other issues covered by consultation responses

- 2.91 A number of respondents also expressed views on issues not covered explicitly in the TPSR Consultation. For instance, some argued that Ofcom had omitted to consider a number of important issues in the review:
- A small number of respondents suggested that Ofcom should give further attention to the working conditions of the largely freelance labour force in the production sector. It was recognised that Ofcom does not have specific statutory powers in this area, but it was suggested that Ofcom should voluntarily work with trade unions and independent producers to develop a set of employment standards on pay and hours, and to work with broadcasters to ensure that producers observe these standards
 - One respondent highlighted Ofcom's duty under section 27 of the Act to require licensees to promote equal opportunities in employment and training. This respondent encouraged Ofcom to take a proactive role in encouraging the industry to promote diversity in employment and training – as a "light touch" approach will not ensure that diversity is given sufficient priority
 - Some respondents expressed concern that Ofcom's review has not given consideration to issues surrounding individual creators' rights (namely the underlying rights held by artists including writers, actors, and musicians). In particular, it was argued that Ofcom should require fair dealing between programme-producers and individual rights holders. It was also suggested that such

fair dealing is becoming even more important as producers' margins are squeezed, and as new media exploitation of TV programmes becomes more prevalent

- Another respondent expressed the view that the outcome of the current review will set important precedents for the UK film industry. Specifically, the resolution of the new media rights issue between broadcasters and independent television producers is likely to set a precedent for the way in which broadcasters, platform owners and rights-owners agree terms of trade in relation to the exploitation of films on new media platforms.

2.92 Ofcom recognises the importance of these issues, but does not consider it appropriate to take specific action in these areas in the context of the present review. The main reasons for this are as follows:

- Ofcom encourages the adoption of fair employment standards, and welcomes the steps that have been taken in this area (e.g. the freelance production agreement and the code of practice for trainees). However, Ofcom's regulatory locus relates to the relationship between the public service broadcasters and independent producers – Ofcom does not regulate the businesses of the producers themselves. Ofcom therefore considers that it is not the appropriate body for the determination of employment standards applicable within production companies. This is a matter for production companies and their employees within the context of the relevant employment legislation
- Similarly, while section 27 of the Act requires Ofcom to take all such steps as Ofcom considers appropriate to promote equal opportunities in employment and training, Ofcom does not consider that this regulatory locus extends to the imposition of obligations on external producers. Ofcom's powers under section 27 of the Act apply only to persons providing radio and television services. Television and radio services are defined in section 405 of the Act as "*(a) programme services apart from those provided by the BBC; and (b) services provided by the BBC in relation to which Ofcom have functions.*" The definition of programme services contained in section 405 of the Act covers services requiring licences under the Broadcasting Acts. As the activities of external producers are not covered by this definition, Ofcom does not have any specific function with regard to employment and training in those organisation
- In terms of individual creators' rights, Ofcom supports the principle of fair dealing between programme makers and underlying rights holders. Ofcom has not, however, considered this issue specifically in the current review, since underlying rights issues sit outside of its regulatory remit. Therefore, whilst fair dealing is encouraged, Ofcom is not empowered to require such practice
- Moreover, Ofcom's regulatory remit does not cover films produced for non-TV distribution. Neither the Act nor any other legislative provision provides for Ofcom intervention in that sector. Therefore, whilst Ofcom notes the potential parallels between rights arrangements for TV and non-TV distribution, rights arrangements for feature films are beyond the scope of the current review.

Section 3

Definition of an independent producer

Ofcom's position in the TPSR Consultation

The current definition of a qualifying independent producer excludes those production businesses that share significant common ownership (a 25% or greater shareholding) with broadcasters. A number of options have been proposed for the introduction of supplementary conditions to this definition that, if met, would allow vertically integrated producers with common ownership above the 25% threshold to qualify as independent when commissioned by another broadcaster.

In reviewing these options, it is recognised that – while the current definition is not perfect – it does meet the objectives of creating a diversity of production without creating perverse incentives, and is also clear and practical.

In the TPSR Consultation, Ofcom did not reach a firm view on these issues, but expressed doubt that any of the proposed revisions are superior to the current definition. As part of the formal consultation on this issue, input was invited from stakeholders – supported by detailed argument and evidence – on whether, and if so how, it is possible for the benefits of any of the alternative options proposed to outweigh – or ideally avoid any – downsides, and on how the practical considerations might be addressed.

Ofcom stated that it would take account of comments received as part of the consultation, and would conclude in this policy statement whether to recommend change to Government. The definition of a qualifying independent is a matter of secondary legislation, and any change to the definition would require amendment to the existing Independent Production Order.

Relevant consultation questions

Question 18. Do you think it would be desirable to propose a change to the definition of a qualifying independent producer, and do you believe that change in this area could help to further the interests of viewers?

Question 19. If so, do you support any of the Options for change to the definition of a qualifying independent producer presented in this document? Are there any other options that Ofcom should consider? Please explain the basis for your views, taking account of the points made by Ofcom, and provide any supporting evidence.

- 3.1 A limited number of responses were received on this issue, a number of them confidential. A number of programme producers who are non-qualifying under the current independent definition argued that the diversity and plurality of production is adversely affected by their exclusion from competing for commissions within the independent production quota. The producers argued that their exclusion inhibits the meritocracy of programme commissioning to the detriment of the quality of programmes for viewers, as the number of competing suppliers for independent quota commissions is reduced.

- 3.2 Those producers contended that, if the independent production quota is in the main intended to counter the negative effects of vertical integration of production by ensuring that a proportion of commissions are sourced externally, than the current definition is disproportionate and poorly targeted. This is because only a few broadcasters have sufficient market power to commission in-house for reasons other than on merit; and that some other supposed in-house producers are vertically-integrated in name alone and have few or no operational or commercial links with their associated broadcaster. The producers argued that, where this is the case, provision should be made to allow such integrated producers to be able to compete fairly for independent commissions from other broadcasters.
- 3.3 A number of respondents also claimed that the current definition is contrary to the aims of increasing investment in programming for UK audiences because it limits the investment a producer can make in the equity of a broadcaster, or the investment an investor with a broadcast interest can make in a producer, if the producer is to hold qualifying independent status. Informally, certain producers referred to such indirect restrictions on investment opportunities, and gave examples of where the definition had affected investment decisions.
- 3.4 Ofcom's discussions with producers suggest that there has been some loss of investment by producers in a broadcaster:
- It has been indicated to Ofcom that producers would be interested in owning a majority stake in a channel that could be used to exploit both secondary rights and new programming
 - Current investments in broadcasting have been made in a way that does not jeopardise their independent status – these may well have been significantly greater, and included greater provision of original programming, if the definition facilitated this
 - The current definition is encouraging producers to investigate 'unlicensed' distribution of programming via new media rather than via broadcast channels.
- 3.5 The limitation on inward investment to an independent producer is a more tangible cost:
- The current definition has the effect of restricting the potential pool of either private equity or trade buyers of an equity stake in a producer. Private equity has been the most likely source of investment but it a) requires a sale of up to 100% of equity and b) is likely to be a specialist fund with potential broadcast interests, the combination of which is problematic under the existing definition
 - A number of producers stated that they have had to either abandon or cap (below 25%) the sale of an equity stake to an external investor due to the risk of losing qualifying status. This is at a time when sources of capital to producers are relatively scarce.
- 3.6 In short, a number of producers argued that a change to the current definition could potentially bring the benefits of an increased number of suppliers and investment in the UK production sector which the current definition would otherwise restrict.
- 3.7 As set out in the TPSR Consultation, Ofcom has considered whether these potential benefits could be realised by a change to the definition, that would be practical to implement and would also address the wider objectives noted by Ofcom in the TPSR Consultation.

