



Review of the television production sector

Consultation document

Consultation

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Section 1

Executive summary

- 1.1 The UK television industry generates annual revenues in excess of £9bn, and spends almost £5bn on programming – of this, around £2.6bn represents spending on original programming. This means that UK television viewers enjoy one of the highest levels of domestically originated content in the world.
- 1.2 The £2.6bn spent by major UK channels on original programming in 2004 comprised over 27,000 hours of new programming, made by a television production sector with over 800 firms around the UK. The amount of original television production has grown at an average rate of 4% per year over the past five years, with production companies also benefiting from new opportunities overseas and on alternative distribution platforms.¹
- 1.3 Ofcom has been conducting a review of the television production sector², which has followed on from Ofcom's review of public service television broadcasting (the PSB Review) carried out in 2004/5.
- 1.4 This document summarises Ofcom's findings from the current review. We have set out the results of our analysis in full, with a view to developing the evidence base and informing debates in the industry. Whilst we find that there is no requirement for major revisions to intervention in the television production sector, we have set out options for change in some important areas. Alongside our proposed options for change, this document sets out a number of questions for consultation.
- 1.5 We now enter a period of formal consultation, which concludes on 21 March 2006. During this period, we welcome stakeholders' views on the issues and options discussed in this consultation document. Following this deadline, we expect to issue a final policy statement in the spring of 2006. Further implementation work may need to follow this review – for instance in relation to the Codes of Practice governing the relationships between the main terrestrial broadcasters and independent producers. Any potential changes to the Codes could require a further consultation exercise with stakeholders, relating specifically to updating Ofcom's guidance on the Codes of Practice. Moreover, if Ofcom recommends a change to the definition of a qualifying independent producer, this issue would be taken forward by Government.

The purpose of this review

- 1.6 This review concerns the key aspects of the television production sector, which comprises programme-making activity both within the main broadcasters (in-house production) and outside (external production – qualifying and non-qualifying independent producers³). We seek to explore the key developments in the sector,

¹ The data in paragraphs 1.1 and 1.2 is drawn from Ofcom research conducted as part of the review of public service television broadcasting, for the Communications Market 2005 report, and for the current review.

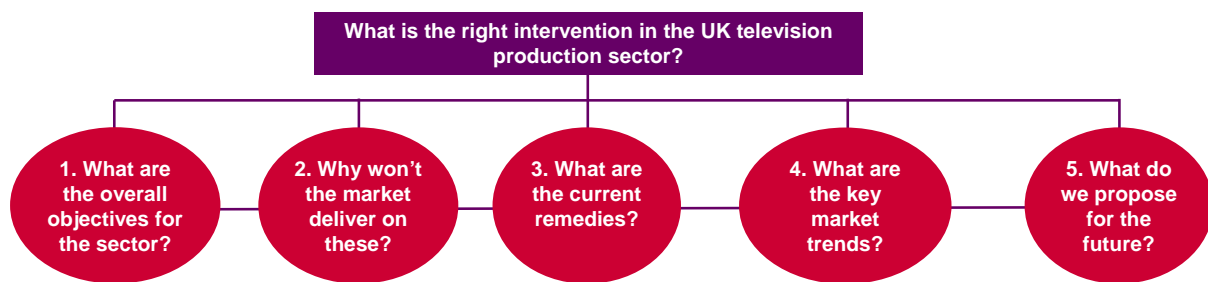
² It should be noted that film production is outside the scope of this review. As noted in the terms of reference for this review, published on 11 May 2005, Ofcom does not have powers to intervene in relation to film production.

³ In this document, we use 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. We use the terms "independent producer" and "independent production" where we need to make reference solely to qualifying independent producers.

and how the interests of television viewers – as both consumers and UK citizens – are met by the industry. Our particular focus is on the key production quotas, the operation of the commissioning system between producers and broadcasters, and the Codes of Practice.

- 1.7 The last major review of the sector was the Programme Supply Review, conducted by the Independent Television Commission (ITC) in 2002. As well as reviewing existing quotas, the ITC's review recommended that Codes of Practice should be put in place between independent producers and the main terrestrial channels – who are licensed public service channels under the terms of the Communications Act 2003 ("The Act"). These recommendations were subsequently incorporated into the Act, and the Codes have since been implemented by the broadcasters based on guidance from Ofcom.
- 1.8 The timing of the current review is therefore driven in part by a need to conduct an initial assessment of the operation of the new Codes. However, Ofcom is also using this opportunity to carry out a more comprehensive review of the overall set of interventions in the production sector.
- 1.9 Ofcom's general duties are set out in Section 3 of the Act, and these provide us with overall guidance in carrying out this review. However, we also have important duties relating specifically to the television production sector, as set out in Chapter 4 of the Act:
- **Section 285 Code for programme commissioning** by the main terrestrial broadcasters. This relates to the commissioning by licensed public service channels from independent producers, and focuses on the principles under which commissions are agreed upon
 - **Section 277 Programming quotas for independent production** requires Ofcom to set quotas for the proportion of independent television production commissioned by licensed public service channels, and **Section 309 Quotas for independent programmes** applies in a similar way to digital television programme services which are not comprised in a licensed public service channel
 - **Section 295 Involvement of C4 Corporation in programme-making** relates to Channel 4's model as a publisher-broadcaster
 - **Section 286 Regional programme-making for Channel 3⁴ and 5** and **Section 288 Regional programme-making for Channel 4** relate among other things to the proportion of programmes commissioned by these channels made outside of the M25 area.
- 1.10 Therefore, whilst we seek to take a broad perspective in carrying out this review, we are necessarily focused on carrying out our duties under the Act – as they apply in general and specific terms to the television production sector.
- 1.11 Figure 1.1 below summarises the framework that we have adopted for this review.

⁴ The term "Channel 3" refers to the licences currently held by ITV plc, SMG plc and Ulster Television plc. We also use the term "ITV1" to refer to the services broadcast under the terms of the Channel 3 licences.

Figure 1.1: Ofcom's approach to the television production sector review

1.12 Our overarching goal is therefore to define the appropriate extent and nature of intervention in the television production sector, taking into account our duties under the Act. This requires us to give consideration to a number of specific issues:

- The objectives that, if met, would enable us to conclude that the production sector is operating effectively
- The rationale for intervention in the sector – i.e. the factors that could mean that the objectives are left unfulfilled – and the specific interventions that have arisen in response
- The key developments in the market – both over the recent past, and in looking to the future
- The implications for intervention going forward – both for the overall rationale, and for the specific policy areas.

1.13 The rest of this section considers each of these issues in turn.

The objectives of television production

1.14 Ofcom's starting point in this review is the interest of viewers. However, it is important to be clear what we mean by viewers. We see two perspectives:

- 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.

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

1.16 In our view, if the interests of viewers as both consumers and UK citizens are met by the programming output they see on their television screens, then we can conclude that the television production sector is fulfilling its purpose.

1.17 This approach requires us to define what types of content viewers expect:

- 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 we are 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 – our 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
- 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; and
 - diversity of commissioning within channels.

1.18 The Act obliges Ofcom to consider measures to ensure that certain aspects of diversity are reflected in the commissioning practices of broadcasters, and therefore within the structure of the television production sector as a whole. For example:

- Diversity of production suppliers in terms of in-house or external producers accords with Sections 277 and 309 of the Act (described above)
- Diversity of UK perspectives accords with Sections 286 and Sections 288 (described above) relating to the location of production.

1.19 It is important to note that we do not seek diversity, in its variety of forms, for its own sake. Rather, we are 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, our objectives are not to further industrial policy goals, although we recognise that some existing policy tools may have developed in response to industrial policy concerns. We believe that diversity in production is a means to the end of meeting the needs and interests of viewers.

1.20 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.

1.21 Thus, whilst we believe in general that the production sector should function in such a way as to ensure that diversity is delivered, we recognise that too much emphasis on promoting diversity in the production sector could ultimately act against viewer interests. A delicate balance needs to be struck.

Intervention in the television production sector

- 1.22 Television is considered an important industry in the UK – from the perspective of fostering investment in creativity and creative talent, and given its significance as a medium of popular entertainment, provider of information and its overall influence within society as a whole.
- 1.23 In this context, a number of different interventions in the sector have been developed. It is therefore important to consider whether the sector – in the absence of intervention – would deliver on the interests of viewers.
- 1.24 In the PSB Review, we explained that this outcome may not arise in the UK television sector. It is often the case that markets routinely provide products that meet the requirements of consumers. However, the television sector has a limited number of free-to-air channels – each with their own different broadcasting objectives. This means that competition is not entirely effective – and so the main terrestrial channels may not deliver on viewers' interests if left unregulated. This has important implications both at the broadcast and production levels.
- 1.25 We also established that – even if a competitive television market provided all the programming that consumers desired and were willing to pay for – it would probably not offer sufficient programmes that are valued by society as a whole or, in other words, by viewers as UK citizens. In the PSB Review, we explored the areas in which the market may under-deliver on particular public service objectives – for which PSB obligations on broadcasters should in the first instance act as a sufficient remedy.
- 1.26 However, these features of the TV sector as a whole also have implications at the production level. 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.
- 1.27 These factors have given rise to a number of different interventions in the television production sector, in addition to the interventions at the broadcasting level. The presumption is that the effects of interventions at the production level will ultimately find their way through to viewers.
- 1.28 In order to address concerns over the strong negotiating position of broadcasters, Section 285 of the Act sets out a requirement for each public service broadcaster to introduce new **Codes of Practice** to govern the relationships between broadcasters and independent producers. The new Codes, which were introduced in 2004, sought to set a transparent basis for commissioning deals to mitigate the exercise of broadcasters' negotiating strength. Ofcom is obliged to approve the Codes, and provide guidance on their development or amendment.
- 1.29 In order to address concerns over vertical integration:
- Channel 4 was established on a **publisher-broadcaster** model (i.e. without any in-house production capacity) – and, under the terms of Section 295 of the Act, Ofcom must approve any change to this model
 - Under Section 277 of the Act, each of the main terrestrial broadcasters must fulfil a quota requiring them to commission at least 25 percent of their content from independent producers – this is the **statutory independent production quota**
 - Definitions of **qualifying independent producers** have been put in place by the Secretary of State – in order to exclude those production companies that share significant common ownership with broadcasters.
- 1.30 In order to address concerns over geographic concentration:
- Under Sections 286 and 288 of the Act, and through the approach to Tier 2 regulation of the BBC, the main terrestrial broadcasters must deliver what Ofcom considers to be a suitable proportion of programmes made outside London – defined as **quotas for production outside London** – as well as a suitable range of production centres. For the BBC this is currently 30%, for Channel 3 50%, for C4 30% and for Five 10% of production
 - These quotas are supported by Ofcom's **definitions of out of London productions**. New definitions were put in place in 2004 to help ensure that out of London (OOL) production makes a significant contribution to diversity of supply.
- 1.31 A key question for the current review therefore concerns the extent to which these interventions are effective, and whether they remain necessary for the future.

Market developments

- 1.32 In order to ensure that our approach to policy proposals is robust, we have developed a strong evidence base regarding the television production sector –

collecting data from both broadcasters and producers. Our analysis amounts to the first comprehensive statistical assessment of the sector ever assembled in the UK.

- 1.33 In relation to the production sector as a whole, and the importance of vertical integration, our 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.
- 1.34 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 our 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.
- 1.35 Our analysis also focused specifically on understanding the position with regard to production outside London. On this issue, our 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.

1.36 In summary, our 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.

The implications for intervention in the future

1.37 We have also conducted forward-looking market analysis, in order to assess how the market might evolve in the future – and how the rationale for intervention may be affected. In particular, our analysis has focused on three sets of issues:

- What are the likely future trends in sources of demand for external production?
- How is the number and size of external production companies likely to evolve?
- What is the future outlook for production out of London?

1.38 We have found that the production sector is evolving rapidly – external producers are becoming increasingly mature, and new sources of demand are emerging. Our discussions with industry stakeholders have suggested optimism regarding the prospects for external production companies.

1.39 Overall, our analysis suggests 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 we have 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”. We do not believe that this is a cause for concern – such producers are likely to bring to bear the benefits of scale and commercial experience. However, while we expect entry barriers to remain low, we recognise that Ofcom 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. We have analysed the factors that would be required to create sustainable production clusters outside London – and our 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.

- 1.40 Overall, this means 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, we believe that intervention to secure out of London production will continue to be required.

Our key policy proposals and propositions

- 1.41 Ofcom has set itself the aim of being a light touch regulator, meaning that it will seek to take a deregulatory approach where appropriate. However, where a need for regulation is identified, Ofcom will seek to focus firmly on the underlying causes of concern.
- 1.42 We believe that there remains a rationale for intervention in the television production sector – negotiating strength, vertical integration and geographic concentration remain significant issues. This conclusion gives rise to a number of specific policy considerations, on which we have developed proposals and propositions for consultation.

The Codes of Practice

- 1.43 Our view – through discussions with independent producers and other industry participants – is that the Codes of Practice (and the associated new terms of trade) are generally regarded as working well in relation to scheduled broadcast television. They have been described as instrumental in shaping a more mature industry, and in introducing more constructive and professional relationships between broadcasters and producers. It is also felt that the new environment will make production companies more attractive to investors. As such, the Codes have helped to underpin growth in the sector.
- 1.44 There are, however, two main areas in which we have been asked to provide more clarity, and a possible regulatory response:
- **The prices paid by broadcasters for programming**
Concern has been expressed about budgets and prices paid by broadcasters for programming. Ofcom has received a number of representations that suggest that budgets have been frozen or reduced
 - **The distribution of TV programmes on alternative distribution platforms**
We have been asked to clarify the position regarding the rights for cross-platform distribution and exploitation of content originally commissioned for television

broadcast – both broadcasters and producers have told us that this issue has not been suitably resolved by the new Codes and the terms of trade. It is important to note that we have not been asked to intervene in the market for content generated specifically for new media platforms. Hence, our specific focus is on the distribution of TV programmes and programme content.

- 1.45 In respect of the prices paid by broadcasters for programming, we have examined this issue through data provided by broadcasters as part of the annual reporting requirements of the Codes of Practice. Using data for commissions in 2004, we have explored a number of different aspects of pricing: whether the prices paid by broadcasters were in line with their indicative tariff ranges; whether broadcasters were commissioning a range of programmes within those indicative tariff ranges; the prices paid for commissions from independent producers relative to prices paid to in-house production; and prices paid for returning series. We have not found any *prima facie* evidence that broadcasters have systematically been reducing the prices paid for programming, nor have we found any evidence that broadcasters are systematically favouring in-house production over external production. Rather, the evidence provided to Ofcom suggests that independent commissions are priced across the tariff range and that, where relevant, there is no obvious discrimination between in-house and external producers.
- 1.46 We recognise that this data represents a snapshot of the industry in the first year of the operation of the Codes of Practice. We therefore propose to keep the situation under review as part of the regular monitoring of the operation of the Codes of Practice – but we do not propose to take any action at this point in time.
- 1.47 We do recognise that there may be an argument for tariff ranges to be reviewed to reflect cost inflation. But, at the same time, efficiency considerations may suggest that cost savings should be sought rather than simply increasing tariff ranges in line with inflation. Over time, it is normal to expect prices to change to take account of changing market conditions. The matter of programme-specific pricing is a matter for commercial negotiation between broadcasters and producers, and not on an individual basis an issue for Ofcom.
- 1.48 In relation to the distribution of television programmes on alternative distribution platforms, we agree with industry stakeholders that more clarity is needed on the rights position. In attempting to deliver this clarity, we do not seek to propose a prescriptive solution to this issue. We believe that the detail of any solution should be a matter for commercial negotiation between broadcasters and producers, rather than a matter for regulatory intervention – the latter risks being pre-emptive, and the definition of specific terms is also outside the scope of Ofcom's powers.
- 1.49 Moreover, we recognise that the Codes of Practice are still bedding down, and that it would not be desirable to change the existing Codes of Practice guidance unless absolutely necessary. There is already much uncertainty around new media rights – our concern is that an early change to the guidance would delay resolution of these issues into 2007, and could reopen broader debates between broadcasters and producers. As such, our strong preference is for the industry to resolve these issues by negotiation – without the need for intervention by Ofcom. However, if a negotiated solution is not found within a reasonable timeframe, we will have little choice but to intervene.
- 1.50 In order to assist in the process of securing a negotiated solution, this document sets out a possible approach that Ofcom might adopt were it required to intervene – by

setting out this possible approach, our intention is to assist industry stakeholders by stimulating debate. We note that, as platforms and types of rights proliferate, a possible approach might involve a new definition of rights windows based on time, rather than platform. We seek views and reactions to this approach during the consultation period.

- 1.51 The option presented in this document suggests a new approach, which could involve two main rights windows:
- A “primary” window in which the rights acquired by a public service broadcaster apply across any distribution platform; across any wholly-owned channel; for a specified duration; and for free-to-view UK distribution
 - A subsequent “holdback”⁵ period in which the broadcaster is able to apply a restriction in relation to the subsequent exploitation of rights by the producer. This restriction could be shorter than the current five-year holdback that forms part of the current primary licence; this could involve holdback against the transmission of the whole or any part of the programme on a scheduled broadcast service in the UK; and the broadcaster could retain an option to extend the holdback period on further payment.
- 1.52 At the end of the holdback period, the ability to control exploitation of the programme would then revert to the producer.
- 1.53 Ofcom considers the above approach to represent a potential framework for negotiation between broadcasters and producers – allowing the negotiating parties to define and agree the specific contractual terms. We emphasise, however, that these are initial thoughts that we now put to consultation – we are consulting on the principle of moving to a windowing system, and on the practical issues that may arise. We also raise a question about the extent to which the principles of a time-based approach might be incorporated into the existing Codes of Practice framework.
- 1.54 In terms of the nature of this discussion, and the process for taking these issues forward if necessary, it is important to be clear about the following:
- We do not seek to present a prescriptive ruling or decision in this document – but an outline approach for consultation. We will consider the consultation responses on this issue, following which we will set out our conclusions in our policy statement in 2006
 - Specifically, we expect industry stakeholders to inform Ofcom by the end of the consultation period whether they expect to resolve these issues through commercial negotiation – so intervention by Ofcom would not be needed. We would also expect stakeholders to define a reasonable timetable within which these issues will be resolved
 - If, by the end of the consultation period, it is clear that the industry is unable to agree that these issues can be successfully resolved, Ofcom will have little choice but to conclude in its policy statement that intervention will be needed through changes to the Codes of Practice. Under this outcome, a separate process will then need to follow
 - Specifically, before the Codes could be changed, Ofcom would need to issue new Codes of Practice guidance. Ofcom would therefore need to run a separate and

⁵ “Holdback” is the right of a broadcaster to prevent a producer exploiting secondary rights within a fixed period of time.

additional consultation process with stakeholders on any proposed changes to the guidance. Moreover, we highlight that Ofcom's guidance will only contain general guidance – we will not dictate specific terms. If required, we envisage that the initiation of this separate process could coincide with the publication of our policy statement in 2006

- Amendments to the terms of trade between broadcasters and independent producers would only be necessary once any required changes to the Codes of Practice had been completed.