- 3.8 The TPSR Consultation set out four possible options for a change to the definition. No option was suggested that would remove the restriction on common ownership between a UK broadcaster and qualifying independent producer entirely. Instead, all of the options were for a supplement to the current limitation on common ownership that, if the supplementary condition were met, would allow a producer with common ownership above the 25% limit to be a qualifying independent when producing for another broadcaster.
- 3.9 Broadly, a version of each of the options was proposed in responses. The options, and the version of each proposed, are summarised below:
- **Option 1:** Introducing a test of economic independence from the parent (or co-owned) broadcaster – so that a co-owned producer could qualify as an independent if only a small proportion of its revenue is sourced from the linked broadcaster
Proposal: that the test of independence would be via a ‘double-lock’ under which the proportion represented by the producer’s commissions from the broadcaster and the producer’s share of the broadcaster’s total commissions did not exceed a defined threshold. The threshold was suggested to be either 10% or 0% of commissions
 - **Option 2:** Changing the restriction on ownership – so that a co-owned producer could qualify as an independent when supplying programming to any broadcaster other than the one with which ownership is shared
Proposal: that the restriction on ownership could be changed so that it does not apply to either the production arms of the non-ITV plc Channel 3 licensees or, in a further proposal, to any vertically integrated producer when supplying programmes to any broadcaster other than the parent
 - **Option 3:** Revising the definitions of relevant broadcasters – such that the ownership restriction only applies to, for example, English language or designated public service broadcasters
Proposal: to exclude non-PSB broadcasters, allowing production companies with common ownership with non-PSB broadcasters to qualify as independent
 - **Option 4:** Introducing a size dimension to the qualifying definition – so that a producer with significant common ownership with a broadcaster could still meet the qualifying definition, provided that the broadcaster or production business concerned falls below a pre-defined size threshold
Proposal: that the size dimension would be based on an individual or group of commonly owned channels having less than a defined share of audience in all UK households. The share of audience was suggested to be less than 0.75% for a single channel, or less than 2% for a group of commonly owned channels.
- 3.10 In setting out the alternative options in the TPSR Consultation, Ofcom’s assessment was that it would only be sensible to revise the current definition if one of the options appeared superior to it in meeting its objectives, namely:
- Ensuring a diversity of production
 - Mitigating against the potential problems associated with vertical integration
 - Being consistent and readily applicable across the industry
 - Being practical to implement now and in the future.

- 3.11 Ofcom has reviewed the proposals made in the consultation responses in order to assess whether they would meet each of the four objectives. A summary of Ofcom's assessment is set out in the table below.

	Proposal variation	Increase diversity of programme supply to viewers	Mitigating negative effects of vertical integration	Consistent and readily applicable	Practical to implement
Option 1 Economic independence of producer	Double-lock with 10% threshold	?	✓	✓	✓
	Double-lock with 0% threshold	?	✓	✓	✓
Option 2 Change definition of ownership	All producers qualify as independent to other broadcasters	✗	✗	✓	✓
	Channel 3 producers qualify as independent to other broadcasters	✗	✗	✗	✗
Option 3 Restrict applicable broadcasters	Exempt non-PSB channels	✓	✗	✓	✓
Option 4 Introduce size dimension	Exempt channels with audience share of less than 2%	✓	✗	✓	✗

- 3.12 Of the proposals made, Ofcom considers that Options 2, 3 and 4 do not meet the objectives set out for, and are therefore inferior to the current definition.
- 3.13 Option 2 – changing the restriction on ownership – does not meet the objectives for a change to the definition. An exemption for the Channel 3 licensees alone is not only inconsistent and not applicable to the industry as a whole, but would not increase the diversity of programme suppliers beyond the few organisations involved. The further proposal – that all producers should be independent when producing externally – is more consistent and applicable. However, it is likely to impair the diversity of supply to broadcasters and incentivise vertical integration as it allows large integrated producers to account for a high share of both in-house and other broadcaster commissions.
- 3.14 Option 3 – restricting the applicable broadcasters to the public sector broadcasters – would be consistent and practical to implement. However, it would not address the negative effects of vertical integration in respect of a broadcaster who, though not a PSB, may either now or in the future have a significant share of audience or of the market for programmes. Additionally, this could also create perverse incentives for PSBs with production arms and an interest in supplying other broadcasters to move away from PSB status.
- 3.15 Option 4 – introducing a size dimension based on audience share – would potentially increase the diversity of suppliers by allowing producers integrated with broadcasters with little share of audience to compete for independent commissions on other channels. However, as with Option 3, it may incentivise exempted channels to commission mainly in-house while also supplying other channels. Even though, by definition, such channels account for small share of total audience they may be the leader in a niche genre or market where it remains beneficial to the viewer to have a diversity of programme supply. Additionally, a size dimension based on audience

share is likely to be problematic to set, require regular review and lead to producers involuntarily changing status year-on-year as audience viewing fragments across both channels and platforms.

- 3.16 In contrast, Ofcom considers that Option 1 – the double-lock proposal – has more merit. It is the only option that may mitigate against vertical integration by creating incentives for a commonly owned broadcaster and producer to commission below a certain proportion of output from each other which ensures that a diversity of supply is maintained in programming. Low thresholds would be required to achieve this without incurring the negative effects of the other Options; however, zero thresholds would force a complete separation of programme broadcasting and production that could nullify some of the possible benefits of a change to the definition. Once established, the thresholds would then be consistent and applicable to all producers who wanted to achieve qualifying status.
- 3.17 However, on the balance of the current evidence, Ofcom is concerned that the double-lock proposal may not increase the diversity of programme supply. In the longer term, the proposal would enable some integrated producers, who would be able to draw on considerable resources and industry expertise, to compete for independent commissions from rival broadcasters. However, it would also have the immediate effect of ‘qualifying’ any ongoing commissions from integrated producers for other broadcasters, possibly at the expense of commissions to existing independent producers under the quota. Additionally, in the current market circumstances, the existing definition creates access for the diverse output of the large number of small independent companies in place of the output of larger vertically-integrated producers.
- 3.18 These views were raised in the consultation responses, giving rise to differing conclusions. Some respondents considered increased competition from well-resourced producers as a positive benefit in the sector. However, several responses – from both producers and broadcasters – noted that the current definition has the effect of fostering diversity in the size and scale of producers, with a resulting diversity of the types of programming on screen. These respondents suggested that a change to the definition would in time reduce the number of commissioned producers overall, and would allow vertically-integrated broadcasters to source commissions from a combination of in-house and large integrated producers. They contended that neither outcome is in the interests of a diversity of programming for viewers.
- 3.19 Since the impact of the double-lock on diversity of programme supply is questionable, a clear understanding of the benefits and costs of this option is required. Based on the current market structure, Ofcom has analysed the possible impact of implementing the Option 1.

The impact of the double-lock on the diversity of programme supply

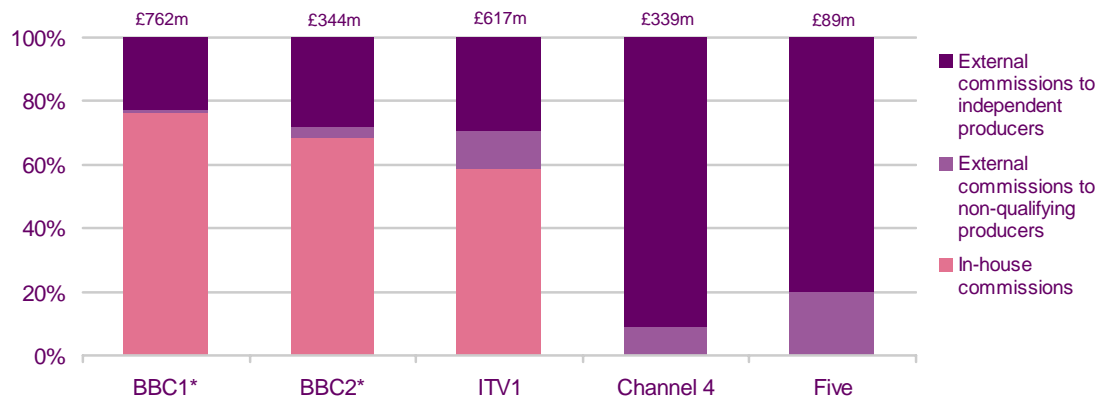
- 3.20 Ofcom’s analysis suggests that the implementation of the double-lock proposal would, in the immediate term, lead to relatively few vertically integrated producers qualifying as independent. A total of 26 UK broadcast channels reported any in-house production in 2005. In almost all cases, commissions from the parent broadcaster channel represent a very high proportion of both total turnover to the integrated producer and of the parent broadcaster’s total original programme expenditure. The majority of vertically integrated producers are commissioned only by their parent broadcaster and would not meet the proposed thresholds of the

double-lock, leading to few newly qualifying independent producers entering the market.

- 3.21 However, Ofcom considers that, in the longer term, a double-lock would act as an incentive for vertically integrated producers who want to qualify as independent to other broadcasters to reduce their dependency on in-house commissions which would lead to a greater number of producers competing for more external commissions. This could have beneficial impacts in terms of competition and diversity.
- 3.22 The double-lock proposal would also allow full equity investment, and limited programme commissions, between independent producers and companies with broadcast interests without the former losing qualifying independent status. This would remove a barrier to investment both into and by production companies that has been cited by some independent producers. However, the scale of such investment cannot be assumed, is dependent on a wider range of factors, and its material benefit to viewers is difficult to quantify.
- 3.23 Ofcom's analysis also suggests that the implementation of the double-lock proposal could, in the short term, have a confined but material impact on the market for independent commissions to UK producers.
- 3.24 The PSBs account for 87% of the value of commissions to UK producers. The chart below breaks down network commissions by the main terrestrial PSBs in 2005, showing the proportions going to in-house producers, to the vertically-integrated producers of other broadcasters (i.e. non-qualifying producers) and to qualifying independent producers.

Main terrestrial PSB channels – total network commissions

Proportion of total value of original commissions by channel 2005



Source: Data from broadcasters

- 3.25 The analysis suggests that, in the main, the independent production quota and associated definition have limited influence on commissioning decisions.
- 3.26 As highlighted in the TPSR Consultation, Channel 4 and Five, with no in-house production, commission independent producers in considerable excess of the 25% quota. While BBC commissions to independent producers are lower as a proportion of total commissions, its proposals for the WOCC are likely to open competition for

more commissions to all types of producers, both independent and non-qualifying. As previously noted, a change in status of some non-qualifying producers is unlikely to have any undue material influence on commissions by these channels to independent producers.

- 3.27 A change to the definition may, however, have a material impact on the diversity of suppliers to ITV1. Outside of the BBC, ITV1 is the largest source of programme commissions. It already commissions a substantial volume of programmes in-house, and its external supplier base is relatively consolidated compared with other PSBs. Non-qualifying external producers currently account for 10% of total commissions by ITV1. If the producers of some of these longstanding commissions were to qualify as independent, their programmes could account for close to half of the 25% independent quota for ITV1. It has been suggested that this may be at the expense of commissions to a number of smaller independent producers, resulting in a decrease in the diversity of suppliers to the channel.

Conclusion on whether to recommend a change to the definition

- 3.28 In summary, implementing the double-lock proposal may allow a small number of integrated producers to qualify to compete for independent commissions. Its main merit is that it may also in time facilitate greater investment in the UK production sector. However, it is not yet clear how significant these benefits will be, and the time horizon in which they will be delivered. Moreover, there is significant risk that these potential benefits would be at the expense of a near term adverse impact on the diversity of production overall, particularly in commissions by ITV1 to smaller independent producers.
- 3.29 There is therefore a lack of clear evidence – and indeed a lack of consensus within the industry – that the benefits of the double-lock proposal would outweigh the costs. Ofcom is therefore not yet persuaded that a change to the definition would prove superior to the current definition. As a result – while Ofcom recognises the merits of the case for change that has been made – it does not recommend a change to the definition to Government at this time.
- 3.30 However, Ofcom considers that the situation should be kept under review. This is for two principal reasons:
- Structural changes in the industry may well lead to more interest in shared ownership and operation of production and distribution of programmes across a number of platforms. If the current definition frustrates such investment, then clearer evidence of the need for change may well be forthcoming
 - As the market for programme commissions evolves, both the independent production quota and definition may well be of diminishing significance. This was suggested by a number of consultation responses, which highlighted the BBC's WOCC, the growth in programme commissions outside of the PSBs and the increasing fragmentation of and competition for audiences as key drivers of change. These are likely to mitigate the negotiating strength of particular broadcasters and increase the strength and stature of independent producers with valuable programming. Under this scenario, the importance and effectiveness of intervention in creating diversity of suppliers will be reduced. A further review of intervention in this area may therefore be appropriate.

- 3.31 As such, Ofcom believes that stronger arguments may arise in favour of a change to the definition in the future, if clearer evidence of the benefits of change (or of the disbenefits of the current definition) emerges. Ofcom therefore proposes that this issue is considered again during the next PSB Review, or earlier if clearer evidence emerges.

Section 4

The Codes of Practice and new media rights

- 4.1 The last major policy issue covered by the TPSR Consultation related to the Codes of Practice in general, and the exploitation of new media rights specifically. This section summarises consultation responses on these issues, and also provides an update on developments since the completion of the consultation. Ofcom does not seek to draw policy conclusions in this section as, due to the industry parties' progress in reaching agreement on Heads of Terms to address new media rights issues, Ofcom does not consider that there is a need for it to intervene to resolve this issue at this time. However, as noted at the end of this section, Ofcom will have a role to play in approving the public service broadcasters' revised Codes of Practice, and it is likely that also it will need to revise its Guidance on the Codes of Practice in order to reflect the changes to the Codes required to deal with new media rights issues. In the context of a consultation on revised Guidance, Ofcom may therefore need to consider some of the issues raised in the responses to the TPSR Consultation.
- 4.2 The respondents who commented in detail on the new media rights issues fell into six basic groups: independent producers (e.g. PACT and a number of individual producers); the BBC; the commercial PSBs; other commercial broadcasters (e.g. the Satellite and Cable Broadcasters Group (SCBG)); "new entrants" such as new media platform operators, and mobile operators. Other respondents commented on the rights issues set out in the TPSR Consultation, but typically not in such detail (e.g. the Film Council and Bectu).
- 4.3 A number of the submissions (e.g. from PACT and the BBC) were made on a non-confidential basis, and can be found on the Ofcom website. However, many of the other submissions were marked confidential, and only a limited number of non-confidential versions were made available. This has restricted Ofcom's ability to report the views of specific respondents or to use data they have provided because of the risk of revealing the identity of the respondent and/or confidential information. However, since the perspectives of the different stakeholder groups were significantly different on a range of issues, for clarity Ofcom has included respondents' names wherever possible in this section of the statement.

Broadcaster/Producer negotiations

- 4.4 Ofcom also notes that responses to the TPSR Consultation were received at the end of March/early April, while negotiations between producers and PSBs on new media rights issues were at a relatively early stage and were still ongoing. Those submissions therefore reflected the positions of producers and PSBs at that point in time. In a number of cases respondents made the point that their ability to comment was constrained by the fact that the negotiations were still in progress.
- 4.5 During the consultation period, Ofcom also sought to facilitate industry discussion as part of the consultation process by organising roundtable discussions for key players with an interest in new media rights issues – namely the PSBs, multichannel broadcasters and new media operators. These roundtables discussed the key issues

around the exploitation of television content on new media platforms. Ofcom feels that these discussions were useful in raising awareness and identifying issues outside the context of a formal negotiation – but, as these roundtables were conducted under the “Chatham House” rule, the discussions are not reported here.

- 4.6 Subsequently, negotiations between the different parties moved on and agreements on Heads of Terms were reached between PACT and the BBC, ITV and Channel 4 in the early part of the summer. At the time of writing, negotiations between PACT and Five are still ongoing. In the course of those negotiations, the parties may have modified and developed their negotiating stance so that the positions which are reported below do not necessarily reflect the final outcome of the negotiations. Similarly, comments from third parties are based on their understanding of how the negotiations were progressing at a point in time.
- 4.7 In light of the developments since the consultation responses were received, and the fact that negotiations did result in Heads of Terms between the PSBs and PACT, it does not seem sensible to place undue weight on the views that were expressed in response to the consultation. Ofcom has therefore noted the views of the PSBs and PACT in response to the consultation, but has not taken a policy stance in relation to those views.

Consultation Responses

Codes of Practice: Ofcom’s position in the TPSR Consultation

Based on discussions with industry stakeholders, Ofcom’s view was that the Codes of Practice (and the associated new Terms of Trade) were generally regarded as working well in relation to scheduled broadcast television: e.g. they had helped to shape more mature and professional relationships between broadcasters and producers and had helped to underpin growth in the sector.

There were, however, two areas where issues had been raised: the prices paid by broadcasters for programmes; and the distribution of TV programmes on alternative distribution platforms.

In respect of the prices by broadcasters, Ofcom had not found any *prima facie* evidence that broadcasters had systematically been reducing prices they paid for programming nor (where relevant) any evidence of broadcasters favouring in-house production. However, Ofcom stated that this was an area that it would keep under review.