1.55 We are therefore seeking stakeholders' views on this issue in the current consultation, and we would welcome a commitment from stakeholders that these issues will be resolved through commercial negotiation. We will set out our conclusions on this subject in our policy statement in 2006 – following which a further consultation may be required on revisions to Codes of Practice guidance.

The independent production quota and the role of the BBC

1.56 In thinking about the future of the television production sector, particular attention needs to be paid to the role of the BBC – there are strong arguments to suggest that the BBC should play a more significant role in the television production sector going forward, given its privileged access to public funding, and its key role in delivering benefits to UK citizens. There are therefore two key issues to consider in the context of intervention to address concerns over vertical integration: the BBC's plans for a Window of Creative Competition (the WOCC), and the future of the independent production quota more generally.

1.57 The BBC has made proposals to improve access for external producers to the BBC commissioning structure. Specifically, in addition to an in-house guarantee of 50% of BBC hours, and the independent production quota of 25% of hours, the BBC has proposed that the remaining 25% of hours should form a contestable WOCC – i.e. the hours for which both in-house and external producers can compete.

1.58 We welcome the principle of the WOCC – we support the BBC's intention to enhance creative competition and create a more level playing field for external producers. However, we believe that more work is still needed in order to ensure that the WOCC works effectively in practice.

1.59 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. We make 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, we believe that Ofcom 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.

- 1.60 In terms of the independent production quota more generally, we have heard no strong case for a general variation in the level of the quota – whether an increase or a decrease. We believe that vertical integration remains a significant issue – and so 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.
- 1.61 In our view, regulatory certainty in this case is more important than regulatory withdrawal. We therefore believe that the independent production quota should be held constant at current levels for all broadcasters – including the BBC.
- 1.62 However, we also believe 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 we recognise that the WOCC may need time to bed down before it is possible to reach a conclusion about its success.
- 1.63 In addition, we believe 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. While we welcome the BBC’s Out of London review, we also recommend that Government should ensure that the BBC’s plans work to secure production outside London for the future. In particular:
- We echo our 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. We believe 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. We do not necessarily see this target as a short-term objective, but one that could be achieved over time
 - At the same time, we suggest 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 here should increase over time.
- 1.64 We recognise 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. We therefore note that the BBC’s current plans may indeed achieve the aims set out above. As such, we will closely follow the BBC’s actions in this area, and will seek a continuing dialogue with the BBC on these issues.

The future of production outside London

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

- 1.66 Our 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.
- 1.67 Our 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. We welcome Channel 4's strategy for production out of London, and recognise the impact of the recent increase in ITV1's out of London quota. We also raise a consultation question about the idea of requiring a major broadcaster or channel to move out of London – we welcome views about whether there are strong arguments for such a proposal, or alternatively whether this might be too intrusive.
- 1.68 Having considered the options for the future of production outside London, we continue to hold the view – as first raised in our PSB Review – that the role of the BBC in promoting production outside London is likely to increase in importance in the future. We welcome the BBC's current plans in this area to relocate a number of its production divisions to Manchester, and its wider out of London strategy. However, we believe that there is a greater role for the BBC going forward – as summarised above, our recommendations relate to the BBC's overall level of out of London commissioning, and its role in external production outside London.

The key definitions

- 1.69 The final area of policy proposals relates to the key definitions – which we have reviewed in three areas:
- The definition of **qualifying independent producers** – namely, those producers whose programming counts towards fulfilment of the independent production quota
 - The definition of **qualifying programmes** – the hours that can be used to count towards all production quotas
 - The definition of **out of London productions** – the hours that count towards quotas for production outside the M25.
- 1.70 Of the three areas, the definition of qualifying independent producers is the issue on which we have received most representations. Ofcom does not make decisions on changes to the definition of qualifying independent status – decisions regarding change are a matter for Government, although Ofcom has a role to play in making recommendations to Government.
- 1.71 The current definition of a qualifying independent producer excludes those production businesses that share significant common ownership with broadcasters. A number of options have been presented for revising the qualifying independent definition:
- Introducing a test of economic dependence on the parent (or co-owned⁶) broadcaster – so a co-owned producer could qualify as an independent if only a small proportion of its revenue is sourced from the linked broadcaster

⁶ We use the term “co-owned” to refer to the circumstance where there is significant common ownership between a broadcaster and a producer – specifically, where a broadcaster has a significant ownership stake in a production business; or, vice versa, where a producer has a significant ownership stake in a broadcasting business.

- Changing the restriction on ownership – so a co-owned producer could qualify as an independent when supplying programming to any broadcaster other than the one with which ownership is shared
 - Revising the definitions of relevant broadcasters – such that the ownership restriction only applies to, e.g. English language or designated public service broadcasters
 - Introducing a size dimension to the qualifying definition – e.g. 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.
- 1.72 In reviewing these options for the purpose of this consultation, we recognise that the current definition of a qualifying independent producer may not be perfect – but the current definition benefits from being a clear, practical rule which has to a great extent withstood the test of time. We believe it is not possible to develop a perfect definition – i.e. one in which no perverse incentives are created.
- 1.73 Moreover, we note that any change in this area may only have a relatively limited impact – Channel 4 and Five already commission from external producers significantly in excess of the independent production quota; the BBC's WOCC proposals seek to increase access for all external producers – whether qualifying or non-qualifying; therefore, the market most likely to be impacted by any change would be independent commissions for Channel 3.
- 1.74 We have not reached a firm view on these issues, but are at present uncertain that any of the proposed revisions are superior to the current definition. Our preliminary assessment of the options suggests that they all have drawbacks: some may risk damaging the diversity of programming available to viewers, by having a negative market impact on already qualifying independent producers; others may create perverse incentives for non-English language broadcasters to develop in-house production with qualifying status, or for broadcasters to retreat from PSB status; and the options may also present significant practical difficulties – which risk creating complexity and uncertainty.
- 1.75 In short, therefore, we are minded to recommend no change to the definition of a qualifying independent producer at this time. However, as part of the formal consultation on this issue, we welcome input from stakeholders – supported by detailed argument and evidence – on whether, and if so how, it is possible for the benefits of any of the above options to outweigh – or ideally avoid any – downsides, and on how the practical considerations might be addressed. In addition, we will consider other options and proposals for change in this area. We will take account of comments received as part of the consultation, and will reach a conclusion in our policy statement in 2006 about whether to recommend change to Government.
- 1.76 In contrast to the question of qualifying independents, the other definitions are largely uncontroversial:
- The definition of qualifying programmes has been drawn relatively widely, so as to capture as much origination as possible. We have had no representations from stakeholders on this subject, and so propose no 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, we do not propose any change in this area.

Contents of this document and next steps

1.77 The rest of this document elaborates on the above issues in the following way:

- Section 2 reviews the objectives of the television production, focusing in particular on the centrality of viewers' interests
- Section 3 considers the factors that may prevent these objectives from being met – and the interventions that have arisen as a result
- Section 4 assesses the current position of the sector. We do not draw policy conclusions in this section – rather, our focus is on presenting the evidence we have collected
- Section 5 considers possible future developments in the television production sector, and assesses the implications for the overall rationale for intervention
- Finally, the main body of this document concludes with two sections on the key policy options and proposals – Section 6 considers the issues surrounding the Codes of Practice, and the exploitation of programming on alternative distribution platforms; and Section 7 reviews the other policy issues, namely the production quotas and the key regulatory definitions.

1.78 This volume also contains a number of supporting annexes. Our work on this review has been informed by a far-reaching industry interview programme, and a series of consultation events around the UK – these are discussed in Annexes 5 and 6 respectively; Annex 7 considers the relationship between television production and the delivery of creativity and innovation; and Annex 8 summarises our review of the operation of the Codes of Practice.

1.79 As noted at the outset of this section, the publication of this document marks the commencement of a period of formal consultation on our proposed approach to intervention in the television production sector.

1.80 The consultation period runs until 21 March 2006. In developing a response to the consultation, we ask respondents to consider the details appended at Annex 1 to this document, and the questions for consultation – these are highlighted at the relevant points in the text of this document, and are set out in full in Annex 4. We also request that a completed consultation response cover sheet (see Annex 3) is included with all submissions.

1.81 Ofcom will review responses to these proposals following the close of the consultation period, with a view to issuing a final statement in spring 2006. The final statement will set out our decisions and recommendations regarding any changes that might be needed to the extent and nature of intervention in the television production sector. Depending on the nature of our conclusions, further implementation work may need to follow the completion of this review – for instance, any changes to Codes of Practice would require Ofcom to develop and consult on new guidance; and if recommendations are made regarding change to the qualifying independent definition, this issue would be taken forward by Government.

Section 2

The objectives of television production

- 2.1 Ofcom's overarching goal in this review is to define the appropriate extent and nature of intervention in the television production sector. In order to ensure that our recommendations on the future of intervention and regulation are appropriate and effective, we first need to make clear what the review is aiming to achieve.
- 2.2 Our review seeks to promote a healthy production sector – but it is important to define what “healthy” means in this context. In other words, what objectives does the production sector need to meet if it is to be described as in good health? This is a central question for the review, and it is the focus of this section.

The centrality of viewers' interests

- 2.3 It is useful to start by addressing this question from two perspectives:
 - **Financial perspective of producers:** producers make television content ultimately to deliver profits to owners and shareholders, or – in the case of BBC in-house production – to deliver value for money in the use of licence fee income
 - **Regulatory perspective of Ofcom:** from the regulatory perspective, television programme content ultimately serves to meet the interests of viewers as consumers and UK citizens.
- 2.4 We should emphasise at the outset that these two perspectives are by no means contradictory – we note, for instance, that profitability and value for money are likely to be maximised through the provision of the types of high quality and creative content that are valued by viewers.
- 2.5 Nonetheless, it is useful to draw this distinction in order to make clear where Ofcom's interests lie: we are reviewing the television production sector not because we are seeking to maximise the profitability of content producers, but because we are looking to secure the delivery of television content that meets the underlying interests of viewers as consumers and UK citizens
- 2.6 This means that the interests of viewers are at the heart of Ofcom's work on the television production sector. In other words, if we intervene, we should do so in order to ensure viewer benefit, or to prevent viewer detriment. In our view, if the interests of viewers as both consumers and UK citizens are met by the programming output they see on their television screens, then we can conclude that the television production sector is fulfilling its purpose. In Section 3, we discuss in more detail how Ofcom's duties under the Communications Act 2003 (“The Act”) apply to this review.

Defining the interests of viewers

- 2.7 In order to understand this approach, it is important to be clear about what we mean by viewers' interests. We believe that viewers' interests are linked to their position as:
 - Consumers who enjoy television as an entertainment medium
 - UK citizens who are affected by television at a social level, related to the viewing habits of all UK citizens as well as their own.

- 2.8 This approach suggests that, as far as possible, the television production sector should operate in support of the objective of delivering what viewers value in their dual roles – as audiences seeking entertainment and as UK citizens contributing to the overall welfare and values of UK society. Therefore, we see the objectives of the production sector to be no different to those of television as a whole.
- 2.9 In order to assess what these objectives might be, we are able to draw on the work carried out by Ofcom for the review of public service television broadcasting (the PSB Review), which was completed earlier in 2005. Specifically, we conducted significant quantitative and qualitative audience research on the role of television in society. This research showed that respondents overwhelmingly agreed that the main terrestrial TV channels should:
- Promote debate and keep the population well-informed (*social values*)
 - Constitute a high proportion of new, innovative, well-made, UK-originated programmes (*quality*)
 - Provide a ‘balanced diet’ of different types of programming at all times of day (*range and balance*)
 - Include programmes that are targeted at a wide range of different audience groups (*diversity*).
- 2.10 More specifically, the key messages from the audience research included the following.
- 2.11 **The provision of entertainment is a key purpose of television.** Programming which entertains and engages is the critical element in audience appreciation of television. 71% of our survey sample said that television is their major source for entertainment, with books coming a distant second at 6%. Entertainment is what people say they most appreciate about television, and it is as a form of relaxation that TV fits in with many people’s everyday lives.
- 2.12 **Television is seen as having a significant responsibility to society.** The fact that television is a medium for entertainment does not mean that viewers downplay its importance to society as a whole. Rather, television is seen as playing a significant role in enabling a cohesive society. For example, genres which provide a form of mainstream connection between viewers in terms of shared experience – i.e. sports and soaps – are seen as more important for the good of society than are other more specialist genres.
- 2.13 **Most of the components of PSB are held to be of importance.** PSB is not well understood as a concept. However, when prompted, most of the components of PSB set out in the Communications Act are considered to be important elements of UK television. Issues of range and balance in programming and across the schedules, production quality, and the social value of certain types of content (e.g. keeping the population well-informed) are considered most important.
- 2.14 **Programme innovation is valued, but current performance scores poorly for many.** Our survey found that programme quality was perceived to be falling in some areas, with concern over the amount of formulaic programming. While reality TV and makeover shows continue to do well in terms of viewing figures, viewers feel strongly that this type of programming is derivative, and that more could be done to create original programming.

- 2.15 **Viewers see benefits in the current mixed schedule strategies of terrestrial provision.** Most people feel that the terrestrial channels should continue to provide a broadly-based schedule that provides a good variety of programming types. By extension, they also see value in a plurality of programme supply. However, a more mixed message emerges over whether programming for minority interests and groups is better carried out on specialist channels.
- 2.16 **Television could have a more proactive role.** Specialist interest groups see potential for the main terrestrial TV channels to play a more active role in terms of community engagement. They feel that more local (and regional) services could be provided, which would properly reflect both meaningful community structures and the social and cultural activities which exist at the community level (e.g. local arts, local sport). Also, they would like television to do more to help inspire people to get involved in – for instance – the political process, or lifelong learning.
- 2.17 In summary, television is seen to be a hugely important and influential medium for the majority of the population. Whilst there is significant cross-over between the requirements of viewers in their dual roles as consumers and UK citizens, it is in our view reasonable to say that:
- Viewers as consumers want the main terrestrial channels to offer easy access to entertaining, high quality, varied and innovative programming
 - Viewers as UK citizens recognise the importance of television as having significant social responsibilities. Therefore, it is in the viewers' interest if the main terrestrial channels offer programming that offers a shared experience, reflecting the diversity of perspectives across the UK.
- 2.18 In summary, from a policy perspective, we believe that television broadcasters and programme-makers alike should be incentivised to provide content that entertains viewers, but also delivers value to society.

A link to public service broadcasting?

- 2.19 Since starting work on this review, we have engaged in a number of discussions with producers, broadcasters, and other industry stakeholders. In several of these discussions, we have been asked how this review is related to Ofcom's PSB Review. Specifically, we have been asked whether we believe that the purpose of the television production sector is to support the delivery of PSB.
- 2.20 In order to address this issue, it is useful to provide a reminder of the purposes and characteristics of PSB, as defined by Ofcom in the PSB Review. These are set out in Box 2.1 below.

Box 2.1: The purposes and characteristics of PSB

The **purposes** of PSB:

- to inform ourselves and others and to increase our understanding of the world through news, information and analysis of current events and ideas;
- to stimulate our interest in and knowledge of arts, science, history and other topics through content that is accessible and can encourage informal learning;

- to reflect and strengthen our cultural identity through original programming at UK, national and regional level, on occasion bringing audiences together for shared experiences; and
- to make us aware of different cultures and alternative viewpoints, through programmes that reflect the lives of other people and other communities, both within the UK and elsewhere.

The **characteristics** of PSB content:

- **high quality** – well funded and well produced;
- **original** – new UK content, rather than repeats or acquisitions;
- **innovative** – breaking new ideas or re-inventing exciting approaches, rather than copying old ones;
- **challenging** – making viewers think;
- **engaging** – remaining accessible and enjoyed by viewers; and
- **widely available** – if content is publicly funded, a large majority of citizens need to be given the chance to watch it.

2.21 A comparison of the contents of the above box with our earlier discussion makes clear that there is much overlap between viewers' interests and the definition of PSB purposes and characteristics – indeed, a key conclusion of the PSB Review was that audiences continue to attach importance to a wider public service role for television.

2.22 In drawing out the nature of this overlap, we first note that the main terrestrial broadcasters are the main vehicles for the delivery of PSB. In addition, the importance of entertainment means that PSB purposes and characteristics are not the overriding focus of this review.

2.23 But we also highlight that there are at least two main areas in which the television production sector can help support the delivery of PSB:

- First, the delivery of **creativity and innovation**: these are important characteristics of PSB, and are areas in which content producers arguably have a critical role
- Second, ensuring that television programming reflects and strengthens cultural identity, and makes us aware of different cultures and alternative viewpoints – these issues can broadly be grouped under the area of **diversity**.

2.24 The rest of this section considers the key issues in each of these areas.

Delivering creativity and innovation

2.25 In our view, the interests of viewers are furthered through the provision of innovative and creative content. The key question therefore concerns what kind of production sector is best placed to deliver innovation?

2.26 During Phase 2 of the PSB Review, Ofcom undertook preliminary research into the factors that drive innovation. A series of interviews were conducted with a number of broadcasting professionals (programme-makers and commissioners) to find out what factors they considered encouraged innovation, and what militated against it. This research was published in Phase 2 of the PSB Review and is summarised below.

2.27 The factors that broadcasting professionals thought encouraged innovation were:

- A healthy independent production sector in a position to negotiate with broadcasters
- Investment in and commitment to research and development (by the independent sector and by broadcasters)
- Creative space to give new programmes the chance to succeed
- A 'chain of trust' between the commissioner and the producer
- A 'binary relationship' between the commissioner and the programme-maker allowing creative conversations
- Devolved commissioning
- Proactive broadcasters who spot and encourage new talent.

2.28 The factors that it was felt discouraged innovation were:

- Smaller programme budgets and stringently defined 'slot prices'
- A constrained independent production sector operating with tight profit margins and therefore unable to invest in development or to negotiate with broadcasters
- Insufficient money available for research and development
- The possibility that multichannel competition might lead to copycat commissioning
- The vulnerability of innovative programmes in the schedule, due to competitive scheduling
- Advertisers pressing for tried and trusted content, rather than new potentially risky programming
- Real decision-making power (i.e. commissioning power) lying in the hands of too few people
- A shortage of talent and lack of training within the industry.

2.29 The results of this research indicate that broadcasters and producers both play an important role in delivering innovative content, with broadcasters and commissioners responsible for creating an appetite and a market for creative and innovative programming.

2.30 For the current review, Ofcom has further investigated the connection between the production sector and innovation to examine whether any one production sector model was more or less likely to deliver the PSB characteristic of innovative and creative content. The results of this work are summarised in Annex 7. Our findings suggest that there is no single model that is best placed to deliver creativity and innovation. Consequently, we believe that it is essential to ensure that the conditions for creativity and innovation exist, but that it is not sensible to regulate specifically for particular types or amounts of innovation.