In respect of new media rights, Ofcom did consider that greater clarity was required in relation to the position on rights exploitation and recognised that there was still considerable uncertainty about the development of this area. To that end the TPSR Consultation put forward a possible “windowing” approach that Ofcom might adopt if required to intervene but at the same time made it clear that the purpose of putting forward this proposal was to stimulate debate and to encourage the industry to resolve matters for itself through commercial negotiations.

Relevant consultation questions

Question 7. Do you agree with Ofcom’s assessment of the operation of the framework created by the new Codes of Practice – both in general terms and particularly in relation to prices and new media rights?

- 4.8 Responses from independent producers and PACT generally agreed that the Codes had brought significant change and opportunity to the external production sector and were helping to underpin growth in the sector. It was felt that the Codes had had the effect of stimulating investment in original production and encouraging competition and growth. For instance, PACT felt that the Codes were key in terms of creating an environment that encouraged risk-taking and that attracted and retained the best talent. PACT also felt that the Codes were important in relation to UK companies' ability to compete globally.
- 4.9 Similarly, the BBC believed that the Codes of Practice were working well and that they struck the right balance of value between the broadcaster and producer. The BBC also recognised that the existing framework required development to reflect the changing nature of the content forms and delivery. The commercial PSBs also commented that they felt that the Codes were working well.
- 4.10 The SCBG did express concerns about the operation of the Codes of Practice. They believed that the Codes had failed to stimulate a fair and competitive market for the secondary (non-primary) rights to exploitation of programmes in the UK. They argued that the use of holdback was the most problematic element in the current Codes and the chief concern was that this gave the PSBs the ability to warehouse programming or apply onerous terms to the waiving of the holdback. They also argued that the launch by PSBs of portfolios of digital channels had had the dual effect of restricting secondary channels' access to content originally commissioned by the PSBs and had also made PSBs reluctant to allow producers to raise co-production funding from the secondary channels. The SCBG argued that the potential for the secondary market to bring new finance to UK production had not yet been fully realised – they felt that it was too early in the life-cycle of commissions under the new Codes of Practice to make such judgements.
- 4.11 New entrants tended to agree that overall, the new Codes of Practice had had a highly beneficial impact on the content production sector. One respondent commented that they had helped the production sector professionalize and attract investment. As a result rights were more widely traded and, in most cases, the value of those rights was significantly more transparent. However, another respondent commented that the consultation focused unduly on the need to preserve and sustain the existing broadcast model rather than assessing how the regulatory framework could promote positive change in the market to secure its health in the longer-term. That respondent considered that Ofcom's review omitted to look at models in markets outside the UK which have shown this to be successful. It also argued that the review omitted a consideration of the potential benefits to UK producers and broadcasters of accessing the growing global audience for quality English-language content.
- 4.12 Another respondent also agreed with Ofcom's assessment of the operation of the framework created by the new Codes. It also commented that a failure to address new media issues would be likely to erode the goodwill that the Codes of Practice enjoyed.
- 4.13 Ofcom notes that the views expressed by the SCBG about the operation of the Codes of Practice appear to be at odds with most other respondents, including new media entrants. Ofcom is aware that as part of the process of implementing the Codes of Practice, PSBs have introduced specific policies in relation to the use of holdback where none had existed before and are looking to simplify the process for releasing rights to the secondary market. Against that background, Ofcom is not

proposing to take any action to address these concerns at this stage but will continue to monitor the situation as part of the regular monitoring of the operation of the Codes of Practice.

Pricing

- 4.14 In terms of the specific issue of pricing, PACT remained concerned that “netting off”¹¹ was taking place. It did accept that Ofcom had not been able to find prima facie evidence of this practice but urged Ofcom to collect sufficient data so as to be able to launch a detailed examination as soon as possible. It pointed to the 2006 *Broadcast Independent Survey* in which 68% of the top 150 independent producers (by turnover) said that they had experienced netting off. Individual producers also disagreed with Ofcom’s position in respect of pricing. One argued that there was very significant pressure by broadcasters on producers to reduce price at a time when broadcasters were also arguing that the scope of the primary licence should be extended to include more transmissions, cross-platform commissioning, on-demand rights etc. The respondent also argued that Ofcom was wrong to suggest that there was no need to index link the published tariff bands: although there might be some cost efficiencies from technical advances, the greatest influences on cost are high-end production techniques and talent costs.
- 4.15 A commercial PSB noted that Ofcom had not found any evidence of systematic price reductions. It went on to argue that because the Codes of Practice were limited to setting out the principles to be applied to independent commissions, it was not in fact the role of the Codes of Practice to dictate specific outcomes. The respondent also argued that it was not for the Codes to stipulate or constrain prices for commissions: prices paid by broadcasters would be determined by a range of factors such as: the cost of production; the rights being acquired; the slot intended for the programme; the overall financial position of the broadcaster. The respondent argued that broadcasters had to be prepared to pay the market rate for commissions otherwise the best content would go elsewhere. It cautioned that before considering “heavy-handed regulation” Ofcom needed to consider whether the particular issue would not be addressed more effectively via the operation of the market.
- 4.16 Ofcom recognises that the issue of pricing for the original commission is a sensitive one for both PSBs and producers but the representations that Ofcom has received have not caused Ofcom to change its views. The position set out in the TPSR Consultation therefore remains the same: namely that this is an area that Ofcom will keep under review through the monitoring requirements set out in broadcasters’ Codes of Practice.

New Media Issues

- 4.17 In terms of new media rights, PACT pointed out that the Ofcom guidelines for drawing up Codes of Practice called for a distinct set of primary rights that a broadcaster could acquire. However, in practice broadcasters had been seeking to bundle new media rights into the primary deal. PACT said that it accepted that, where a broadcaster has fully funded or paid most of the licence, it should be able to acquire limited propositions on other platforms in addition to exclusive transmission rights. PACT pointed out that, under the existing Codes, broadcasters could legitimately acquire further uses of the licensed programme from a producer in return for an additional payment. The concern was that broadcasters were seeking to bundle new media rights into the primary package rather than negotiate a market-

¹¹ PACT defines netting off as the situation where broadcasters pay less for programmes because independents benefit more from the rights in their programmes.

based value for each new media right: there was the concern that if “re-bundling” did occur, new media technologies would not be fully exploited.

- 4.18 One new entrant considered that the operation of the holdback had prevented new media rights from being traded in a meaningful way, and had therefore nullified the value of these rights and was holding back the development of the new media platforms. It proposed that the release of the holdback and clarification of the control of new media rights should be a central priority of Ofcom’s review. Another new entrant also considered that the key issue was control. If control of new media rights was vested with the party which had the greatest incentive to secure their long-term value, then the market would determine the price. Thus broadcasters could outbid new entrants and vice versa in a free and open process.
- 4.19 The mobile operators noted that the new media rights associated with television content on newer alternative platforms was an area that required clarity to enable provision of commercial services. The importance of access to compelling TV content was a point made by a number of the mobile operators: although in some cases, the operators would be looking to commission their own original content, this was not their core business and they needed to work closely with broadcasters to source existing content. Greater clarity and certainty on the use of alternative distribution platforms in the primary licence would be important for the development of the mobile TV market.

Ofcom’s objectives in developing proposals in relation to new media rights

Ofcom took as its starting point, the position that new media rights offered opportunities for both broadcasters and producers and that these opportunities could deliver significant benefits to viewers. With that in mind, Ofcom considered that its approach to developing proposals in relation to new media rights should:

- Be in keeping with the overall approach to the Codes of Practice, namely that rights resided with the producer unless sold to the broadcaster
- Not be considered in isolation from other rights in the primary licence
- Seek to provide greater clarity and certainty on the use of alternative distribution platforms in the primary licence, that should assist the development of the market
- Set a flexible framework that is platform and technology neutral – going forward, this should assist in the negotiation of rights and minimise the need for revisiting this issue
- Not distort the decision of a broadcaster to commission external producers
- Preserve the exclusivity in distribution required by broadcasters in the primary licence, while preserving the scope for secondary exploitation by producers and expanding it where possible
- Incentivise all parties to exploit new platforms and markets for distribution, rather than increasing either motives or means of restricting opportunities to develop new distribution mechanisms
- Further the interests of viewers by maintaining investment in and encouraging further exploitation of programmes and by protecting the value of content creation and legal distribution by the industry.

Relevant consultation questions

Question 8. What are your views on the objectives and range of options which Ofcom has set out to assist it in developing proposals in relation to new media rights?