The benefits of diversity

- 2.31 As mentioned earlier, two of the four key purposes of PSB set out by Ofcom in the PSB Review are:
- To reflect and strengthen our cultural identity through original programming at UK, national and regional level, on occasion bringing audiences together for shared experiences
 - To make us aware of different cultures and alternative viewpoints, through programmes that reflect the lives of other people and other communities, both within the UK and elsewhere.
- 2.32 Given that these are key objectives for television as a whole, they are also important for the television production sector. In general, we believe this means that a key objective for content producers is to help deliver diversity in television programming.
- 2.33 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** (whether location, ethnicity, gender, lifestyle)
 - Diversity of corporate **scale and structure** (in-house or external, large or small)
 - Diversity through **plurality** – having a large number of businesses in the market⁷
 - Diversity of **channels** – different channels seek different target audiences
 - Diversity of **commissioning** within channels.
- 2.34 This definition of diversity has structural as well as cultural dimensions – for instance by suggesting that diversity is best delivered with a mixed ecology of production (whether in-house or external). However, it is important to note that we do not seek diversity of – for instance – location or structure for their own sake, or as a form of industrial policy. Rather, we believe that such diversity is a means to the end of meeting the needs and interests of viewers.

Diversity across the UK

- 2.35 A key aspect of the debate around diversity concerns the view that location of production can promote a diversity of perspectives – i.e. there is an argument that viewers' interests are best served through production across the Nations and Regions of the UK, as well as in London. We support this view, but recognise that there are potential limits to the benefits associated with out of London production.
- 2.36 Ofcom's audience research has demonstrated that audiences place value on seeing their Nation or Region represented on screen across the UK. There was, for instance, considerable support in our PSB Review Phase 3 quantitative survey for representation of the three devolved Nations to other parts of the UK. As Figure 2.1 shows, over 70% of those in Scotland and in Northern Ireland felt it more important to show programmes about their Nation across the UK rather than only to their Nation.

⁷ In our view, the need for plurality applies across the broadcasting value chain – whether broadcasting outlets, commissioning or production. See Ofcom report, "Ofcom review of public service television broadcasting. Phase 3 – Competition for quality", paragraph 2.56.

Figure 2.1: Reflecting the Nation to other parts of the UK is important

Q: Thinking about programmes for and about [Wales/Scotland/Northern Ireland], is it more important to have them shown across the UK as a whole, or shown only in [Wales/Scotland/Northern Ireland]?

Source: Ofcom/ICM December/January 2004-5 Telephone survey n = 2,237

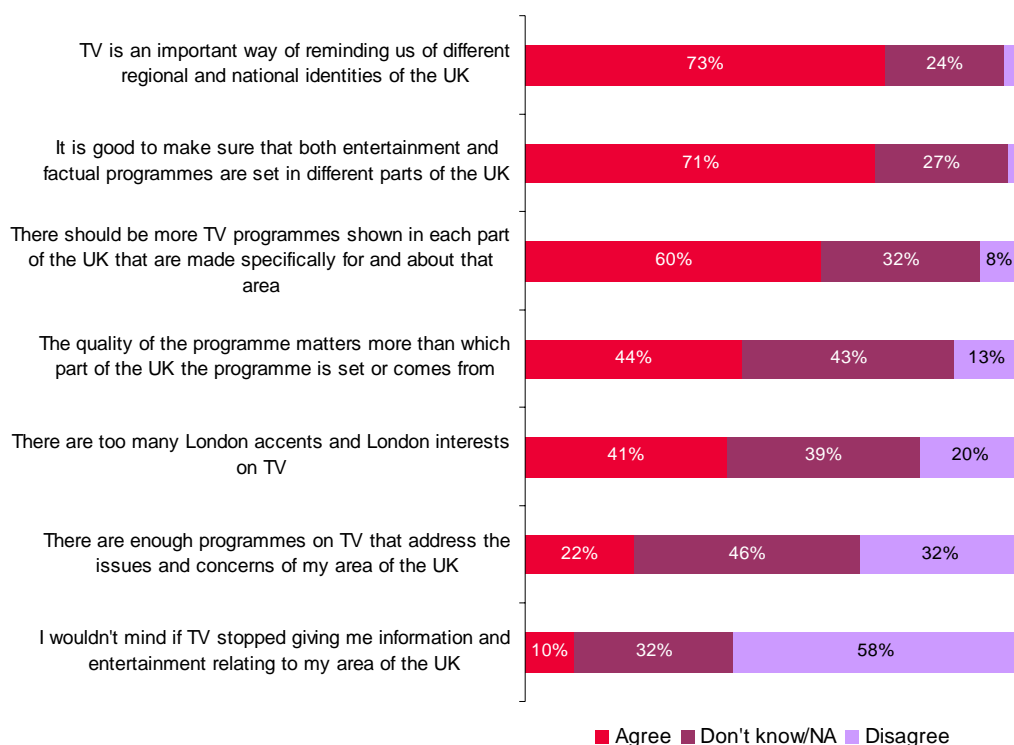
- 2.37 This issue was also addressed in qualitative workshops carried out in Wales, Northern Ireland and Scotland. Workshop participants were also keen for such programmes to be seen UK-wide, not least as current representation on the network was held to be in some cases poor and stereotypical. This concern was particularly prevalent in Northern Ireland.
- 2.38 Our PSB Review Phase 2 quantitative survey also canvassed the views of those in England, with similar themes emerging. We asked respondents how much they agreed or disagreed with a range of statements about regional television provision. Interestingly, strongest agreement came for statements which can be interpreted as an appreciation of network-wide provision – Figure 2.2. shows that 73% of the overall sample agreed that “TV is an important way of reminding us of different regional and national identities of the UK”, and 71% that “it is good to make sure that both entertainment and factual programmes are set in different parts of the UK”.

Figure 2.2: Attitudes to regional programming

Q: How much do you agree or disagree with the following statements?

Base: all respondents, N: 4067

Source: Ipsos/Ofcom July 2004



- 2.39 In addition to cultural representation, there are also benefits associated with plurality and diversity of supply. Most of the industry professionals we have spoken to – whether broadcasters or producers, whether based within or outside the M25 – agree that the UK television production sector needs a plurality and diversity of supply in order to remain healthy and deliver on viewers' interests. Having a large rather than small number of producers is, the argument goes, a driver of competition and quality. And maintaining a diverse spectrum of suppliers – large and small, London-based and based outside the capital – means that the widest possible range of ideas and talent is available, thus bolstering innovation and delivering range and diversity of content and perspectives.
- 2.40 While plurality of supply – essentially about the number of suppliers rather than the nature or range of those suppliers – could be achieved via an exclusively London-based production sector, diversity of supply depends on the sector being served by a range of producers, from in-house to independent, from large to small, from metropolitan to remote, and from London-based to geographically dispersed.
- 2.41 Some industry professionals have suggested that different sized producers are able to bring different qualities to programming and that it is therefore important that there should be a mixture of small and large producers. While London is home to many small producers, the rise of the almost entirely London-based “super-indies” and consolidation within the independent sector may mean that small regional external producers also have a role in ensuring that production does not contract into a small number of very large external and vertically-integrated producers.

The limits to diversity

- 2.42 We mentioned earlier that diversity – whether of sources of supply, or of content on screen – is only important if it helps to meet viewers’ interests. It is therefore important to note that there are likely to be limits to the benefits associated with diversity.
- 2.43 For instance, does the emphasis on diversity imply that production should be equitable? Should production be spread across the UK in proportion to population distribution? This argument is most commonly made in relation to the BBC – since the BBC is funded directly from the population as a whole, it is sometimes argued that it should use its licence fee income proportionately across the UK.
- 2.44 In our view, production dispersed out of London it is likely to bring with it benefits for viewers, albeit at some cost (the nature of which we discuss in more detail in the next section). This benefit may outweigh the costs of delivering it. However, it is likely that if more and more production were to take place out of London, eventually the additional benefits may no longer outweigh the costs – largely due to the dilution of the talent base, and the possible lack of critical mass in highly dispersed production centres. As a result, we believe that increased dispersal past a certain point may even reduce the overall quality of content supplied – which would have a negative effect on viewers.
- 2.45 Whilst there may be some optimal point for the level of production outside London, we believe that it is impossible to directly quantify this level. We hold the view that more and more dispersed production is unlikely to be the answer to the question of how best to meet the needs of viewers. Therefore, while we recognise that there are arguments for ensuring that public service broadcasters represent the UK as a whole, it may well be counter-productive to seek an equitable dispersal of production across the board: directing the sector to such an outcome could come at the expense of on-screen quality.
- 2.46 Overall, we take the view that there are benefits to diversity of production (including in terms of location) – and so the production sector should have an objective of delivering these benefits. Sections 4 and 5 present evidence on diversity, and show that – in terms of geographic dispersal – UK production remains fairly concentrated. But, while diversity is important, it should not be pursued at the expense of programme quality as a whole.

Summarising the objectives of television production

- 2.47 Ofcom’s focus is in trying to ensure that the television production sector works effectively to meet viewers’ interests. Viewers’ focus is on the maintenance or strengthening of programme quality, not on the conditions for its production. But we believe that the conditions of production can have an impact on programme quality – and hence on viewers’ interests.
- 2.48 This overarching objective has a number of specific dimensions:
- Viewers as consumers seek entertaining content. As UK citizens, they also recognise the importance of television as having the ability to enhance overall social well-being. The television production sector should therefore aim to provide content that entertains viewers, but also delivers value to society

- Television programme producers have a particular role in delivering creativity and innovation – but our analysis suggests that no single model or industry structure is most associated with creativity and innovation
- Diversity of programming – including, but not limited to, diversity across the UK – is also important to viewers. The production sector therefore should function in such a way as to ensure that this diversity is delivered in the interests of viewers.

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?

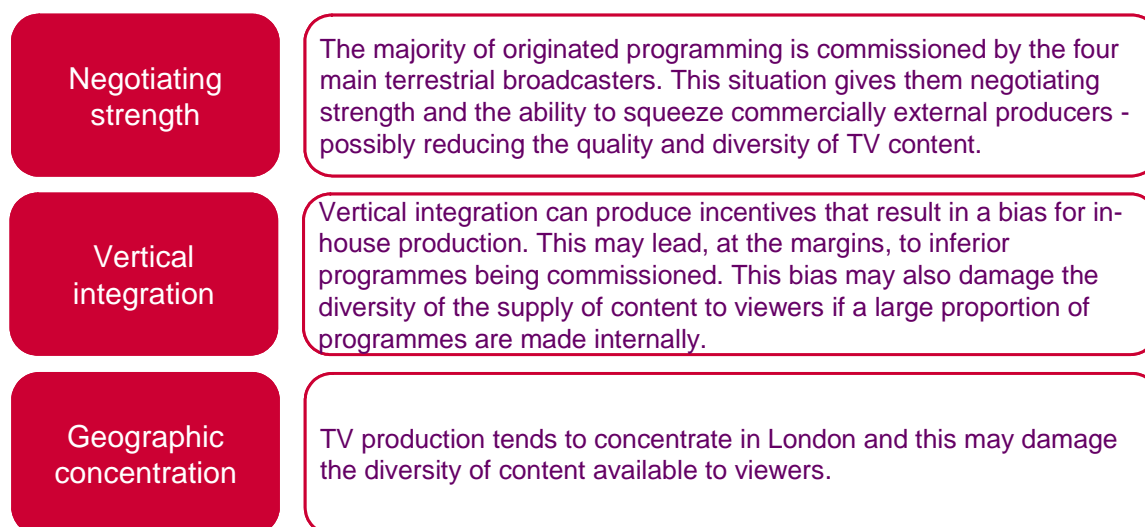
Question 2: Do you agree that Ofcom's assessment of the role of diversity in its different forms is an appropriate framework within which to think about the link between viewer interests and diversity of production?

Section 3

Intervention in the television production sector

- 3.1 Television is considered an important industry in the UK – from the perspective of fostering investment in creativity and creative talent, and given its significance as a medium of popular entertainment, provider of information and its overall influence within society as a whole.
- 3.2 As discussed in the previous section, our core objective in this review is to ensure that the conditions exist to enable the television production sector to deliver on the interests of viewers as consumers and UK citizens. In this section, we explore the areas where intervention may be needed in order to deliver benefits, or indeed to prevent detriment, to viewers.
- 3.3 It is often the case that markets routinely provide products that meet the requirements of consumers. However, as we explained in the PSB Review, this may not be the case in the television market because there are a limited number of free-to-air channels – each with their own different broadcasting objectives. Therefore if this market is left unregulated, the main terrestrial channels may not deliver on viewers' interests.
- 3.4 We also established in the PSB Review that – even if a competitive television market provided all the programming that consumers desired and were willing to pay for – it would probably not offer sufficient programmes that are valued by society as a whole. In other words, the interests of viewers as UK citizens may not be met in full.
- 3.5 These two factors give rise to concerns that the television market may not deliver on viewers' interests. In the PSB Review, we explored the areas in which the market may under-deliver on programmes that address particular public service objectives – for which PSB obligations on the main terrestrial channels should in the first instance act as a sufficient remedy.
- 3.6 In this context, we recognise that these factors have also given rise to a number of interventions which have a direct impact on the supply and acquisition of original programmes. These interventions seek to deal with the issues that arise from three particular features of the television production sector – relating to its market structure and the conduct of programme-buyers. It is therefore important to consider in this review whether viewers' interests would be satisfied without this intervention.
- 3.7 The key features of the market that have driven the need for intervention are summarised in Figure 3.1 below.

Figure 3.1: Key issues behind intervention

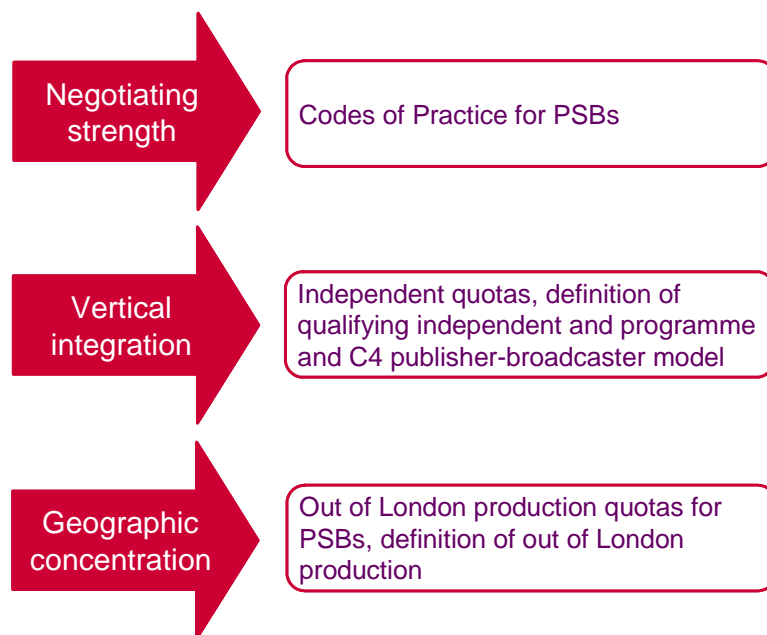


3.8 These issues have led to public intervention in the production sector, because they are felt to result in a detriment to the interests of viewers. Figures 3.2 and 3.3 below provides a summary of the background to intervention in the sector:

Figure 3.2: Background to intervention in the production sector

1955	ITV was created as a federal, regionally based organisation
1982	Creation of Channel 4, stimulating growth of independent production
1986	Peacock Committee recommends 40% independent quota
1990	Broadcasting Act introduces statutory 25% independent quota
1993	Statutory independent quota takes effect
1996	Broadcasting Act introduces 10% independent quota on DTT channels
1997	Creation of Channel 5
1998	Channel 4 required to spend 30% out of London
2001	Channel 5 agrees to 10% out of London target
2002	ITC Programme Supply Review published
2003	Communications Act imposes Out of London quotas on BBC and ITV and PSBs Codes of Practice
2005	PSB review increases ITV's out of London quota to 50% and introduces new out of London definitions

3.9 While there are some important areas of overlap, it is broadly possible to map these public interventions to the three issues set out above. This is shown in Figure 3.3 below.

Figure 3.3 Mapping the key issues to specific interventions

- 3.10 Looking at these different interventions may motivate the question – why is it in the viewers’ interests to intervene at the input level of television (i.e. production) as opposed to at the output level (i.e. broadcasting)?
- 3.11 Intervention at the production level would seem one step removed from the viewer, and hence a more indirect and perhaps less effective mechanism for achieving the regulatory objectives. We acknowledge in this regard that, in general, regulation for viewer benefit is focused at the broadcast level – for instance through PSB obligations. However, for the reasons discussed in this section, the existence of the three issues discussed above suggests further remedies may be needed at the production stage of the value chain. Moreover, to the extent that these issues remain present and material, intervention by Ofcom may continue to be necessary.
- 3.12 We discuss in this section how these issues may act against the objective to further the interests of viewers. In Section 5, we discuss the potential importance of these issues in the light of current and future developments in the sector.

Ofcom’s duties

- 3.13 It is important to set the context for Ofcom’s role in this area. Section 3 (1) of the Communications Act 2003 sets out Ofcom’s general duties:
- “...to further the interests of citizens in relation to communications matters and to further the interests of consumers in relevant markets, where appropriate by promoting competition...”***
- 3.14 With respect to these duties, and as already discussed in Section 2, Ofcom focuses on viewers as both consumers and citizens who have a primary interest in having access to the content that satisfies their underlying interests. The UK television production sector plays an important role in enabling viewers to achieve this aim.
- 3.15 More specifically, Section 3 (2) of the Act states Ofcom’s objective to secure, amongst other things:

“...the availability throughout the United Kingdom of a wide range of television and radio services which (taken as a whole) are both of high quality and calculated to appeal to a variety of tastes and interests;

the maintenance of a sufficient plurality of providers of different television and radio services...”

3.16 This can be thought of as applying to broadcasters and producers, who play an important role in the range and quality of TV output as well as contributing to the general plurality of providers of TV services.

3.17 In carrying out these duties, Section 3 (4) of the Act lists a number of points that Ofcom should have regard to (where relevant to the specific circumstance). In this case it is worth highlighting:

“... (b) the desirability of promoting competition in relevant markets ...

(d) the desirability of encouraging investment and innovation in relevant markets ...

... (k) the opinions of consumers in relevant markets and of members of the public generally”.

3.18 In this case, the promotion of competition can be interpreted as meaning competition amongst broadcasters and producers, resulting in output for viewers that satisfies their underlying interests.

3.19 Encouraging investment and innovation applies to both producers and broadcasters. Investment and innovation are important to the long run development of businesses and services – and we expect that viewers’ interests would be furthered by new and innovative approaches to the delivery of content.

3.20 Finally, we note that Section 3 (3) of the Act seeks to ensure that Ofcom’s regulatory activities should be:

“...transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed”

3.21 In this section, we are seeking to be transparent. We set out what we perceive as the reasoning behind intervention in this sector, and discuss the proportionate nature of intervention when compared with the perceived benefits and costs that intervention may bring about.

3.22 These general duties provide us with guidance in carrying out this review. However, we also have important duties relating to the television production sector, as set out in Chapter 4 of The Act. Specifically:

- **Section 285 Code for programme commissioning** by the main terrestrial broadcasters. This relates to the commissioning by licensed public service channels from independent producers, and focuses on the principles under which commissions are agreed upon
- **Section 277 Programming quotas for independent production** requires Ofcom to set quotas for the proportion of independent television production commissioned by licensed public service channels; and **Section 309 Quotas for independent**

programmes applies in a similar way to digital television programme services which are not comprised in a licensed public service channel

- **Section 295 Involvement of C4 Corporation in programme-making** relates to Channel 4's model as a publisher-broadcaster
- **Section 286 Regional programme-making for Channel 3 and 5 and Section 288 Regional programme-making for Channel 4** relate among other things to the proportion of programmes commissioned by these channels made outside of the M25 area.

3.23 Therefore, whilst we seek to take a broad perspective in carrying out this review, we are necessarily focused on carrying out our duties under the Act – as they apply in general and specific terms to the television production sector. We now turn to a more detailed discussion of each of the issues summarised in Figure 3.1.

Negotiating strength

- 3.24 The production sector is characterised by relatively few buyers of original programming (i.e. the free-to-air and pay-TV broadcasters), in comparison to the large number of producers. Broadcasters can rely on a wide range of producers, whereas producers are reliant on a limited number of broadcasters.
- 3.25 Although this was not a new observation in the sector prior to 2002, it was the ITC's Programme Supply Review that first characterised and sought to address this issue. The ITC recommended that the public service broadcasters should be required to develop and implement new Codes of Practice setting out principles regarding the commissioning process, and a framework for agreeing terms of trade with independent producers. These terms of trade have been agreed between PACT (the independent producers' trade body) and the majority of the main terrestrial broadcasters (except for the ITV Network) and have been in operation in most cases for just over a year.
- 3.26 The ITC held the view that large buyers of original programming can be viewed as holding a stronger bargaining position in their negotiations with the vast majority of producers.
- 3.27 However, it is worth exploring whether this fact in itself is cause for concern and regulatory intervention. The exercise of negotiating strength can, for instance, have a positive impact on viewers. Broadcasters may be able to negotiate relatively favourable terms with programme-makers. To the extent that these savings are passed on to viewers – through, for example, increased expenditure on high quality original programming – this is a positive outcome. But such savings may not necessarily be passed on to viewers – rather, they could contribute to increased margins for the broadcaster.
- 3.28 Even if broadcasters were to pass on all the benefits they derive to viewers, there could still be a negative impact on viewers in the longer term. A number of practices associated with negotiating strength could severely damage the viability of production companies, and so might reduce the diversity and quality of original TV production in the long term. This could include non-cost related reductions in the price of commissions (leading to reductions in producers' margins), securing excessively long periods of credit, warehousing rights both at the development stage and after commissioning, or appropriating secondary and ancillary rights without paying a fair price for them.

- 3.29 Moreover, we understand that any reduction in producers' margins beyond a certain level means they may spend less on research and development. In the round, this negative reaction by producers may offset the benefits broadcasters pass on to viewers.
- 3.30 Negotiating strength is therefore a double-edged sword. However, in our view, the potential negative impacts mean that there is a case for restraining excess negotiating strength in the interests of viewers.
- 3.31 In its 2002 review, the ITC found evidence of broadcasters using their negotiating strength and concluded that this was to the significant detriment of viewers. The ITC identified "a number of features of the UK programme supply markets which suggest that competition is not necessarily effective". Those features were:
- Lack of transparency in pricing of rights, which prevents the effective operation of the price mechanism and restricts producers' ability to develop alternative sources of financing
 - Linked to this are restrictions on the ability of producers to determine how and by whom their rights are exploited
 - A restriction on the ability of independent producers to grow, to exploit available economies of scale and/or scope and develop into mature organisations.
- 3.32 The ITC found that certain broadcasters were not transparent in the way they were pricing different elements of the rights packages they were acquiring from producers. The broadcasters were seeking to secure bundles of primary, secondary and ancillary rights without being clear about what they would be prepared to pay for them separately. In addition, broadcasters were in some cases not offering producers a realistic choice of funding routes based upon different rights packages. This restricted the ability of producers to develop alternative sources of funding, and evidence from the time showed that fully-funded deals (where broadcasters generally acquired all the rights to a production) accounted for the vast majority of commissioning deals for some broadcasters (although there was evidence that this may have varied by genre). The introduction of the Codes of Practice for each broadcaster sought to set a transparent basis for commissioning deals to mitigate the broadcasters' strong negotiating position.
- 3.33 Looking forward, it is worth considering the conditions that reinforce broadcasters' strong negotiating position and what if anything producers can do to mitigate its effectiveness.
- 3.34 Generally, in a market with many sellers such as this, it is important for firms to seek to differentiate themselves and to provide a product that buyers hold at a premium. Producers face the challenge of developing a successful brand and reputation for delivering "must-see" television. They must balance delivering ideas that are attractive to a wide range of broadcasters to maximise their appeal and bargaining position, and also take into account a broadcaster's specific audience strategy – requiring tailored unique ideas. These conflicting objectives may mean that, from a producer's perspective, certain ideas are less likely to be transferable across broadcasters, which reduces their ability to overcome the broadcaster's strong bargaining position.
- 3.35 These issues are more prevalent in certain genres and programme formats. The more slots a broadcaster has for a certain type of programme, the less concentrated competition will be. In addition, some programmes are more likely to have the

potential to be highly branded ongoing strands, e.g. successful soaps, comedies and game shows, which offer the potential for the producer to increase their long term bargaining position with a particular broadcaster. In the long term, it is possible that bargaining positions could be reversed, e.g. in the case of long running successful soaps or entertainment formats. However, at this stage, examples of producers who have at least an equal bargaining position with broadcasters are the exception rather than the norm.

Vertical integration

- 3.36 There has been a long history of intervention in the television production sector, focused on addressing a perceived problem associated with organisations being both producers and broadcasters.
- 3.37 Box 3.1 below summarises intervention in this area.

Box 3.1: The Independent quotas and definition of qualifying independents and programmes

In 1982 Channel 4 was created as the UK's first publisher-broadcaster, thus triggering the growth of an independent sector that had until then been extremely small. The 1986 Peacock Committee on Financing the BBC recommended the introduction of a 40% independent quota on the BBC and Channel 3. In the following year, Channel 3 entered into a voluntary agreement with the independent sector, aiming to reach 25% by the end of 1992. The Independent Broadcasting Authority (IBA) also began monitoring Channel 3's independent commissions and transmissions by hours and value. By the end of 1992, 22% of Channel 3's originated hours were from the independent sector.

The 1990 Broadcasting Act marked the introduction of the statutory independent quota on the BBC, Channel 3, Channel 4, S4C and, later, Channel 5. Set at 25% of qualifying programmes and measured in hours, the quota took effect on 1 January 1993. On Channels 3, 4 and 5 the quota was monitored by the ITC while on the BBC it was overseen by the Office of Fair Trading (OFT), and applied across BBC One and Two taken together.

The definitions of qualifying programmes (excluding, for example, acquired programmes, repeats and news) and independent production (broadcasters having no more than a 25% share in an independent production company and vice versa) were set out in the Government's Broadcasting (Independent Productions) Order of 1991, which was amended in an order of 1995 to preclude two or more broadcasters having an aggregate shareholding of more than 50% in a qualifying independent producer.

The 1996 Broadcasting Act introduced a 10% independent production quota for digital terrestrial television channels, using the same definitions of qualifying programmes and independent producers as apply to the 25% quota on the BBC and Channels 3, 4 and 5.

ITV1 has met the quota every year since its introduction, helped by the fact that the licences awarded in the early 1990s included publisher-broadcasters such as Meridian and Carlton. As publisher-broadcasters, Channel 4 and Five have also met the quota comfortably. The BBC has sometimes struggled to meet the quota in the past, although the quota was exceeded in 2004. The BBC has also said that it is taking steps to ensure that it will never again fail to meet the quota, and that the quota is viewed as a floor, not a ceiling. A key reason cited for the shortfall in the past for the BBC has been the loss of qualifying independent status of large independent suppliers. In the past, this has meant that programmes which had qualified at the point of commission no longer qualified at the time of broadcast, and so could not be counted towards the quota.

In 2002, the ITC Programme Supply Review made a number of recommendations on the independent quota. These are summarised below:

- The 25% quota should remain in force and continue to be measured in hours
- The definitions of qualifying programmes and qualifying independents should remain largely unchanged, although some revisions to the operation of the quota were proposed
- Specifically, the ITC proposed that there should be some clarification of the application of the quota so that 1) it should apply to BBC One and Two separately rather than across the two as previously, 2) it should apply to all PSB channels, including for example the BBC's licence fee funded digital channels, 3) that independents owned by European broadcasters with no UK presence should not be excluded, and 4) that qualifying independence should be measured at the point of commission rather than transmission
- Ofcom should review the operation of the quota with regard to range, value, the definition of qualifying independents and regional distribution
- Ofcom should be able to impose sanctions on broadcasters who fail to meet the quota.

The 2003 Communications Act set the 25% independent quota for all public service channels, including the BBC's digital channels, to be measured by hours but with the provision to measure by spend as well. It also gave Ofcom the power to require broadcasters to carry forward any shortfall into the following year. As of April 2005, the quota applies to BBC One and Two separately rather than taken together. While the BBC's other channels are taken together it should be noted that BBC Three has a separate commitment to a 25% quota. The Communications Act also required the introduction of the new Codes of Practice for broadcasters and independents and retained the 10% independent quota for digital terrestrial channels.

The Television Without Frontiers directive (1989, 1997) says that European independent production should account for at least 10% of transmitted hours where practicable on all channels, including digital satellite and digital cable. The relevant definitions are slightly different from those that apply to the 25% and 10% independent quotas in the Communications Act, and Ofcom has the power to assess the extent to which compliance is or is not practicable.

- 3.38 Given the history of regulation focused on vertical integration, it is important to be clear about the reasoning that lies behind it.
- 3.39 Vertical integration is not usually considered a problem by competition authorities and regulators, unless it is combined with market power. In the case of vertically-integrated broadcasters without market power, they would be incentivised to commission programmes that offer the best value for money. In doing so, this may serve the interests of viewers – particularly as consumers of television.
- 3.40 However, as discussed above, the current market structure may not provide this incentive – and could therefore lead to a diminution in programme quality. This is because competition between broadcasters for audiences may not be sufficiently effective. For example, broadcasters may give the objective of serving the interests of viewers by commissioning the highest quality programmes a lower priority than using the option to commission in-house to enhance their bargaining position with external producers.
- 3.41 Intervention in this area may therefore be considered necessary because of a potential failure by broadcasters to commission the programmes that satisfy the interests of viewers as consumers.
- 3.42 Moreover, even if competition were effective, the BBC and Channel 3 commissioners would still routinely face the question of whether to commission in-house or from external producers. If the theory holds that broadcasters are primarily motivated to commission programmes that will attract audiences, the issue of whether the producer is in-house or external should not be a decision-changing factor.
- 3.43 However, if the outcome of a commercially rational decision were to lead towards a natural tendency to commission in-house production, then this may be considered a cause for concern – partly because this could also result in a reduction in the diversity of production.
- 3.44 This tendency to commission in-house could arise if there were significant efficiencies associated with in-house production. With this in mind, it is useful to understand what these efficiencies might be by considering why broadcasters like the BBC and ITV plc may seek to hold such significant in-house production capacity. The motivation can be explained in part by a number of factors:
- The need for broadcasters to develop output tailored to their specific needs. They may increasingly require their programming to be distinct and consistent with their overall programme strategy. An in-house capability allows them to control or manage a producer whose incentives are aligned explicitly with their own
 - In-house production provides security of supply and the ability to control the production process, which is particularly important to broadcasters who commission large volumes of original productions
 - There may be synergies arising from in-house production, e.g. reduced transaction costs in the commissioning process, savings from sharing of fixed overheads across a critical mass of production, savings associated with material developed for cross-platform, cross-channel exploitation and savings to be made from on and off the job training for talent working across different in-house productions
 - Producing in-house may be cheaper on an incremental cost basis if the capacity is otherwise to be left underutilised

- Producing a programme in-house allows the broadcaster to retain all the rights to the programme, which differs from the current situation with most external commissions. This can have a commercial impact on future revenues from the exploitation of the programme in secondary markets.
- 3.45 The BBC goes further in its support of in-house production and raises a number of further benefits from maintaining a material in-house production capability. These may in some cases be generic for any broadcaster, but the majority are specific to the BBC⁸:
- Protecting range and diversity in programming. The BBC argues that market imperatives result in a narrowing of the range of programming provided by independent production companies. As a result, in-house production can help ensure range and diversity, and security of supply
 - Underpinning risk-taking and innovation. The licence fee is said to allow the BBC to develop public service content which is high-risk editorially, has long production lead times, delivers lower secondary value, and which can be maintained in spite of downward trends in the international co-production market
 - Providing the foundation for industry training. The BBC argues that the whole industry benefits from the BBC's commitment to raising employment standards, establishing suitable apprenticeships, and investing in individuals' training needs
 - Sustaining a diverse production base in the Nations and Regions. The BBC recognises that it is vitally important to audiences to bring different regional flavours to programming. The BBC believes that its plans to increase production in the Nations and Regions can only be delivered and sustained if the BBC can commit to sufficient levels of investment and maintain a critical mass in many parts of the UK. This issue is discussed later in further detail
 - Creating a 'treasure chest' of content for the nation. The BBC believes that in-house production has been an important enabling force to help create this national resource. And the BBC also argues that in-house production helps in securing value for money for the licence fee payer. Specifically, it allows the BBC to own and control a range of programme rights that can be exploited easily and cost-effectively, without the need for substantial additional payments.
- 3.46 Taken together, these reasons for maintaining an in-house production capability are the basis for the view that – even if competition were effective – vertically-integrated broadcasters may have a natural tendency to commission in-house.
- 3.47 From Ofcom's perspective, issues of competitive advantage potentially apply, but nonetheless may not be a cause for concern or intervention. A broadcaster displaying a natural commercial tendency towards its in-house production may simply be operating with increased efficiency – the benefits of which could be passed on to viewers.
- 3.48 However, this natural tendency towards in-house may lead to a reduction in the diversity of the supply of programming. From a social perspective regulatory intervention may be justified to help ensure that there is diversity and plurality in the supply of programming – which is in the interests of viewers as UK citizens.

⁸ The BBC's arguments in the bullets that follow are summarised from pages 78 to 80 of the BBC's response to the Green Paper on the Review of the BBC's Royal Charter, *A strong BBC, independent of government*.

- 3.49 This point may seem contentious, because there is ultimately a trade-off between the potential benefits of in-house production, and any potential reduction in diversity and plurality in the supply of programmes. For example, would it be unattractive for the BBC and ITV1 to make all their programmes in-house if this allowed the full benefits of in-house production to be realised?
- 3.50 It would seem from previous interventions that this outcome is seen as undesirable. After many years of speculation as to what the fourth channel in the UK should look like, Lord Annan's 1977 report on the future of broadcasting recommended that it should be a publisher-broadcaster with no in-house capacity, commissioning all of its programmes from external producers.
- 3.51 The intention of this policy was to grow an external production sector that could be a counterweight to powerful in-house production, seen among other things as stifling creativity and not taking advantage of the widest range of ideas. In fact, despite the formation of Channel 4, in 1986 Peacock recommended a 40% independent quota for the BBC and Channel 3, a proposal that was ultimately implemented in 1993 as a 25% quota. This quota is supported by definitions of qualifying independent producers, which exclude those production companies that share significant common ownership with broadcasters. These interventions are not only intended to address concerns over vertical integration, but also to help deliver a diversity of production. Specifically, it would not be sufficient for two producers (at the BBC and ITV1) to supply all broadcasters – a broader diversity of production has been sought.
- 3.52 Given the direction of policy in this area, it could seem a backward step for viewers if in-house production were to increase in the future even if this were the outcome of rational commercial decisions being made in a competitive market. The independent production quota, the definition of qualifying independent producers and Channel 4's position as a publisher-broadcaster ensure that the external production sector can support a plurality and diversity of producers that continue to attract and retain the creative talent needed to make programming of high quality, range and diversity – and which impose a strong competitive constraint on in-house production at the BBC and ITV1.
- 3.53 With intervention in the past focused on moving the production sector from one structure to another – i.e. from a situation of almost entire in-house production to one of mixed production – intervention today would seem focused on ensuring that both in-house and external producers compete fairly on a "level playing field" for commissions from broadcasters. This will allow the competitive process to ensure that each is motivated to provide broadcasters with the best ideas, and that commissioners are motivated to commission solely on the basis of the quality of ideas. We note the inherent subjectivity of the commissioning process – for instance, a commissioner can never truly know the quality of a commissioned idea until after the programme has been broadcast, and the audience reaction has been gauged. But the focus of intervention to create a level playing field is to maximise the likelihood that the best ideas reach television screens.
- 3.54 An open question concerns the nature of competition between external and in-house producers. At present, aside from the ITV Networking Arrangements, there is no direct intervention to ensure competition between external and in-house producers is on a level playing field. If intervention were to be introduced, this would potentially negate the efficiencies of in-house production. One view might be that external producers must strive to overcome these inherent benefits, rather than for these benefits to be removed.

- 3.55 In the case of the ITV Network, the structure of the ITV Network Centre and the commissioning process go some way to ensuring such a level playing field. The BBC's new WOCC proposals (discussed later in this document) provide a good opportunity to enshrine principles of free and fair competition between BBC in-house and external producers. However, it is worth highlighting that one way to achieve absolutely free and fair competition for commissions may be to move entirely away from vertical integration, either through structural or more functional separation. This would ensure greater meritocracy in commissioning, but would come at a cost in terms of the loss of efficiencies associated with in-house production.