- 4.20 PACT started from the principle that rights reside with the producer unless sold to the broadcaster. Against that background, PACT argued that PSBs should be able to acquire certain core rights as part of the primary licence but that there should be sufficient flexibility to allow producers to innovate and develop new ways of exploiting content. PACT endorsed the view that this was an opportunity to incentivise all parties to exploit new platforms and markets for distribution. Submissions from individual producers commented on specific issues: for instance, one respondent accepted that some holdback in favour of the broadcaster in relation to existing linear content on new platforms might be necessary although it did caution against too long a period. Another producer endorsed the principles set out by Ofcom but made the point that there was much detail to be resolved about the uses and revenue attached to uses of rights.
- 4.21 The BBC welcomed the objectives set out by Ofcom in relation to the treatment of new media rights, particularly in relation to achieving greater clarity, setting a flexible framework and incentivising all parties to exploit new opportunities in interests of viewers. One of the commercial PSBs also indicated that it “broadly agreed” with Ofcom’s objectives.
- 4.22 Responses from other commercial PSBs indicated that there was a concern that Ofcom had already prejudged the issue of new media rights and had come down against the broadcaster. The comment was that this would be a grossly premature outcome. One commercial PSB commented that, although in theory it had sympathy with Ofcom’s objective of setting a flexible framework that was platform and technology neutral, it did not believe that it was reasonable in practice to “future proof” the Codes of Practice in the way that Ofcom had suggested in the TPSR Consultation. It argued that different technologies have different business models that in turn require different treatments, and it was more appropriate to consider the specific and discrete arrangements that need to be devised in order to meet the challenges posed by new media rather than to re-think the Codes of Practice. The respondent felt that at the heart of this debate was a lack of clarity about whether revenues from new media exploitation of broadcast content represented additional income or whether they displace traditional broadcast income.
- 4.23 The SCBG agreed that concerns over PSBs’ negotiating strength provided a key reason for intervention. It argued that there was a need for the dominant position of incumbents to be regulated not only in relation to independent producers but also with a view to maintaining plurality in the rest of the broadcasting market. It argued that Ofcom had not made a sufficient distinction between incumbent broadcasters’ terrestrial channels – where regulatory intervention to support PSB roles and obligations was justified – and their digital channels which the SCBG characterised as purely commercial enterprises. The SCBG argued that free market access to programme rights after a reasonable primary window was paramount if independent channels were to keep investing in UK content. It was also concerned that UK PSBs did not appear to be prepared to consider co-production arrangements with other UK broadcasters.
- 4.24 A response from a platform operator identified clarity in respect of platform and technological neutrality and maintaining incentives to exploit content as key priorities.

- 4.25 Responses from new entrants supported Ofcom's objectives in dealing with the new media rights issue. However, there was the concern that considering new media rights in isolation from other rights in the primary licence ran the risk that the broadcast window/platform would be prioritised to the disadvantage of new media platforms. A concern was that viewers should have the opportunity to consume programming in the manner and on the platform they wish. It was argued that putting the focus on the preservation of existing funding models meant that Ofcom did not take into account the fact that these models exclude the substantial and much faster growing revenues accessible via new media.
- 4.26 One new entrant thought that Ofcom's proposed approach did not provide sufficient vision or prescription for the way in which funding models might evolve to cope with the clear and indisputable direction of change in technology and consumer demand. It advocated the separate trading of different platform rights because this would be the only way to ensure that the value of individual windows was determined in a transparent way and that broadcasters did not use their current negotiating strength to acquire rights they either did not need or did not intend to use other than to defend their competitive position against new entrants.
- 4.27 Another respondent commented that from its point of view, new media rights were now viewed as considerably more integral to primary rights than was previously the case. It argued that rights should be available to those best placed to exploit them and commented that producers had clear incentives to secure exploitation.
- 4.28 Bectu commented that there was no discussion over individual creators' rights although they did acknowledge that this had been identified as being outside the scope of Ofcom's review.

Scope for commercial resolution of new media rights issues

The TPSR Consultation made the suggestion that a move to a "windowing" approach could provide a framework for addressing new media rights issues.

However, Ofcom did not wish to be prescriptive on this issue – a windowing approach represented a possible framework within which parties could negotiate and agree specific contractual terms. Ofcom set broadcasters and producers the challenge at the end of the consultation period as to whether they expected to be able to resolve the issues around new media rights through commercial negotiation or whether intervention by Ofcom would be required.

Relevant consultation questions

Question 9. To what extent could new media rights issues be addressed through negotiation within a reasonable timeframe, without the need for intervention by Ofcom?

- 4.29 PACT and the PSBs all broadly agreed that their preference was for a negotiated commercial arrangement rather than intervention by Ofcom. However, a number of the commercial PSBs cautioned against intervention by Ofcom even if a negotiated settlement could not be arrived at.
- 4.30 The BBC considered that a negotiated settlement was the right way forward. Given the rapidity of change in audience behaviours and technology, the immaturity of the market for on-demand media and the paucity of data in relation to audience behaviour, regulatory intervention would risk being premature and disproportionate.

The BBC believed that Ofcom was right to urge broadcasters to reach agreement with independent producers: a negotiated settlement would deliver a fairer and more sustainable outcome than an imposed solution. The BBC also agreed that it was reasonable for different broadcasters to conclude different agreements depending on their circumstances: in the face of uncertainty, intervention needed to be flexible enough to adapt to change and should not try to prescribe a particular structure or set of arrangements in an emerging market.

- 4.31 One commercial PSB agreed that Ofcom was right to highlight the uncertainty surrounding the development of new media content: this meant that no-one in the market could be sure about the precise value competing and complementary new media products and services would command over coming years, or the extent to which they would substitute for linear viewing. This uncertainty also meant that Ofcom should adopt a bias against intervention.
- 4.32 Another commercial PSB made the point that it was in the interests of broadcasters and producers to aim for a temporary arrangement for the exploitation of TV content on new media platforms which would provide opportunities for new markets to develop, and for the parties to gain experience and revenue from them.
- 4.33 S4C stated that it had been able to work out a framework to address new media rights issues with TAC (the Welsh equivalent of PACT) on a commercial basis. The approach that had been agreed was effectively a time-based windowing system. S4C described their approach as a progressive.
- 4.34 A concern was expressed by other broadcasters and some of the new entrants and platform operators that that they were not party to the current negotiations and so it was difficult to have a view about the prospects for their success. The SCBG commented that it was important to have regard to the availability of UK content across the entire ecology of the broadcast sector and that Ofcom should bear in mind its duty to promote competition when it came to approving new Codes.
- 4.35 Another new entrant noted that, whilst Ofcom's market research showed that broadcasters remained the main source of financing of audiovisual content for the UK market and were likely to continue to be the primary source of financing for some time to come, the options outlined in the TPSR Consultation seemed largely focused on the need to sustain the current market structure rather than exploring variations on the status quo. In its view, some of the options outlined could only be achieved at the expense of growth in the new media sector which in turn suggested some discounting of Ofcom's duty to promote innovation and competition.

The introduction of a system based on a windowing concept

Based on discussions with the industry, the TPSR Consultation made the suggestion of a move to a "windowing" approach. Under this option, a windowing approach would consist of a "primary" window which would allow broadcaster to secure the simultaneous exploitation of a TV programme across a number of platforms for a specified period of time. There would then be a subsequent "holdback" window which would still provide a degree of protection for the broadcaster's exclusivity in respect of the first transmission of the programme but would be shorter than the current 5-year licence period to allow for secondary exploitation to take place sooner.

Relevant consultation questions

Question 10. What are your views on the principles of moving to a system based on a windowing concept – i.e. a system involving primary and holdback windows?