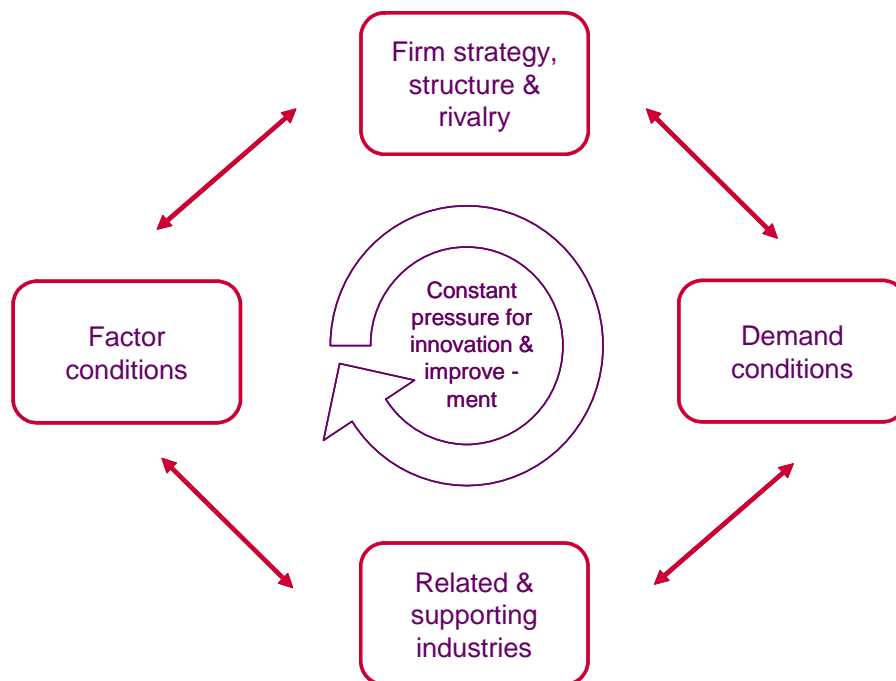
Geographic concentration

- 3.56 Spanning both external and in-house production is the issue of where production takes place. As discussed in Section 2, Ofcom takes the view that the geography of production matters from the perspective of viewers. Production concentrated in London could carry with it significant detriment for viewers from a lack of diversity in TV content. Moreover Section 2 suggested that the main terrestrial channels have a responsibility to ensure not only that their content is representative of the different cultures and views from across the UK, but also that their expenditure is not overly concentrated in London.
- 3.57 This idea has a long history of intervention associated with it, comparable to that of the issues of vertical integration. In 1955, ITV was created as a federal, regionally based organisation, partly in order to provide a counterbalance to a then largely London-centric BBC. Licences were awarded periodically based on a 'beauty parade' system which emphasised the programme-making achievements and aspirations of the applicants. While the Independent Broadcasting Authority (IBA, the predecessor organisation to the ITC) measured how much network programming was provided by each ITV region, formal regional production quotas did not arrive until 1998 when, as part of its licence renewal, Channel 4 was required to spend at least 30% outside London. Five agreed to a 10% out of London target in 2001, and in 2002 the ITV Charter committed ITV1 to an out of London spend of at least 50% including both regional and network programmes.
- 3.58 The Communications Act requires that a suitable proportion of programmes are made outside the M25, that these constitute a suitable range of programmes, and that a suitable proportion of money is spent in a suitable range of production centres. The BBC's out of London quota is measured across all BBC channels and is 25% by hours and 30% by spend. Channel 4 and Five's commitments are 30% and 10% respectively, measured by hours and spend, while ITV1 is committed to 50% by both hours and spend. Ofcom recently sought to give further clarity to the meaning of these quotas and implemented new definitions – excluding non-network programming and defining a programme as an out of London production only if it satisfies at least two of the following three conditions:
- It is made by a company with a substantial business and production base outside London
 - 70% of the programming budget is spent outside London
 - 50% of the talent contributing to the programme is based outside London.
- 3.59 This intervention is considered necessary because of the view that, without intervention, the majority of production would base itself in London – the reasons for this are considered below. As discussed earlier, from the perspective of diversity, this would not be a good outcome for viewers.

- 3.60 As noted in Section 2, the importance of diversity – and by implication the need for intervention to secure it – is driven by the underlying interests of viewers, and is not related to any specific industrial regional policy. We recognise, however, that the policy tools developed to secure out of London production may appear to be consistent with an industrial policy approach – namely, the intervention takes place at the input (production), rather than the output (broadcast) level.
- 3.61 This focus on promoting diversity by intervening at the production level is reflected in the Communications Act. However, it is useful to explain why it may not be appropriate to intervene to resolve this issue by imposing obligations solely at the broadcast (output) level. The key reason relates to the difficulty of measuring diversity in this case, where we use the term diversity in a broad sense – i.e. diversity of perspectives as well as more direct cultural depiction. Intervention at the production level can be thought of as promoting the various types of diversity in the production process, and therefore ultimately in the content viewers receive. In contrast, regulating diversity purely through output regulation would require constant monitoring of content – and so would be highly intrusive.
- 3.62 In order to understand why intervention is required, it is necessary to examine the key reasons behind the “London pull”. We have adopted a framework based on Michael Porter’s work on *The Competitive Advantage of Nations*⁹. This framework can be used to help us understand the forces which may drive production to concentrate in London. Porter examines the reasons behind the development of national and regional clusters of excellence and expertise. He identifies four sources of local or national competitive advantage:
- **Factor conditions**, such as skilled labour, knowledge/research resources or natural resources
 - **Demand conditions**, such as the segment structure of demand, or the presence of sophisticated and demanding buyers
 - **Related and supporting industries**, which support the process of innovation and improvement
 - **Firm strategy**, structure and rivalry which promote competition and innovation.
- 3.63 These sources of regional competitive advantage work together in a mutually-reinforcing dynamic way. They promote success by generating constant pressure for innovation, invention and entrepreneurship. Figure 3.4 below summarises these interrelationships.

⁹ Porter examines why different countries – and by extension different geographic locations – develop skills in particular areas of commercial activity. For instance, why is it that the Swiss have developed such strong positions in watch manufacture, pharmaceuticals and luxury chocolate processing, while the Germans excel in producing high specification automobiles and the Italians leather footwear? Focusing more directly on geographic location, why does the global feature film industry concentrate on Los Angeles, the US high tech industry in Silicon Valley and Boston, the US insurance business in Stamford, Connecticut and the US automotive industry in Detroit?

Figure 3.4 Porter's "Diamond": the determinants of national or local competitive advantage



3.64 For the UK television production sector, London is such a location where all these factors come together and reinforce each other to create constant pressure for success:

- **Factor conditions:** the predominant factor condition for TV production is a skilled workforce. London's workforce covers every technical skill and every genre and production type. Highly skilled workers who live outside London are, in the majority of cases, willing to make themselves available in London at no extra cost – in contrast, London-based workers expect to be paid extra to work outside London
- **Demand conditions:** the overwhelming majority of mainstream channel commissioners – and more precisely budget-holders – are based in London. Producers tend to believe they stand more chance of winning a commission if they are based in London. In our discussions with external producers, including those based outside London, the importance of relationships with commissioners and access to the decision-makers has been a core and common theme. Commissioning is a subjective process of weighing up the merits of one idea over another, so naturally relationships and trust play a strong part in the process. Moreover, there are lower transaction and search costs in seeking out and securing commissions from the perspective of producers and commissioners if all are based in the same place
- **Related & supporting industries:** there is a legacy of production and investment in London which has led to extensive networks in infrastructure and other suppliers of crucial inputs into the production process. London has the widest range of facilities businesses supporting TV production, working at all technical and budget levels. Whilst this is beneficial to London producers, London-based producers also give commissioners a greater confidence and security that they are capable of delivering on commissioners' needs – this is because commissioners know that there are extensive networks available to producers in London to help them seek out talent and secure infrastructure. Looking at related industries, London is home to the advertising and commercials industries, which at the high end drive creative

and technical innovation in production techniques, and provide parallel employment for skilled freelancers. London is also the main base for the UK's film and theatre sectors, which provide similar creative stimulus and employment opportunities

- **Firm strategy, structure and rivalry:** London is home to the widest range and largest number of production companies, which in turn accentuates competition, information-sharing, and encourages spin-offs and new entrants.
- 3.65 The London TV production cluster has long been self-reinforcing. It acts as a magnet for talent, drawing ambitious and talented individuals to the capital. The processes that generate competition, innovation and success are all accelerated by proximity within the London cluster:
- Proximity allows the rapid flow of information, so producers hear quickly of creative and technical innovations and shifts in broadcaster taste. They can more easily hear about and seek out skilled freelancers to staff their productions
 - Proximity amplifies competitive pressure, making producers constantly aware of their position relative to peers, and the advances competitors are making
 - Proximity allows commissioners to take a more active role in the development and production process – this is an increasingly common trend
 - Proximity and concentration encourage increased specialization and the development of deeper levels of technical skill.
- 3.66 Ultimately, from the perspective of producers and commissioners, the likelihood of success – defined in the broadest sense – is higher with production taking place in London. There would therefore be costs involved in doing things in any other way.
- 3.67 Section 4 of this document summarises the current position with regard to production outside London, and later sections consider the question of whether intervention in this area remains necessary.

Summarising intervention in the television production sector

- 3.68 Three particular features of the television production sector have been identified as acting against viewers' interests, and so driving the need for intervention :
- **Negotiating strength:** there are 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.

3.69 These factors have given rise to a number of different interventions:

- **To address concerns over broadcasters' negotiating strength:** the Act set out a requirement for each public service broadcaster to introduce new Codes of Practice to govern the relationships between broadcasters and independent producers
- **To address concerns over vertical integration:** Channel 4 was established on a publisher-broadcaster model, each of the main terrestrial broadcasters must fulfil the statutory independent production quota, and definitions of qualifying independent producers have been put in place in order to exclude those production companies that share significant common ownership with broadcasters
- **To address concerns over geographic concentration:** the main terrestrial broadcasters must adhere to quotas for production outside London; and these quotas are supported by definitions of out of London productions.

3.70 Figure 3.5 below summarises the different quotas in relation to independent and out of London production as they stand today:

Figure 3.5 Production quotas per calendar year for main terrestrial channels

Quotas (% of hours)	BBC One	BBC Two	Channel 3	Channel 4	Channel 5
Independent production ¹⁰	25% ¹¹	25%	25%	25%	25%
Original production ¹²	70%	70%	65%	60%	53%
Original production broadcast in peak	90%	80%	85%	70%	42%
Regional production ¹³ (% of hours)	25% across all BBC channels	See BBC1	50%	30%	10%
Regional production (% of spend)	30% across all BBC channels	See BBC1	50%	30%	10%
Regional programmes made in and for the region	95% BBC1 & 2 together	See BBC1	90%		
European original production ¹⁴	50%	50%	50%	50%	50%
European independent production ¹⁵	10%	10%	10%	10%	10%

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?

¹⁰ DTT channels are also required to fulfil an independent production quota of 10%. The definition of 'independent production' excludes repeats, news and acquired programmes.

¹¹ BBC One, BBC Two and BBC Three each have to achieve 25% independent production separately, and all BBC channels need to achieve the 25% quota collectively.

¹² Original production, by this definition, includes repeats.

¹³ Regional production consists of network programmes made outside the M25, including repeats.

¹⁴ The Television Without Frontiers Directive excludes news, sport and game shows from the quota for European programmes.

¹⁵ The same quota applies to all digital channels, where practicable.

Section 4

Current position of the television production sector

4.1 In this section, we summarise the key findings of our survey of TV programme production in the UK. This section is focused on the evidence base, and does not draw conclusions about the policy implications of current developments in the sector – we return to these implications later in this document. Specifically, the next section sets out a range of propositions regarding likely future developments in the sector, and the implications for intervention that follow.

4.2 Our analysis of the TV production sector amounted to the first comprehensive statistical assessment of the sector ever assembled in the UK. We focused on answering three broad areas of questions:

- **General market overview**

- How much has the production market grown in recent years?
- What is the relative importance of in-house and external commissions?
- Who are the major commissioners?

- **External production sector**

- What is the composition of external production sector by size of producers?
- What is the relative importance of commissions from different broadcasters?
- What are the sources of revenues for production companies?

- **Out of London production**

- What is the value of network and non-network programming out of London and where does it take place?
- What is the BBC and ITV1 activity out of London?
- What genres are commissioned out of London?

Context

- 4.3 The statistical survey of the TV production sector carried out as part of the Review comprised both supply and demand perspectives.
- 4.4 On the supply side, we have analysed the information supplied to Ofcom by all major broadcasters. Broadcaster data was provided on the programmes broadcast rather than the programmes commissioned. The figures are nominal and given for calendar years. The programme cost data provided by broadcasters excludes any indirect costs of production, such as marketing or general administration, and reflects the purchase price or the internal transfer price. The data also excludes the cost of sports rights and expenditure on premium sports and gaming channels.
- 4.5 On the demand side, we have used the information submitted by producers to the census of the production sector that was commissioned jointly by Ofcom and PACT in the summer of 2005, and undertaken by Digital-I. This was the first ever comprehensive census of the production sector in the course of which over 800 active production companies in the UK were contacted for information. Full or partial responses were received from 200 production companies which jointly account for £1.1bn of external production sector turnover, excluding Channel 3 production companies. Financial data from the producers was provided for the latest complete financial year up to, and including June 2005.
- 4.6 Amongst the respondents to the census, 53% of companies reported turnover in excess of £1m. In terms of location, 120 respondents had their headquarters based in London. Amongst 80 respondents whose headquarters were based outside London, 50 were based in the English Regions, 15 in Scotland, 10 in Wales and 5 in Northern Ireland.
- 4.7 There are some key differences in the broadcaster and producer data used in the Review. These differences mean that it is impossible to fully reconcile the supply and demand perspectives in the analysis, and that the external production sector data presented in the Review should therefore be treated as estimates only.
- The time periods for which the data was provided by the broadcasters and producers are different, with broadcaster data provided for full calendar years and producer data for a range of financial years
 - Broadcaster data was reported for programmes broadcast while producer data covered programmes commissioned
 - Respondents to the producer census do not represent 100% of the external production sector – as such, the reported figures may in some instances not be representative of the industry as a whole.

Definitions

- 4.8 For the purposes of the statistical analysis, we have employed a number of definitions. The channels included in the analysis are the principal UK channels that reported to Ofcom a significant volume and value of original production in 2004.

Major UK channel categories

- Main terrestrial channels – network
 - BBC1, BBC2, ITV1, Channel 4, Five

- Main terrestrial channels – non-network
 - BBC1/BBC2/ITV1 national and regional variations, S4C
- Main multichannel services
 - BBC3, BBC4, CBBC, CBeebies, E4, ITV2, Sky One, Disney Channel, Bravo, Trouble, Challenge, Living, UKTV channels, Discovery channels, BBC News, ITV News, Sky News

First run originations expenditure

- Programme production qualifying expenditure for the main terrestrial channels, and multichannel originations expenditure

Network and non-network programming

- Network programming – programming commissioned for network broadcast on any major UK channel. Includes both in-house and external commissions
- Non-network programming – programming commissioned for non-network broadcast on BBC1, BBC2, ITV1 and for S4C. It may also be subsequently broadcast on network. Includes both in-house and external commissions

External production companies

- Qualifying independents
- Non-qualifying external producers
- Vertically-integrated multichannel broadcasters (e.g. BSkyB)
- Vertically-integrated terrestrial broadcasters, when producing programmes for another broadcaster (e.g. Granada, SMG)
- TalkbackThames is classified as an external producer when commissioned by all broadcasters, including Five.

General market overview

- 4.9 UK channels spent £4.7bn on programming in 2004, including £1.2bn spent on sports and movie rights. Excluding rights, total programming spend amounted to £3.5bn and has been increasing at a compound annual growth rate (CAGR) of 3% per year since 1999. Total spend includes acquisitions as well as in-house and external commissions for both network and non-network broadcast. (See Figure 4.1)

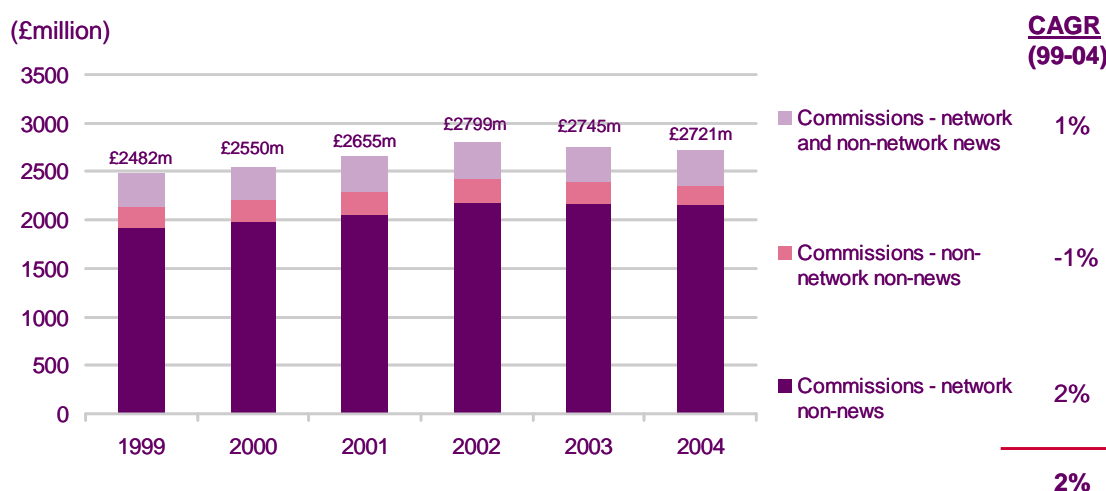
Figure 4.1: Major UK channels – total programming expenditure (including News)

Source: Data from broadcasters

Note: * Data included for ITV News from 2002; Sports/Movies rights from Ofcom Communications Market (2005)

4.10 Total first-run originations spend by the main terrestrial channels amounted to £2.7bn in 2004 and has been increasing at a rate of 2% per year since 1999. In 2004, network non-news commissions accounted for 79% of total first run originations spend, up from 77% in 1999. Non-network non-news commissions accounted for 8% of total spend in 2004; while network and non-network news accounted for 13% of total spend. (See Figure 4.2)

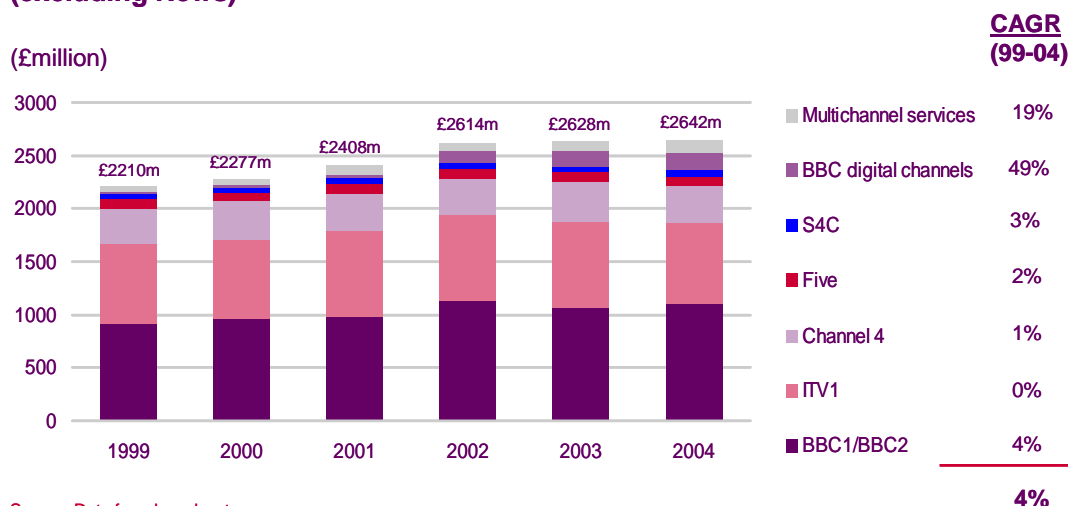
4.11 Over the same period, first run originations hours by the main terrestrial channels have declined by 2% per year. Network non-news commissions accounted for 44% of all hours in 2004, having declined at 1% per year since 1999. Hours of non-network non-news commissions experienced the biggest decline over the period, decreasing by 9% per year to represent 19% of all hours in 2004. Network and non-network news hours increased by 2% per year over the period and accounted for 38% of all hours in 2004.

Figure 4.2: Main terrestrial channels – first run originations expenditure (including News)

Source: Data from broadcasters

- 4.12 In terms of spend by different broadcasters, the main terrestrial channels accounted for 87% of total first run originations expenditure in 2004, with their share down from 95% in 1999. The most significant growth in expenditure came from the BBC digital channels. Their spend on first run originations grew at a rate of 49% per year over the period to £163m in 2004, albeit from a very small base. The first run originations spend by other multichannel services also grew significantly at a rate of 19% per year since 1999, amounting to £123m in 2004. Overall, the total spend on first run originations, excluding News, by all major UK channels grew at 4% CAGR since 1999 and amounted to £2.6bn in 2004. (See Figure 4.3)

Figure 4.3: Major UK channels – first run originations expenditure (excluding News)

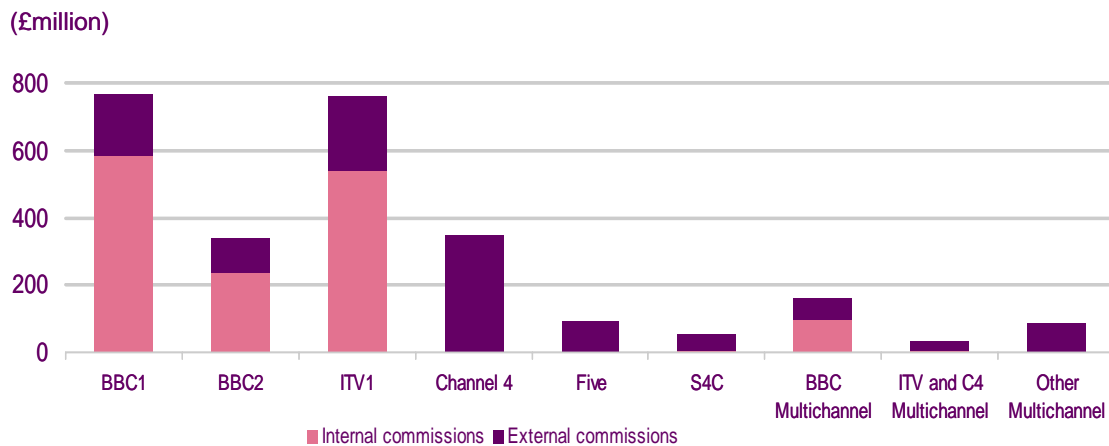


Source: Data from broadcasters

Figures for Multi-channel services exclude Sky's sports, films and gaming channels

- 4.13 Although total spend has increased at a rate of 4% per year since 1999, hours of first run originations have declined at 1% per year over the same period. The proportion of first run originations spend going to in-house and external producers has remained steady in the period between 1999 and 2004. In-house commissions accounted for 59% of all first run originations spend in 2004 – the same percentage as in 1999. In-house commissions hours have declined by 2% per year over the period, while external commissions hours have remained constant.
- 4.14 Across the main terrestrial channels, 56% of the 2004 first run originations spend was in-house, with publisher-broadcasters Channel 4 and Five obtaining 100% of their first run originations externally. External commissions accounted for 63% of first run originations spend by multichannel services. (See Figure 4.4)

Figure 4.4: Major UK channels – 2004 first run originations expenditure (excluding News)

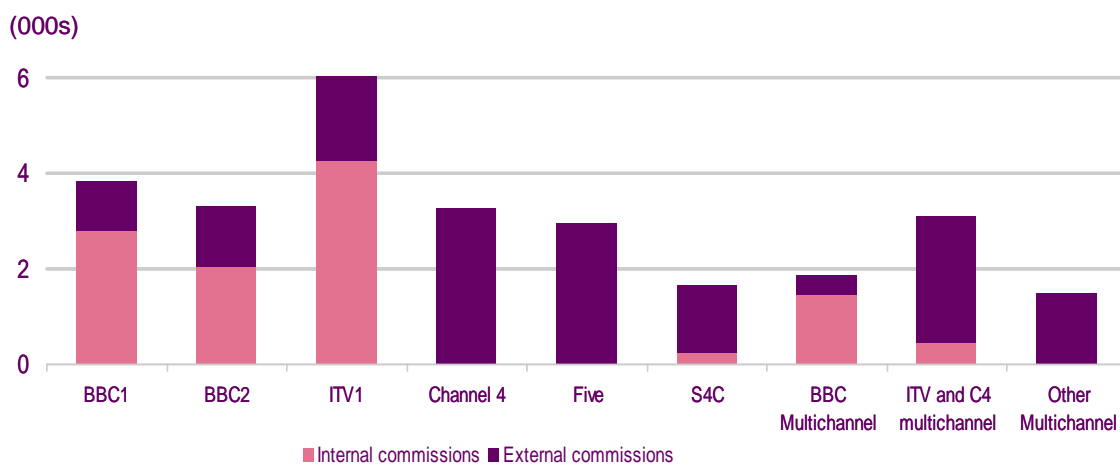


Source: Data from broadcasters

Note: Figures for Other multi-channel exclude Sports and Gaming programming. Figures for ITV and C4 Multi-channel include estimate of brand extensions from main terrestrials.

- 4.15 Channel 4 and Five were the largest commissioners of external hours of first run originations in 2004, jointly accounting for 38% of all external hours. 71% of hours commissioned by multichannel services were externally produced. (See Figure 4.5)

Figure 4.5: Major UK channels – 2004 first run originations hours (excluding News)



Source: Data from broadcasters

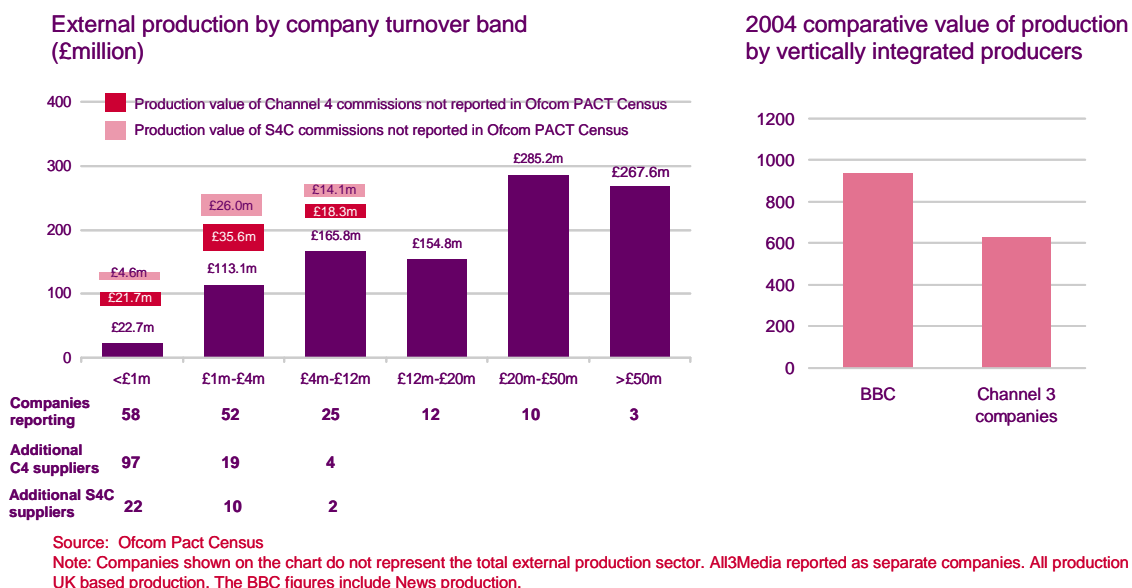
Note: Figures for Other multi-channel exclude Sports and Gaming programming. Figures for ITV and C4 Multi-channel include estimate of brand extensions from main terrestrials.

External production sector

- 4.16 The Ofcom PACT census undertaken in the summer of 2005 identified over 800 active production companies in the UK. In July 2005, 704 of the companies were registered members of PACT, with around 200 affiliate member companies with turnover of less than £100,000 per year. In addition, there is a small number of companies who are members of the Welsh trade association TAC, and a small number who are not affiliated to any trade association. The number of unaffiliated companies is difficult to assess with certainty because their activity may vary from year to year.

- 4.17 The census questionnaire was sent to all identified production companies. 200 of these companies submitted responses to the census, of which 187 companies provided turnover data. The total value of turnover reported by the census participants was £1.1bn. Our analysis suggests that the responses represent around 70% of the total external production sector turnover, estimated at £1.6bn.
- 4.18 The data we received suggests that a relatively small number of production companies accounts for the bulk of the turnover generated by the sector. In addition, there is a large tail of small production companies each generating less than £1m of turnover per year.
- 4.19 Amongst the respondents, 25 companies reported turnover in excess of £12m while 58 companies reported turnover of £1m or less. Based on industry information available, we estimate that there around 50 additional external production companies that did not participate in the census which generate revenues in excess of £1m. The remaining tail of active producers consists of smaller companies that tend to generate less than £1m per year in turnover. (See Figure 4.6)

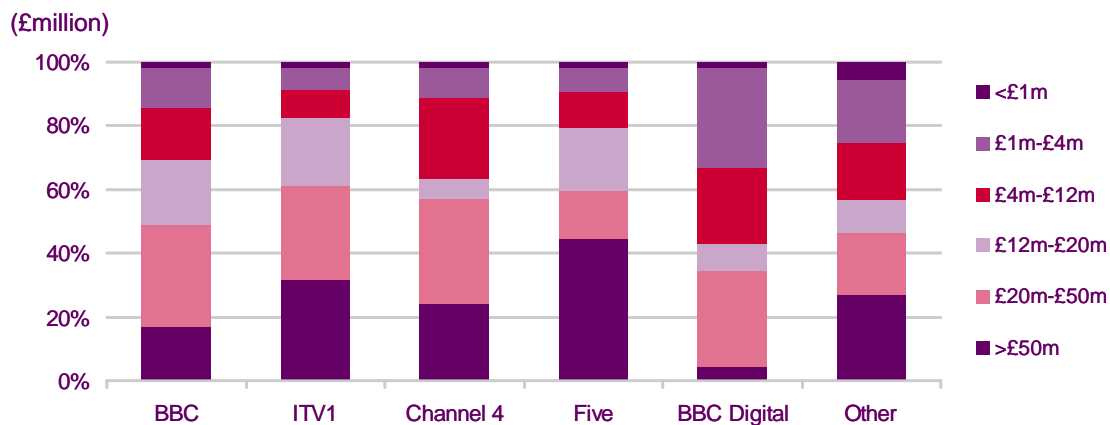
Figure 4.6: External production – 2004 reported turnover by company size



- 4.20 In the sample of respondents, larger external companies generating in excess of £12m in turnover (25 companies in the figure above) accounted for a relatively high proportion of commissions for the main terrestrial broadcasters - 69% of all reported commissions for the BBC, 83% for ITV1, 63% for Channel 4 and 79% for Five. Amongst census respondents, companies with turnover in excess of £12m accounted for 43% of all reported commissions for BBC digital channels. This is detailed in Figure 4.7. Given that the census responses were weighted in favour of larger companies, in Figure 4.8 we adjusted the data to take into account additional companies that have been commissioned by the main broadcasters in 2004, but did not submit a response to the Ofcom PACT census¹⁶.

¹⁶ Due to unavailability of data, we were not able to adjust the bar relating to the BBC Digital channels.

Figure 4.7: External production – 2004 reported commissions by channel and company turnover band

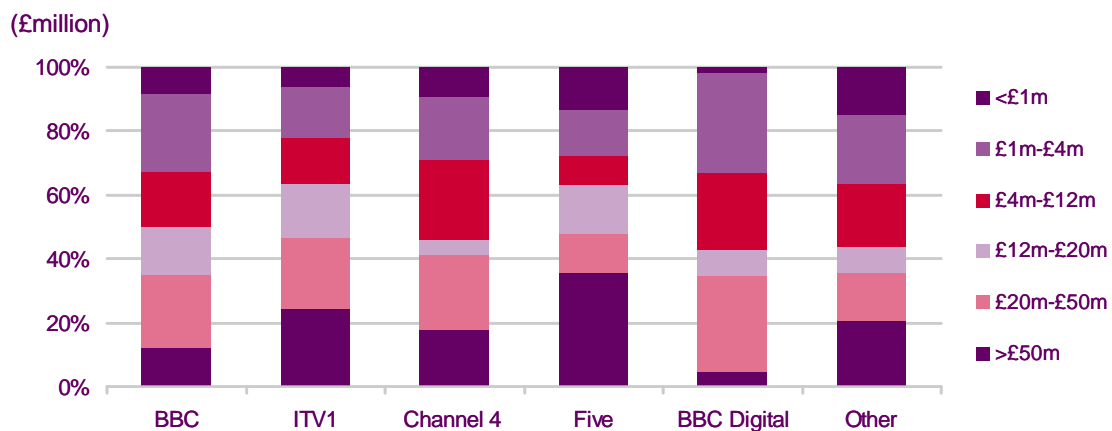


Source: Ofcom Pact Census

Note: Companies shown on the chart do not represent the total external production sector.

- 4.21 Taking those additional companies into account, the adjusted data shows that production companies with turnover in excess of £12m accounted for a smaller proportion of all commissions – 50% of commissions for the BBC, 63% for ITV1, 46% for Channel 4 and 63% for Five.

Figure 4.8: External production adjusted* – 2004 commissions by channel and company turnover band



Source: Ofcom Pact Census and data from broadcasters

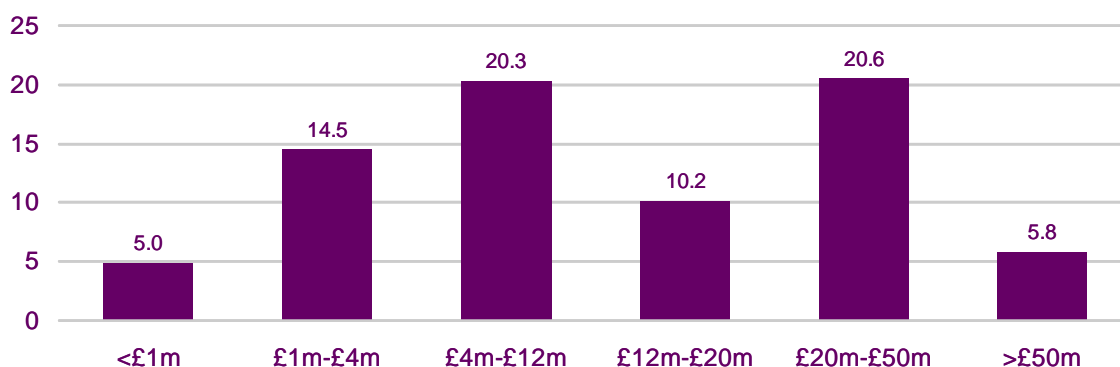
Note: Companies shown on the chart do not represent the total external production sector.

* Ofcom adjustment is based on production companies that have been commissioned by broadcasters but that did not submit a response to the Ofcom Pact Producer Census. The adjustment figures for the BBC and ITV1 do not include non-network external production.

- 4.22 Commissions for multichannel services, excluding the BBC, ITV and Channel 4 digital services, were reported by companies of all sizes. 48% of all reported commissions for multichannel services were from companies with turnover in excess of £12m. Companies with turnover of £1m or less accounted for 7% of reported multichannel commissions. (See Figure 4.9)

Figure 4.9: External production – 2004 reported commissions from Multichannel services by company turnover band

(£million)



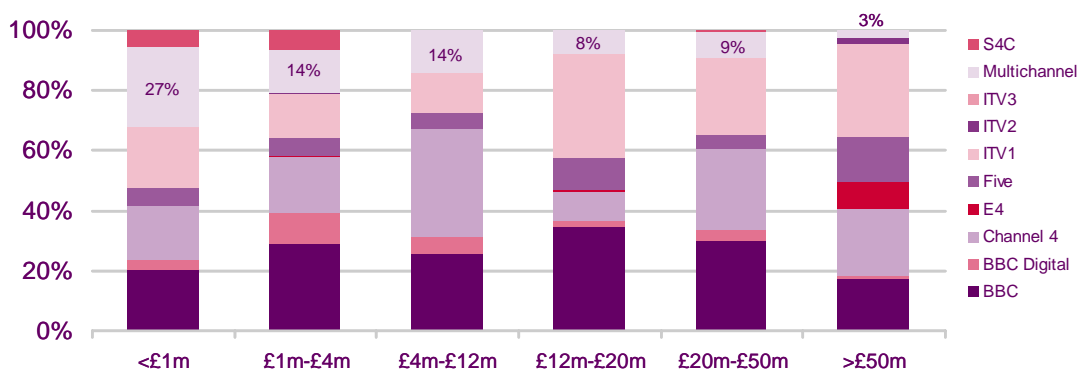
Source: Ofcom Pact Census

Note: *Multichannel excludes commissions from ITV2, ITV3, BBC Digital, and E4

- 4.23 Though smaller producers tended to have a larger proportion of their total turnover from multichannel services, a range of broadcasters was represented in the turnover reported by producers of all sizes. Multichannel commissions represented 27% of turnover reported by companies with £1m or less of total turnover. That proportion was 9% for companies with turnover between £20m and £50m, and 3% for companies with turnover in excess of £50m. Taking into account commissions for the BBC, ITV and Channel 4 digital services, multichannel commissions accounted for 30% of total turnover of companies in the lowest turnover band, and 14% of total turnover of companies in the highest turnover band. (See Figure 4.10)

Figure 4.10: External production – 2004 reported commissions by company turnover band and commissioning channel

(£million)