- 4.36 Independent producers were broadly supportive of this move, although one respondent commented that a “When, not where” approach was too simplistic a concept to be implemented as it stood: there were important issues of detail and implementation to be worked through. PACT itself expressed a concern that any holdback should be limited and argued that the prompt exploitation of rights was key to developing new markets.
- 4.37 The BBC broadly endorsed a windowing based framework although cautioned that there was the risk of an over simplistic interpretation of the “when, not where” principle. In terms of the value created by on-demand media and whether it was additional or substitutional to existing scheduled forms of consumption, the BBC had found little evidence to support the idea that on-demand viewing of full programmes on the home screen created additional value. However, it did recognise that other forms of new media consumption e.g. viewing of full programmes on mobile devices or permanently downloading clips or programmes to own, could create additional value. The BBC also pointed to the potential significance of PVRs in the future on-demand environment. The BBC argued that PVRs posed a clear challenge to the simplicity of a “when, not where” approach and the appropriateness of regulatory intervention targeted at on-demand services.
- 4.38 A commercial PSB also endorsed the principle of a windowing based framework, pointing out it had been a strong advocate of the principle of a move to a timed window approach. However, it did caution that the outcome of such a move was highly dependent on the detail of the implementation. Another commercial PSB expressed scepticism about the level of support within the industry for a time-based windowing system, and argued that it was uncomfortable with what it saw as the imposition of a technology-neutral solution.
- 4.39 Other commercial broadcasters considered that, whilst Ofcom’s proposals were a step in the right direction in achieving its goals, there was a risk that the proposals were overly prescriptive and did not go far enough in providing the parties with the flexibility necessary to encourage further investment and innovation.
- 4.40 The new entrants were more divided about the principle of a windowing system. A number recognised the importance of a primary window for broadcasters and noted that this would provide a sound basis for a framework for preserving value for PSBs and sustaining investment in UK-based production as the market evolved. A platform operator commented that a windowing approach had many positive aspects but that primary windows should apply to all platforms so that broadcasters should not be able to favour one platform over another.
- 4.41 However, there was general scepticism about the role of holdbacks: a number of respondents did not recognise any justification for a subsequent holdback applied to new media rights, including on-demand rights when the value of the rights could diminish rapidly. A respondent argued that PSBs should not be able to impose any restrictions on the way in which non-linear and VoD content was branded and marketed.
- 4.42 Respondents also argued that Ofcom should not permit any automatic bundling of new media rights with the present core rights package. A concern was expressed that holdbacks were against the viewer’s interest and motivated the consumer to find

ways to acquire programming in ways which deliver no value to the producer or the broadcaster (i.e. encouraged piracy).

- 4.43 The mobile operators argued that new media exploitation on mobile platforms complemented conventional scheduled broadcasting and indeed could even attract viewers to traditional programming. As such one respondent argued that new media rights should not be included in the primary licence that broadcasters purchase, nor should they be subject to a holdback period since this is not justified on the grounds that it may protect the broadcasters' investment in programming. One specific respondent reported that its research has found that customers want to watch television on the move – e.g. filling in spare time whilst travelling or over lunch breaks – in situations where they would not normally have access to television. Customers also want increased flexibility in terms of what they watch and when. On this basis it argued that content on mobile did not address the same market as traditional TV.
- 4.44 Respondents also referred to the European Commission's inquiry into the provision of sports content over 3G mobile networks in which the Commission concluded that a perceived threat to broadcasters by operators of new media services "does not seem to be substantiated". They referred to the Commission's finding that the two types of consumption of sports services had different demand characteristics, and were therefore not part of a single relevant market.
- 4.45 Another respondent broadly supported a windowing approach subject to an appropriate shortening of holdback periods. It argued that new media platforms would tend to promote a more intensive use of content. It referred to the film industry's use of windows to manage the rights chain and to preserve longevity in revenue streams.

Potential issues of implementation of a new windowing framework

Although Ofcom was only consulting on the principle of moving to a windowing approach, the TPSR Consultation identified a number of more detailed issues that were likely to be relevant to the implementation of a windowing approach. Ofcom set out a number of specific questions in relation to those issues in order to inform the discussion on how a windowing approach might be implemented.

Relevant consultation questions

Question 11. Do you agree with Ofcom's assessment of the main issues that are likely to be raised in relation to the implementation of such a framework? Specifically:

- Should there be an interplay between the duration of the primary and holdback windows? If so, what factors would determine this interplay?*
- How could repeats be treated within a windowing framework?*
- There is potentially a spectrum of Video on Demand (VoD) rights from free to air through to pay per view. The potential of VoD rights to affect existing viewing patterns (and therefore existing advertising-based funding models) differs across this spectrum. At the same time VoD rights represent a new potential source of revenue for both broadcaster and producer. How might this threat/opportunity trade-off best be managed within a windowing framework?*
- What options might be developed for allowing the early exploitation of re-purposed content while taking into account the legitimate concerns of broadcasters?*
- How might returning series be treated within this framework?*

The interplay between primary and the holdback windows

- 4.46 PACT's starting point was that it wanted to ensure the long-term future of broadcasters as major investors in UK content and as public services, but that this should not take place at the expense of the UK production sector and it should not allow broadcasters to take a protectionist approach to these issues. PACT therefore argued that rights should be available for commercial exploitation promptly after the initial transmission. If a broadcaster was seeking to control more rights as part of a primary licence, then there must be a quid pro quo in relation to restrictions on other means of exploiting programmes in the market. PACT had proposed that, in return for broadcasters having the right to offer a branded, wholly-owned commercial VoD service on any platform for an initial period from first transmission as part of the primary licence, holdbacks should be shorter and should be free from any restrictive approvals on the part of the broadcaster.
- 4.47 The BBC stated that it had already established a primary window of 7-days and did not anticipate the need to change the length of such a window at this stage. However, it did anticipate that audience expectations would be for the BBC to increase the *value* of the primary window to audiences. Thus, experience from its interactive Media Player (iMP) trial suggested that downloads themselves of programmes could be subject to a 7-day restriction but viewing of those downloads would then be time-limited only when the programme was first viewed i.e. the

programme could be downloaded for up to 7-days after first transmission but did not necessarily have to be viewed within that 7-day period as well. The 7-day viewing period would only start once the programme was opened and viewed for the first time and after the end of that 7-day viewing period the programme would no longer be accessible.

- 4.48 The BBC also argued that “series stacking” (i.e. all the episodes of a series being available on-demand during the duration of the series) should form part of the primary window. Data available to the BBC suggested that this would not undermine DVD sales: the BBC argued that DVD sales were not driven by a viewer desire to catch up – there was a separate and distinct desire among some consumers to own some content. The BBC went on to argue that it was possible that series stacking could contribute to later commercial DVD sales by increasing the number of views to a first transmission.
- 4.49 The BBC also argued that there was an important interplay between the licence period and holdback windows. The BBC believed that the current five year licence period was a key element in providing value for the licence fee payer but that it was beneficial for all parties to release commercial value in programmes during the exclusive licence period through use of an appropriate holdback policy. The BBC proposed making changes to its existing holdback arrangements to make commercial exploitation easier within the licence period, e.g. simplifying arrangements and having a consistent framework for linear and VoD holdback release.
- 4.50 Commercial PSBs welcomed Ofcom’s recognition that a “one size fits all approach might not be appropriate”. They all regarded the 7-day window that the BBC had secured as too short for their needs and argued that it should not set a precedent for commercial PSBs. In addition, some of them did not accept that there was an inverse relationship between the intensity of exploitation and the length of the holdback period in a fully digital world.
- 4.51 Other (non PSB) broadcasters considered that the holdback was an “anachronism” and urged Ofcom to resist any Terms of Trade agreements that did not significantly reduce or eliminate the holdback altogether.
- 4.52 New entrants were divided in their opinion. One respondent did not consider that a holdback was appropriate at all and so the issue of the interplay between primary and holdback period was not a relevant consideration. However, another noted that shortening of the period of exclusivity could affect the value of what broadcasters might be prepared to pay for the primary licence. However, at the same time a more open and transparent market for new media rights would ensure that those rights found their market value and market driven exploitation could then provide alternative revenue streams for producers to finance their productions.

The treatment of repeats within a windowing framework

- 4.53 PACT reported that it had proposed that, in addition to transmission packages negotiated as part of the primary window, all wholly-owned channels (and “plus one” channels) could acquire extra transmissions at the producer’s discretion and at a commercial price.
- 4.54 One of the commercial PSBs reported that it did not accept Ofcom’s suggestion that broadcasters might be content with a “non-exclusive repeat” after the start of the holdback period. It argued that the value of a broadcast repeat would be impacted by VoD exploitation – on whatever basis – within the licence term. It argued that repeats

played a crucial role in channel economics in a number of ways e.g. cost effectiveness; as a means of marketing new series; and attracting audiences in their own right. It also argued that, where there was release of the holdback, it should be able to share in the profits generated.