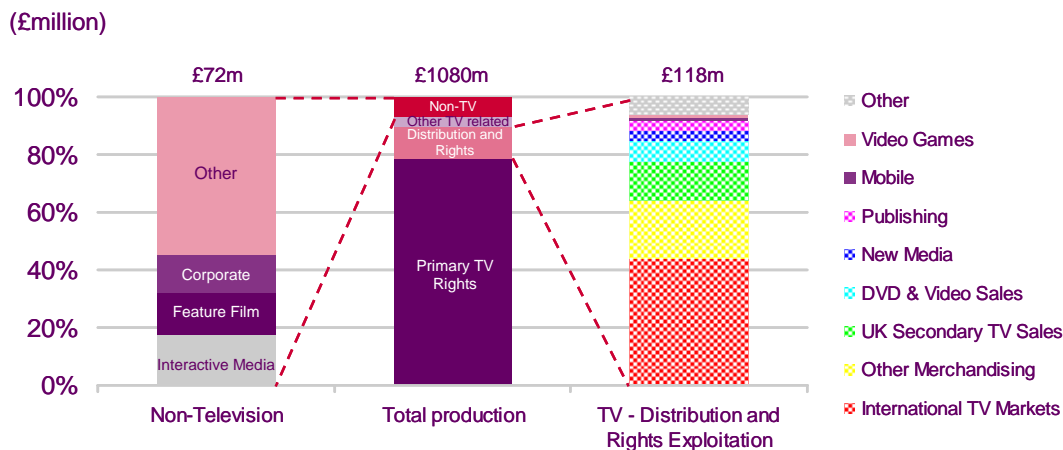
Source: Ofcom Pact Census

Note: *Multichannel excludes commissions from ITV2, ITV3, BBC Digital, and E4

- 4.24 In terms of sources of turnover, primary TV rights accounted for 79% of total reported production turnover. Distribution and rights exploitation accounted for an additional 11% of reported turnover, amounting to £118m. Non-television turnover represented 7% of total reported turnover, with £13m reported from interactive media production. This is detailed in Figure 4.11 below.
- 4.25 Figure 4.11 also shows that 44% of total reported distribution and rights exploitation turnover was accounted for by UK-originated programme and format sales in

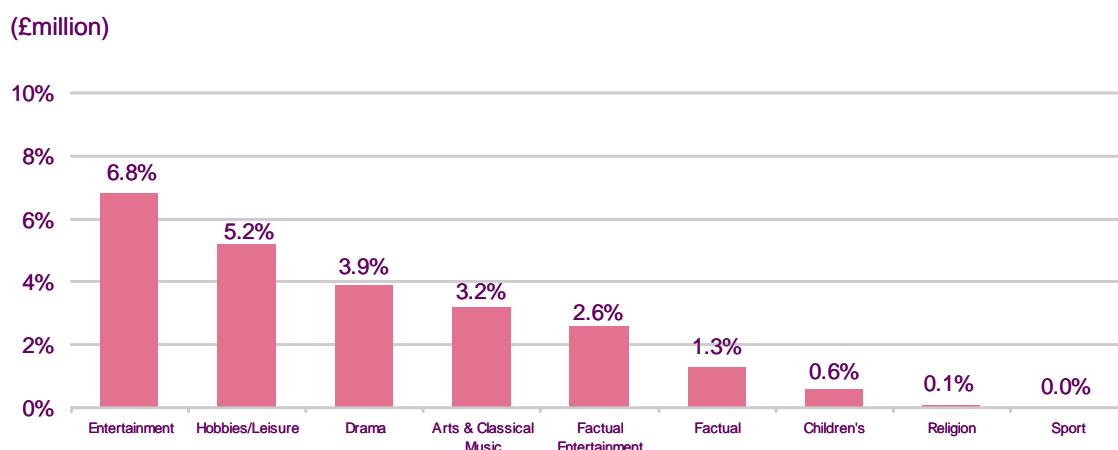
international TV markets. Merchandising and UK secondary TV sales were two other significant categories of distribution and rights exploitation turnover, accounting for 20% and 14% of the total reported respectively. The reported turnover from new media and mobile platforms was £6m or 5% of the total. Due to timing and accounting issues, the reported revenues may underestimate the full financial impact of Codes of Practice on producers' turnover.

Figure 4.11: External production – 2004 reported production turnover



- 4.26 Our analysis also suggests that the potential for generating additional turnover from secondary rights exploitation may differ across genres. As demonstrated in Figure 4.12 below, Entertainment & Hobbies and Leisure genres reported the highest additional revenues as a percentage of total TV turnover within genre – 6.8% and 5.2% respectively. Drama, Arts & Classical Music and Factual Entertainment reported a smaller proportion of additional revenues, while for other genres reported additional turnover was minimal.

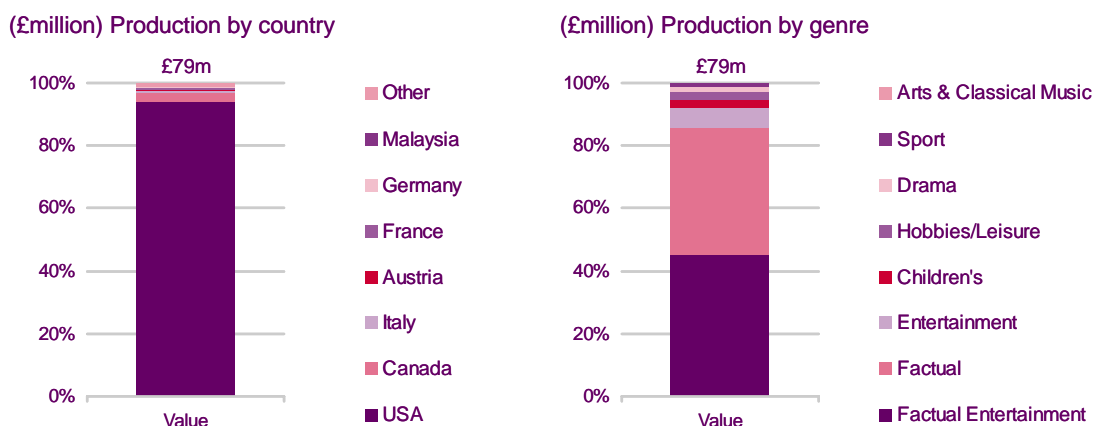
Figure 4.12: External production – 2004 reported additional turnover as proportion of total TV turnover within genre



Source : Ofcom Pact Census

- 4.27 Respondents to the Ofcom PACT census reported £79m of international production turnover. By far the largest proportion of international production was for the US market, amounting to £75m. In terms of genres, Factual Entertainment and Factual were the most significant genre categories, accounting for 45% and 40% of total reported turnover respectively. (See Figure 4.13)

Figure 4.13: External production – 2004 reported UK production for international broadcasters by country and genre

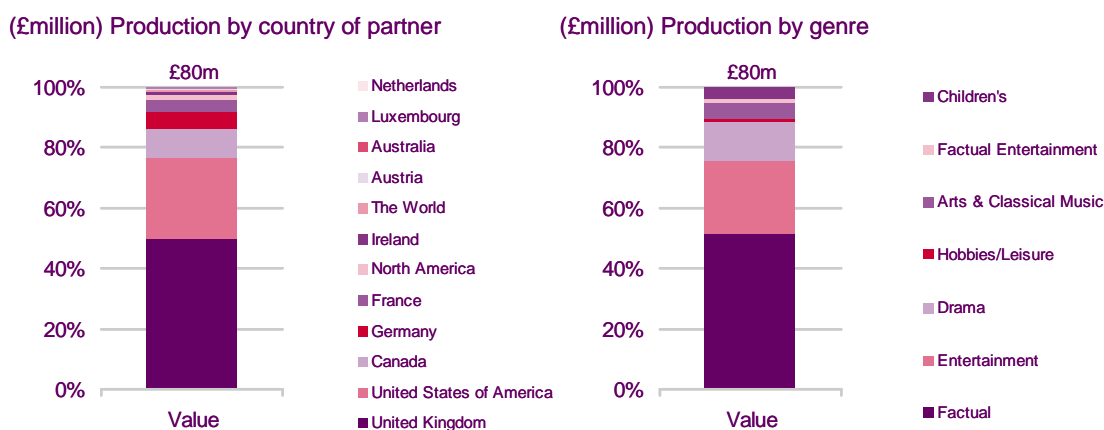


Source: Ofcom Pact Census

Note: Figures exclude Granada, SMG, GMTV, UTV. All production is UK based carried out for broadcasters outside the UK.

- 4.28 Respondents to the census reported £80m turnover from co-production. UK based co-productions represented 50% of the total reported turnover, with USA and Canada representing a further 27% and 10% respectively. In terms of genres, Factual was the most significant genre, accounting for 52% of total reported turnover. Entertainment was the second largest genre category, representing a further 24% of the total. (See Figure 4.14)

Figure 4.14: External production – 2004 reported UK co-production for by country of co-production partner and genre



Source: Ofcom Pact Census

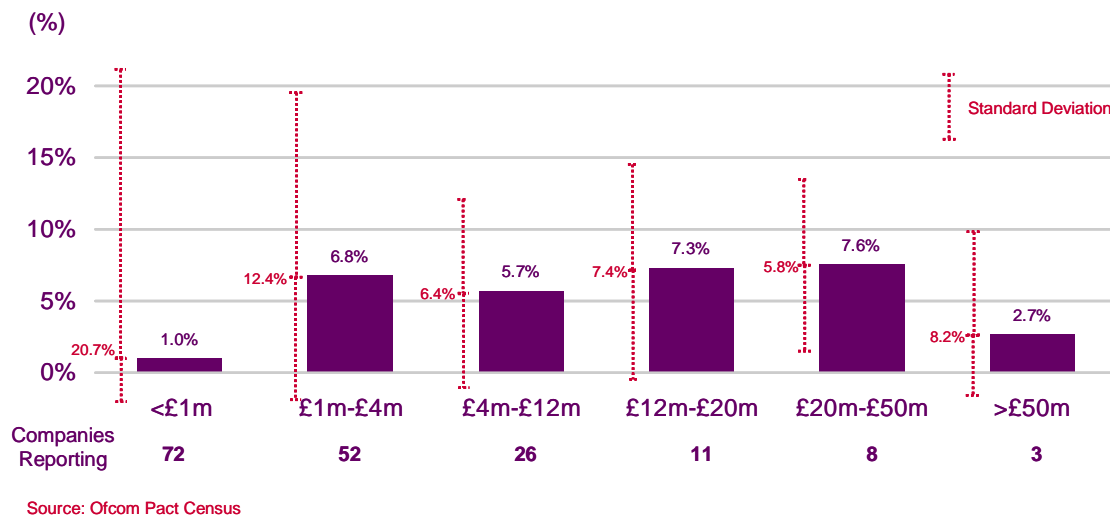
Note: Figures exclude Granada, GMTV, SMG, and UTV

- 4.29 Our analysis of profitability of external production companies revealed that the smallest companies, with turnover of £1m or less, have the lowest average operating profit margin of 1% and also exhibit the largest variation in profitability of any turnover category. The largest companies, with turnover in excess of £50m, also reported a

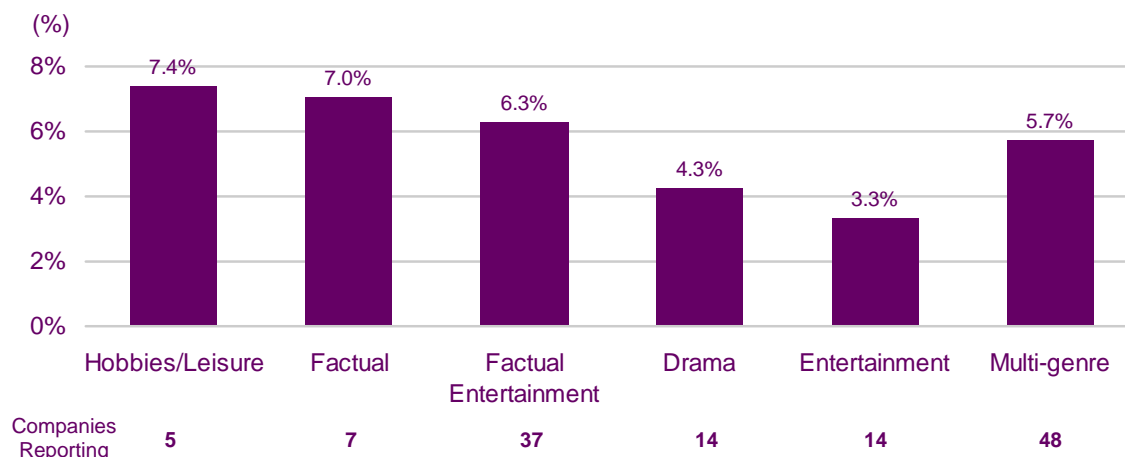
relatively low average operating profit margin of 2.7% – albeit with smaller variation within the category. This is shown in Figure 4.15 below.

- 4.30 Companies in all other turnover categories showed a similar average operating profit margin, ranging from 5.7% for companies with turnover between £4m and £12m to 7.6% for companies with turnover between £20m and £50m. The variation in profitability was again largest for relatively small companies with turnover between £1m and £4m. (See Figure 4.15)

Figure 4.15: External production – 2004 reported average operating profit margin by company turnover band



- 4.31 Our analysis suggests that profitability also varies by genre. We looked at the average operating margin of single-genre companies which, for the purposes of the analysis, we defined as those companies with 75% or more of their turnover sourced from a single genre. As Figure 4.16 shows, Hobbies & Leisure and Factual companies had the highest average operating profit margins of 7.4% and 7% respectively. On the other hand, Drama and Entertainment companies reported lower average operating margins of 4.3% and 3.3% respectively. We note, however, that the sample of Hobbies & Leisure and Factual companies is smaller than that of other genre groups.

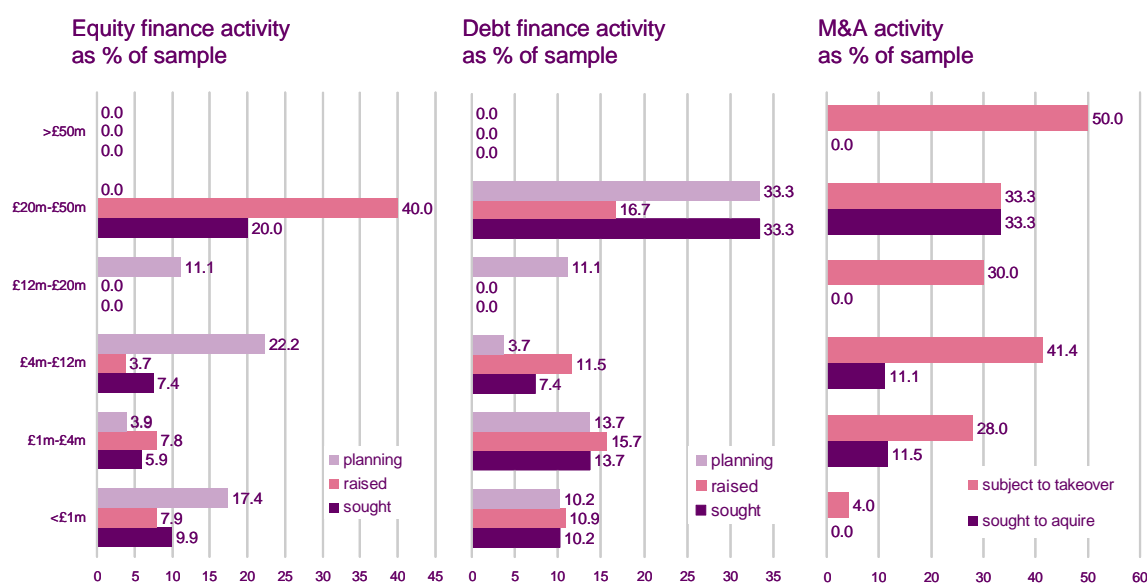
Figure 4.16: External production – 2004 reported average operating profit margin by company genre classification*

Source: Ofcom Pact Census

Note: *A company with $\geq 75\%$ of production revenue in a single genre is considered a single genre company

4.32 The corporate finance activity reported in the census varied considerably by company size. Figure 4.17 shows that 8% of companies with turnover of £1m or less raised equity finance in the past 12 months, compared to 40% of companies with turnover between £20m and £50m. Similarly, 11% of smallest companies raised debt finance compared to 17% of companies with turnover between £20m and £50m. And while 11% of smallest companies were planning to seek debt finance over the next 12 months, 33% of companies with turnover between £20m and £50m were planning to do so.

4.33 Relatively small production companies, with turnover of £12m or less, appeared more likely to be takeover targets than to seek to acquire other companies themselves. Companies with turnover between £20m and £50m, however, appeared just as likely to seek to grow through acquisition as to be approached for takeover. (See Figure 4.17)

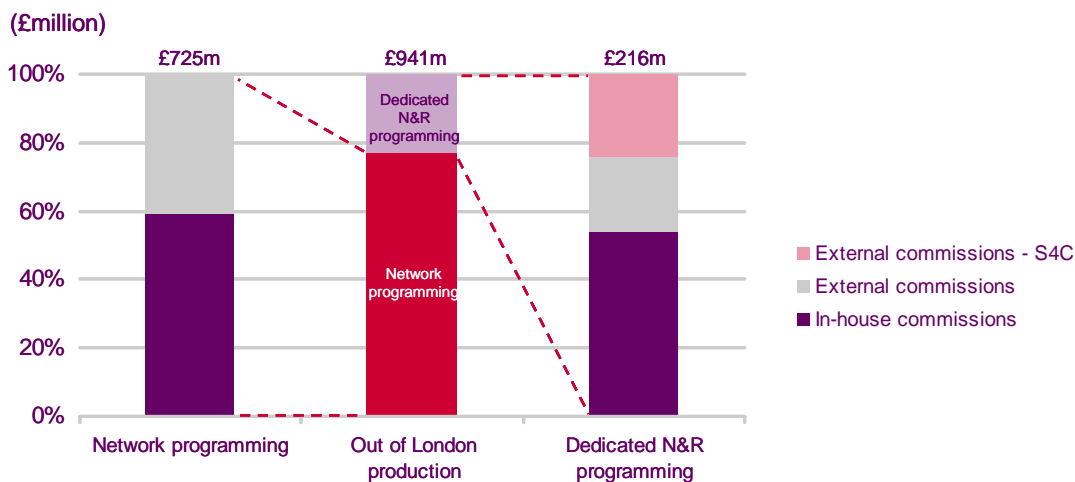
Figure 4.17: External production – 2004 reported corporate finance activity

Source : Ofcom Pact Census

Out of London production

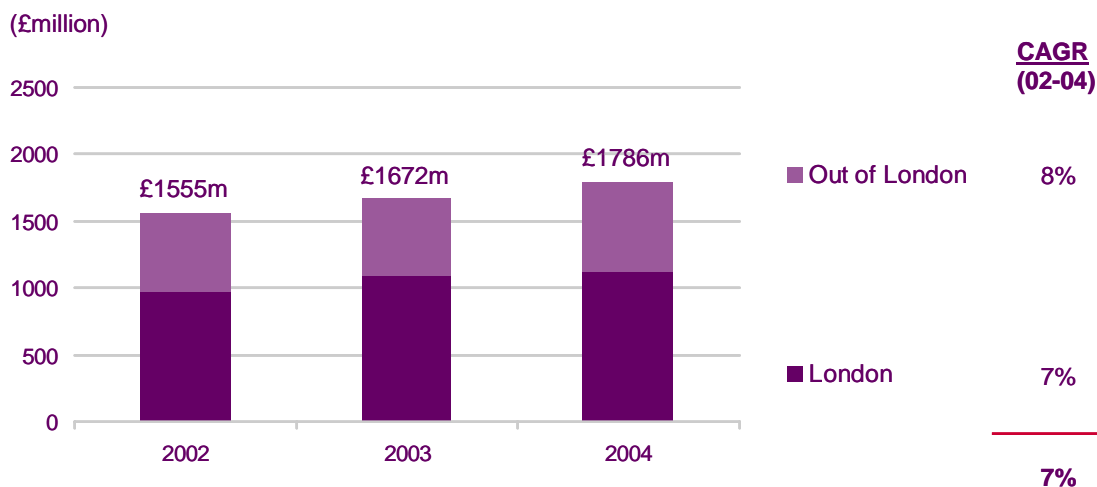
- 4.34 Total production out of London, excluding News production, amounted to £941m in 2004. 77% of the total, or £725m, consisted of commissions for network programming. In-house production companies accounted for 59%, or £429m, of all network commissions, with the remaining £296m commissioned from external production companies. Spend on non-network dedicated Nations and Regions programming amounted to £216m in 2004, or 23% of the total production out of London. In-house production companies accounted for a similar proportion of non-network programming, representing 54% of the total. Of the remaining 46% of non-network programming, external commissions for S4C accounted for 22% or £53m, and other external production for 24% or £47m. Statutory production by the BBC for S4C is not included in the numbers – our data suggests that the value of the BBC production for S4C was around £6m in 2004. (See Figure 4.18)