- 4.55 Another commercial PSB argued that Ofcom's proposal for a much shorter holdback period would mean that it would either have to repeat programmes very soon after first transmission in order to retain exclusivity for the repeats, or face the prospect that repeats of a programme would be non-exclusive because the secondary rights to the programme had been sold to another broadcaster which was then also broadcasting that programme. The commercial PSB argued that this could undermine their business model. However, it did not put forward any specific alternative proposals.
- 4.56 A new entrant commented that it did not consider that there was any implicit conflict between a free to air repeat and the availability of a programme on a paid-for on-demand service. Therefore, there was no reason why a programme should not be repeated on a free to air channel while being available on-demand.

VoD exploitation within a windowing framework

- 4.57 The issue of VoD exploitation was the aspect of the proposed windowing approach which generated the most comment from broadcasters and producers. With the exception of the BBC, producers and PSBs were agreed that a "free" catch-up window as postulated by Ofcom in the discussion of implementation issues around a windowing approach was likely to have a significant detrimental impact on "paid-for" exploitation, whether VoD or Download-to-Own (DTO). There was no consensus however, on whether and the extent to which, VoD might represent a substitute for either linear broadcasting or DVD use.
- 4.58 PACT argued that although producers owned the rights to the content they created, PACT was sympathetic to broadcasters having limited control over some of those rights. As referred to answers in earlier questions, PACT had proposed that broadcasters should be able to offer commercial (i.e. paid-for) VoD services on any platform for an initial period following first transmission. PACT was, however, concerned about the potential impact of any free download windows.
- 4.59 PACT argued that free downloads would harm income from paid for VoD services developed by producers. Consumer research commissioned by PACT from the market research company YouGov suggested that over half of respondents would be less likely to be interested in pay VoD if there were a free 7-day catch up service available, although the same research suggested that pay-VoD would not significantly damage audience for free-to-air channels. The same research also suggested that pay-VoD services would be likely to undermine DVD sales and to the take-up of pay-TV channels. Thus, independent production companies faced a potential decline in revenues from DVD sales and sales to secondary pay-TV channels, and this meant that producers needed to retain control over pay VoD rights as well as DVD and pay-TV rights in order to maximise value from exploitation across these markets.
- 4.60 In a separate response, an individual producer made the point that producers depended, to a significant extent, on revenue derived from secondary media sales e.g. TV distribution, DVD sales etc. The advent of free or heavily-discounted VoD services would have a detrimental impact on these secondary revenues. It believed

that VoD services should be commercially priced and that the producer should retain most of this income to balance out any potential losses from more traditional media. Another producer also stated that it was opposed to the concept of a free VoD service, even as part of a catch-up service. It argued that a broadcaster should be entitled to offer subscription and pay-per-view VoD as part of a branded service in an exclusive on-demand window. However, pay-to-own VoD should be controlled by the producer immediately after transmission on the grounds that it was analogous to DVD rights.

- 4.61 Two of the commercial PSBs also argued against the idea of a free to view catch-up window. One argued that recent US experience suggested that PPV or per download VoD around the primary transmission could offer a significant commercial opportunity for broadcasters. At the same time it was concerned that broadband homes in the UK with access to VoD represented the potential for mass substitution away from scheduled viewing to a much more significant degree than video/DVD. It questioned why a broadcaster would pay for a right to broadcast and repeat over a licence period if, within the same period, the producer was able to make the same content available to millions of homes on a free-to-view or pay basis, undermining broadcaster exclusivity. It also regarded any parallel between VoD exploitation in general and video/DVD rights as “profoundly misguided”. It argued that in fact in terms of: a means of distribution; funding; consumption; pricing; and retail experience, the two were completely different. It argued that VoD was likely to represent an impulse buy rather than a significant outlay for consumers and was also open to far greater control in terms of the viewing window right down to allowing only a single immediate viewing. It also commented that the content of DVDs was increasingly differentiated from the broadcast material e.g. in terms of “behind the scenes” footage.
- 4.62 Another commercial PSB agreed that the threat posed by VoD services to established business models was not clear. It suggested that the best way for this issue to be taken forward was to adopt an approach which meant that programming could not be exploited on a VoD service without the agreement of the broadcaster. In respect of the general exploitation of VoD, it argued that it made sense for broadcasters and producers to negotiate a temporary arrangement which would allow room for experimentation before concluding longer term arrangements once the shape of the VoD market became clearer.
- 4.63 In contrast, a number of respondents warned that if broadcasters sought to impose excessive holdback periods in a way that prevented exploitation through legitimate means there was significant risk that viewers would seek the content out through illegal means.
- 4.64 One of the new entrants suggested that the extent of rights acquired should be the subject of commercial negotiation on a project-by-project basis. It noted that the value of different levels of on-demand rights would change rapidly over time: as operators gain greater information about viewer demand; as viewer behaviour evolves; and as on-demand services are rolled out and build their subscriber bases. In its view there was no fixed way such a rapidly changing set of relationships could be captured except through individual commercial negotiation.
- 4.65 Another new entrant commented that Ofcom was wrong to assume that only a broadcaster would be interested in exploiting free VoD. It considered that there were a number of business models which could easily incorporate a free VoD service, including their own. Other types of VoD rights – e.g. subscription or PPV rights – had the potential to be exploited in a variety of ways in a new media business model. It

believed that control of these rights should rest with producers as they have the greatest incentive to agree commercial arrangements which maximise their value. It also argued that these services would not be substitutes for traditional linear broadcast services and were likely to attract a similar (but not identical) audience to DVD sales and therefore should be treated as such.

- 4.66 The response from the Film Council identified the absence of a generally agreed definition of VoD rights. It indicated that what was agreed in relation to television was likely to set a precedent for the film industry. In particular it warned against a situation in which incumbent platforms sought to encourage a form of “rights creep” in order to exclude new platform providers and to restrict the ability of content providers to benefit from licensing of rights to new platforms.

The exploitation of re-purposed content

- 4.67 PACT proposed that the producer should control the rights and exploitation of repurposed content from the first day of transmission. Broadcasters would be able to make use of repurposed content for promotional purposes, including preview clips.
- 4.68 An individual producer argued that developments in new media allowed for the creation of enriched format content or “extras”. Such content enriched and deepened the viewer’s expectation of a programme and should therefore strengthen rather than detract from linear programming. It considered it important that broadcasters’ terms of trade should be explicit that rights to exploit enriched content should lie exclusively with the producer.
- 4.69 The BBC argued that re-versioned and repurposed content were increasingly becoming integral parts of significant numbers of commissions and were designed to enhance and enrich the viewing experience. They were also potentially usable in other ways (e.g. DVD extracts). Because it was inherently linked to the programme, the BBC considered that the rights to such material should broadly follow the rights in the programme. However, the BBC did recognise that this was a complicated area and suggested that it was likely that there would have to be more individual discussions over particular projects as the market developed.
- 4.70 One of the commercial PSBs reported that it was unhappy with the term “repurposed” content because it covered a range of existing and potential services: the traditional (promotional and commercial) clips market; the nascent mobile market; and on-line applications. It believed that bespoke solutions might be appropriate for each and suggested that, if Ofcom’s main concern was with the emerging mobile market, then it would be better to deal with this specifically. Another commercial PSB raised concerns that uncontrolled use of this material had the potential to lead to brand confusion and dilution and could also in some cases substitute for linear viewing.
- 4.71 In its response a new entrant argued that broadcasters had legitimate concerns about the use of their brands and the value of any onscreen promotion. The extent to which these are relied upon would differ markedly from project to project, so it considered that these issues would need to be dealt with through individual commercial negotiation. It went on to propose that, at a more general level, it would be helpful if the terms of trade negotiated between producers and broadcasters set a default level for revenue share for re-purposed content which provided broadcasters with an adequate incentive to cooperate with this kind of exploitation. However, in general the principle that rights remain with the producer unless explicitly sold to the broadcaster should be retained.

- 4.72 Another new entrant supported Ofcom's proposal that all rights to re-purposed content should rest with the producer unless explicitly sold to the broadcaster. However, it did not support the idea of broadcasters preventing exploitation until after the primary window. In its view these rights had the most value in the primary window and the secondary market for this content was so limited as to make it commercially unviable. It proposed that there should not be any holdback for this category of rights.
- 4.73 Furthermore, it went on to note that it was important not to confuse repurposed content with new media content derived from format rights. The former generally related to extracts or edited versions of the original production re-packaged for a particular media (e.g. web or mobile). The latter was content produced wholly separately from (and in addition to) the original production (e.g. interviews, exclusive web clips, behind the scenes footage). It did not consider these types of content to be substitutes for scheduled broadcast services; rather, they could in fact deliver additional and complementary audiences.
- 4.74 One of the mobile operators argued that there needed to be consideration of the transaction costs and the relative bargaining positions of the relevant parties. Creating excessive transactions costs or placing the bargaining power all in the hands of one party would be likely to reduce the ability and incentives of all parties to invest in developing new platforms as well as potentially distorting competition. There needs to be a balance between all parties in the value chain (which becomes more complex in relation to new platforms) so that all parties have the incentive to increase output (choices and products for consumers). A solution needed to be found which ensured that commercial reward was available to those who are prepared to undertake the risk in terms of investment, but did not allow any individual party to hinder development of a particular proposition. If Ofcom confirmed the proposal in the consultation that the rights to re-purposed content should remain with the producer, then there still needed to be sufficient flexibility so that broadcasters could protect the value of their brand, but equally not block completely the use of such content on alternative platforms.

Returning Series

- 4.75 One independent producer argued that there should be no differentiation made by broadcasters in relation to holdbacks on secondary television or new media platforms when dealing with returning series. It felt that it would be against the spirit of the terms of trade for these valuable rights to be warehoused by broadcasters. It argued that there is no strong or coherent rationale from broadcasters to back up their desire to extend holdbacks over returning series.
- 4.76 Another independent producer argued that the holdback period could be extended so that the previous series was not released for non-exclusive exploitation by the producer until after the transmission of the last episode of the next series, subject to a re-commissioning decision having been taken within 3 months of the end of the previous series.
- 4.77 One of the commercial PSBs emphasised the importance of returning series as the foundation of modern broadcast channels in both economic and brand terms. As a result it looked to secure exclusivity over returning series. Another commercial PSB favoured the third alternative suggested by Ofcom – the one in which producers had to obtain the agreement of the commissioning broadcaster for the secondary sale of any series still under commission.

- 4.78 Another commercial PSB argued the only practical approach would be for the primary window to start from the transmission of the last episode. It argued that much of the new media value at such a point would still be derived from viewers seeking to catch up with previous episodes. There would also be issues around sponsorship and advertiser relationships. It went on to argue that, once the primary window had expired, the key issue was not the duration of the licence but rather the holdback release policy within that period. It proposed that it would develop a policy setting out the conditions for holdback release beyond its portfolio of channels after a two-year period from primary transmission. At the very least there would be an expectation that holdback would not be released for transmission by another terrestrial broadcaster.
- 4.79 A new entrant considered that as far as on-demand services are concerned, there is no need to treat returning series differently from any other type of programme.

Accommodating a windowing framework within the existing Codes of Practice/terms trade

In the TPSR Consultation Ofcom recognised the need to build on the existing Codes of Practice approach rather than undermining it. Given that the Codes of Practice were still bedding down, Ofcom did not want to have to change its existing guidance unless it was absolutely necessary. To that end Ofcom wanted to explore with broadcasters and producers the extent to which the principles of a windowing approach could be accommodated within the existing Codes of Practice/Terms of Trade framework without the need for significant revisions to Ofcom's guidance.

Relevant consultation questions

Question 12. To what extent could the principles of a “when, not where” approach be accommodated into the existing Codes of Practice/terms of trade framework?

- 4.80 PACT stated that it has been willing to adopt the “when, not where” approach in order to facilitate agreement. It thought that the framework under the existing Codes of Practice could be adapted to an extent, although it is vital to retain the underlying principles that the rights resided with the producer unless sold to the broadcaster, and that those rights were defined and separated.
- 4.81 One of the commercial broadcasters repeated that it was not convinced that a pure “when, not where” approach across all media was appropriate or necessary. A number of the commercial PSBs argued that it should be possible to accommodate new media platforms within existing Codes of Practice or terms of trade without all the other aspects of the terms of trade having to be renegotiated.
- 4.82 The new entrants were generally supportive of the principle of a “when not where” approach to exploiting the core package of rights in the primary window. However, their view was qualified by their perspective on what rights should constitute the core package; issues around extending the holdback period; and where control of the exploitation of new media rights should rest going forward.

Miscellaneous issues in relation to the Codes of Practice

Finally, Ofcom wanted to ensure that there was an opportunity for all interested parties to raise any issues that they felt were relevant in relation to the Codes of Practice to ensure that it was aware of all the main issues that were relevant to the consideration of the operation of the Codes.

Relevant consultation questions

Question 13. Are there any other aspects of the Codes of Practice which require further consideration by Ofcom?

- 4.83 There was general consensus among the responses that any commercial agreement on new media rights should be subject to review in two to three years time. Given the degree of uncertainty over the relative value of different sets of rights, there was a general desire on all sides of the debate to review the effect of agreements reached in 2006 and not to regard any new agreements as being set in stone.
- 4.84 Linked to this, PACT stated that it would be important for there to be a meaningful review in two to three years time, i.e. unless there was actual experience of trading these rights, any such review would be hampered by the lack of actual data about the market value of these rights.
- 4.85 Other parties commented that it was important that any agreement reached between broadcasters and producers should strike a balance between creating the right incentives and level of certainty to grow investment in UK production, and avoiding holding back market development. It was also important for Ofcom to be clear on how it would assess the success or otherwise of the agreement when it came up for review. The creation of a market mechanism for the exploitation of new media rights would have the benefit of providing robust and measurable data on which Ofcom could base its analysis.
- 4.86 A number of mobile operators commented that, given the current uncertainty over new media rights, it was often unclear to the buyer (and sometimes the licensor) who in fact owned the rights required in order to clear the content for new media exploitation. These responses argued that any new agreements on new media rights should aim to: provide clarity over the definition of different categories of rights; ensure a single point of contact for negotiations over clearing content to allow a reduction in transactions costs; and avoid warehousing of rights.

Subsequent Developments

- 4.87 As noted at the outset of this section, the PSBs and PACT sought to resolve the treatment of new media rights issues on a commercial basis, rather than to rely on a situation where Ofcom was required to intervene and impose a solution on the industry.
- 4.88 In fact, in early summer the BBC, ITV and Channel 4 all separately reached agreement on Heads of Terms with PACT. The agreements on Heads of Terms were the culmination of a period of intensive negotiations, and Ofcom acknowledges the hard work and resource that was committed by all sides to achieving this outcome. At the time of writing, negotiations between PACT and Five are still ongoing.

- 4.89 Following on from the agreements on Heads of Terms, Ofcom understands the parties have agreed that the next step is for the broadcasters to transcribe the principles set out in the Heads of Terms into long-form contractual amendments to their existing Terms of Trade. Once the amendments to the long-form agreements have been drafted they will be given to PACT for it to copy to its members for comment and agreement. Once PACT has confirmed its agreement to the new Terms of Trade then broadcasters and producers are keen to move ahead with implementing the new arrangements.
- 4.90 In order to accommodate the new Terms of Trade, Ofcom is conscious that there may be a need for some modifications to broadcasters' existing Codes of Practice. Ofcom further recognises that its existing Guidance on the Codes of Practice may also require amendment. Given the uncertainty at the time around the development of new media content, the existing guidance clearly states that new media rights are an issue which need to be kept under review. It was therefore anticipated that the guidance (and with it the Codes) might need to adapt in light of developments in the industry and Ofcom will seek to ensure that the guidance remains up to date in this regard.
- 4.91 In order to enable programmes to be commissioned under the new arrangements Ofcom anticipates that it may need to conduct a short consultation with the interested parties on changes to Ofcom's Guidance on Codes of Practice to broadcasters. In drawing up new guidance for consultation Ofcom will take into account the range of issues that have been raised in the course of this consultation process as far as it is able to within the requirements of section 285 of the Act. That short technical consultation is likely to be launched before the end of the year.
- 4.92 Once the guidance has been updated, broadcasters can then make any necessary changes to their Codes to bring them into line with the revised guidance and submit them to Ofcom for formal approval. As part of Ofcom's approval process Ofcom would need to take into account not just the requirements under section 285 of the Act but also its wider duties under section 3 of the Act. Those duties include furthering the interests of citizens in relation to communications matters and furthering the interests of consumers, where appropriate by promoting competition.
- 4.93 Given the agreement on new terms of trade, Ofcom would anticipate that the process of consulting on new guidance and updating Codes of Practice could largely run in parallel so that this process should not cause any unnecessary delay in implementing the new commercial arrangements.