Figure 4.18: Major UK channels – 2004 first-run originations expenditure (excluding News)



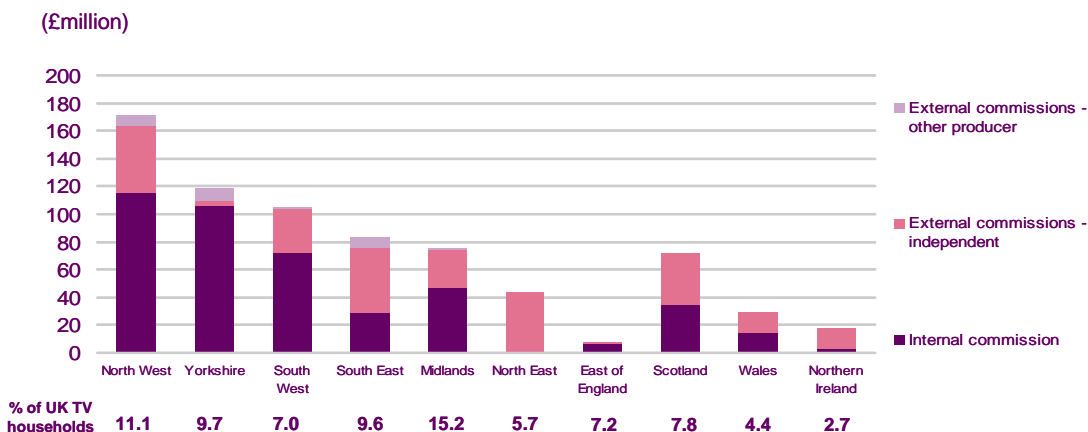
Source: Data from broadcasters

- 4.35 Investment in out of London network production by the main terrestrial channels has grown at a faster rate than the overall investment in network production. Figure 4.19 shows that since 2002, network production out of London has grown at a rate of 8% per year compared to the overall growth rate of 7% per year. Over the same period, total hours of network production out of London have grown at a slower rate of 4%, compared to the growth rate of total hours of network production of 9% per year since 2002.

Figure 4.19: Main terrestrial channels – network originations expenditure (excluding News)

Source: Data from broadcasters

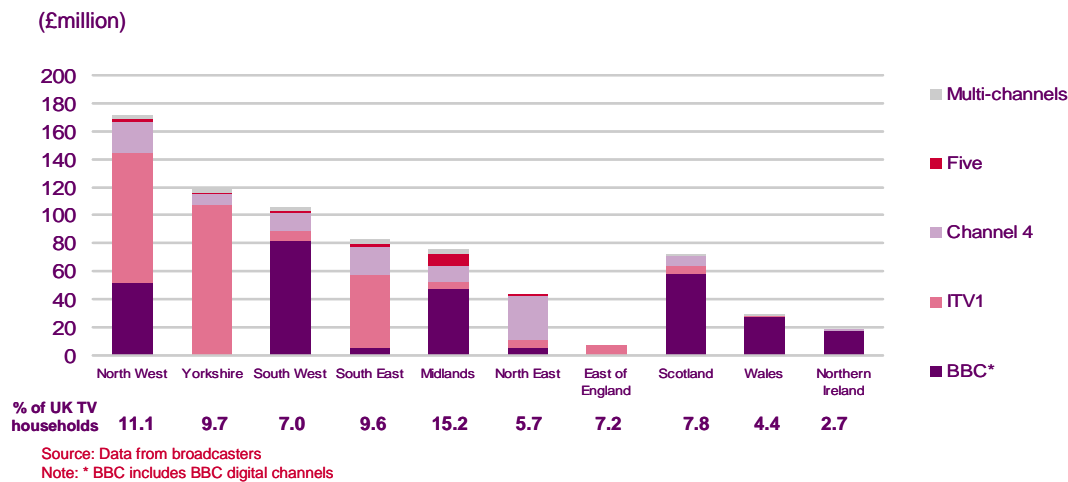
- 4.36 In terms of network production distribution across the Nations and Regions, North West England and Yorkshire were the largest centres of out of London network production in 2004, accounting for 24% of the total spend. Network production in the Nations accounted for 16% of the total network spend out of London. External production for the network came predominantly from qualifying independent producers, who accounted for 37% of the total production spend. Non-qualifying external producers represented 4% of total network production out of London. (See Figure 4.20)

Figure 4.20: Major UK channels – network first-run originations expenditure in the Nations and Regions (excluding News and Sport)

Source: Data from broadcasters

- 4.37 As shown in Figure 4.21, the BBC, including its digital services, and ITV1 were the most significant commissioners of network production out of London, representing 41% and 39% of the total respectively. Channel 4 accounted for a further 16% in 2004. Five accounted for 2% of the total, as did other multichannel services.
- 4.38 Channel 4 and the BBC were the largest commissioners of out of London external production, respectively accounting for 40% and 35% of the total value of out of London network external commissions.

Figure 4.21: Major UK channels – network first-run originations expenditure in the Nations and Regions (excluding News and Sport)



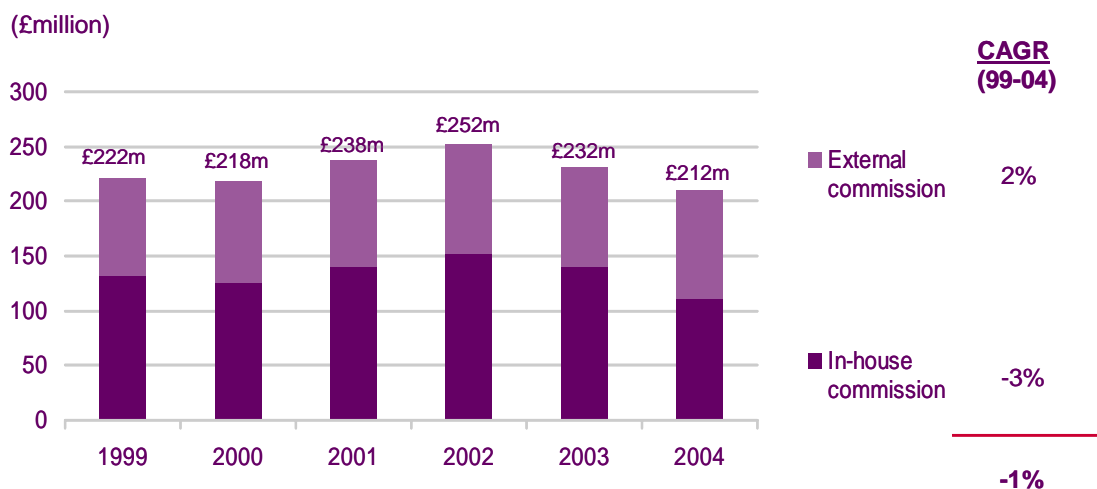
- 4.39 Expenditure on non-network programming in the Nations and Regions has declined since the peak reached in 2002. It has been reducing at a rate of 1% per year since 1999, and amounted to £212m in 2004. The proportion of expenditure in the Nations and Regions has however changed since 1999. Non-network production in the English Regions has declined at a rate of 7% per year since 1999, while production in Scotland has grown at a rate of 6% per year over the same period. S4C commissions in Wales have increased marginally at a rate of 1% per year since 1999 while non-network production for other broadcasters in Wales declined at the same rate. Non-network expenditure in Northern Ireland grew at a rate of 1% per year over the period. (See Figure 4.22)

Figure 4.22: Main terrestrial channels – non-network first-run originations expenditure (excluding News)



- 4.40 The mix of external and in-house commissions for non-network broadcast has remained relatively constant between 1999 and 2004. In-house commissions have declined at a rate of 3% per year since 1999 while external commissions have grown at 2% per year over the same period. (See Figure 4.23)

Figure 4.23: Main terrestrial channels – non-network first-run originations expenditure (excluding News)



Source: Data from broadcasters

- 4.41 As shown in Figure 4.24, the BBC's spend on non-network production in the Nations and Regions has grown at a rate of 4% per year since 1999. The most significant growth in expenditure was in Scotland, where it grew at a rate of 11% per year. Between 1999 and 2004, external commissions expenditure grew at a much faster rate of 17% per year, compared to in-house expenditure which grew at a rate of 2% per year.

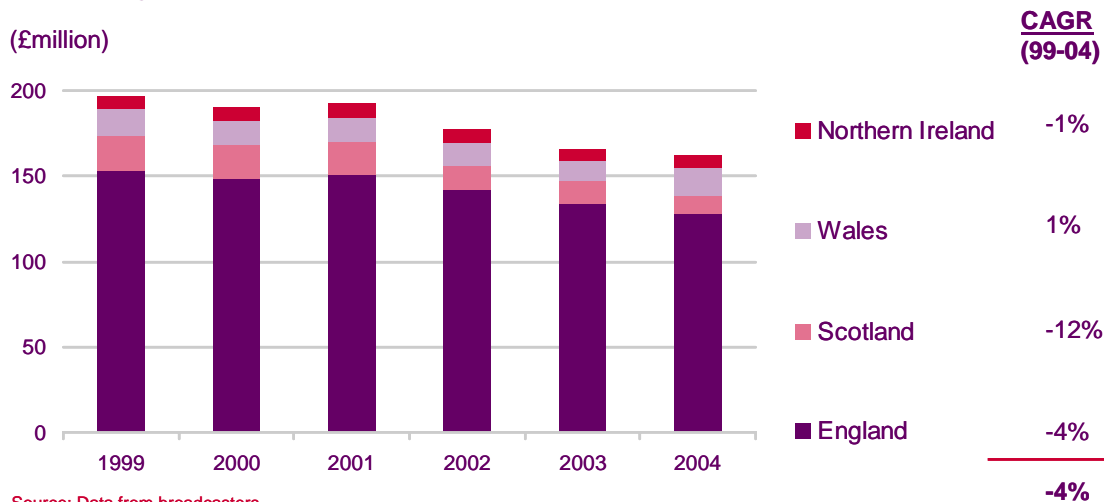
Figure 4.24: The BBC – non-network first-run originations expenditure (excluding News)



Source: Data from broadcasters

- 4.42 Channel 3's total out of London expenditure on non-network programming has decreased at a rate of 4% per year since 1999. Expenditure in the English Regions represented 76% of the total spend in 2004; it decreased at a rate of 4% per year since 1999. The decrease in expenditure on external commissions was marginally higher at 5% per year since 1999 compared to the decrease in in-house expenditure of 4%. (See Figure 4.25)

Figure 4.25: Channel 3 – non-network first-run originations expenditure (excluding News)

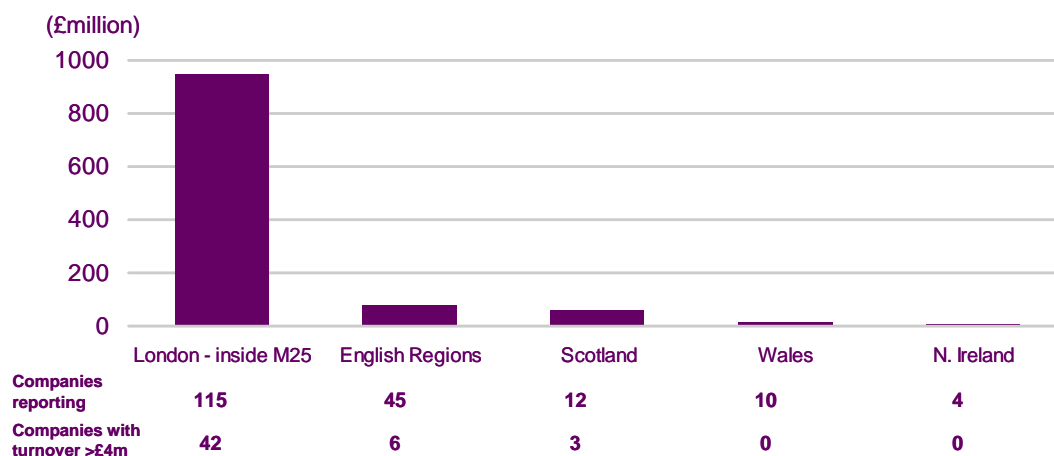


Source: Data from broadcasters

Note: The minimum requirement for non-network non-news programming for most of the ITV English licensees will halve from 3 hours to 1.5 hours per week from 2005

- 4.43 Our analysis also looked at the location of external production companies across the Nations and Regions. As shown in Figure 4.26, amongst the participants in the Ofcom PACT census, 85% of the reported external production sector turnover was accounted for by companies whose main office location is in London. Participating external production companies located out of London included only nine companies with turnover of £4m or more. We note, however, that our data does not include some larger production companies that are based out of London, as they did not return a response to the census.
- 4.44 This data does not suggest that location of external production is concentrated in the same way. Many production companies have offices in more than one location, and location of production is not always the same as the main office location.

Figure 4.26: External production – 2004 reported turnover by location of company's main office



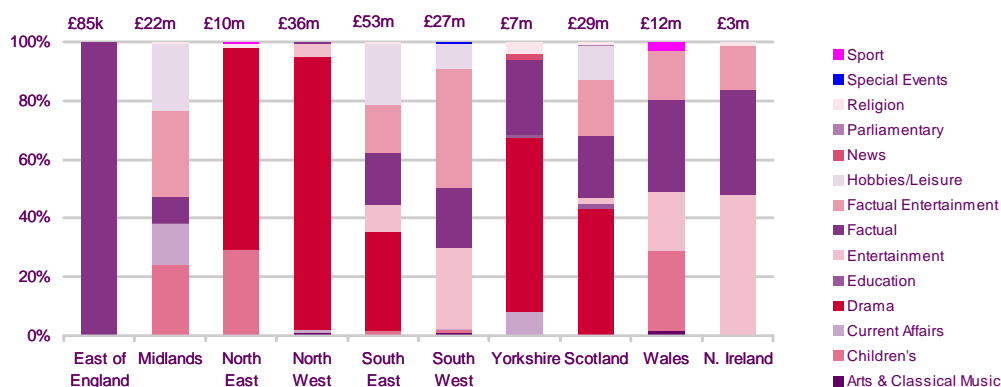
Source: Ofcom Pact Producer Census

Note: Location of the main offices is not the same as location of production. Total turnover includes TV production as well as non-TV turnover.

- 4.45 In terms of genre mix of production in the Nations and Regions, our analysis of the Ofcom PACT census does not suggest that particular genres are more likely to be made out of London. Although some Regions appear to be dominated by one particular genre, overall there is a relatively wide spread of genres in external production across all Nations and Regions. Drama production accounted for 38% of all reported production in the Nations and Regions, with Factual Entertainment, Factual and Hobbies & Leisure each accounting for more than 10% of reported production – at 17%, 15% and 11% respectively. (See Figure 4.27)

Figure 4.27: External production – 2004 reported production in the Nations and Regions by genre

(£million)



Source: Ofcom Pact Census

Note: Figures exclude BBC, Granada, GMTV, SMG and UTV

- 4.46 In-house production in the Nations and Regions appeared to be slightly more concentrated by genre. Drama accounted for 54% of all production out of London and Factual production for a further 17%. No other genre accounted for 10% or more of total out of London in-house production, with highest proportions for Entertainment and Children's at 8% and 7% respectively. Similarly, production in different Nations and Regions tended to be dominated to a larger extent by one particular genre. (See Figure 4.28)

Figure 4.28: In-house production – 2004 production in the Nations and Regions by genre (excluding News and Sport)

(£million)



Source: In-house production companies' submissions to Ofcom Pact Census

Summary

- 4.47 In summary, our analysis suggests the current value of the 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 by 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. The overall position is summarised in Figure 4.29 below.

Figure 4.29: 2004 value of UK originated production



Source: Data from broadcasters

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

Section 5

Future developments and implications for intervention

- 5.1 Having reviewed the evidence on the current state of play in the television production sector, we now turn to a consideration of possible future developments – and the implications of these for intervention going forward. This section explores whether the rationale for intervention in this sector continues to be supported. Moreover, where intervention continues to be relevant, we discuss the conditions that could facilitate its withdrawal, and the potential for their achievement.
- 5.2 In looking to the future of television production in the UK, we built on independent research commissioned by Ofcom as part of the Review. When setting out our view on the likely future developments in the sector, we considered three broad areas of issues:
- What are the likely future trends in sources of demand for external production?
 - How is the number and size of external production companies likely to evolve?
 - What is the future outlook for production out of London?
- 5.3 By answering these questions, we will be able to assess the rationale for intervention in the following way:
- Negotiating strength will be affected by the first two questions above – namely the way in which demand for external production evolves (if the sources of demand expand, broadcasters' negotiating strength is likely to reduce), and on the size of individual external producers
 - These two questions will also impact on the future importance of vertically-integrated production. This will depend in part on the overall size of the external production sector, and on the extent to which broadcasters alter their demand patterns between in-house and external production
 - Depending on the future outlook for out of London production, the continuing need for intervention in this area may change.

Evolution of sources of demand

- 5.4 The UK production sector is one of the largest in the world. Within Europe, only the German production sector is of comparable total value. The value of the sector, whether defined in terms of expenditure per capita or as a proportion of GDP, is higher for the UK than the majority of its European peers.
- 5.5 As we saw in Section 4, the overall demand from major UK channels for first-run originations (defined in terms of expenditure) has been growing at a rate of 4% per year since 1999. However, the growth rate of demand from digital channels over the period has been much higher than that from main terrestrial channels. While demand from the main terrestrial channels grew between 0% and 4% per year,

demand from multichannel services grew at 19% per year, and that of the BBC's digital channels grew at 49% per year (See Figure 4.3).

Demand from digital channels

- 5.6 The growth in demand from digital channels is important for a number of reasons. First, an increase in the number of sources of demand for programming could to some extent diminish the negotiating strength of the main terrestrial broadcasters. Although the main terrestrial broadcasters still accounted for 87% of all first run origination commissions in 2004, that proportion is down from 95% in 1999. Given their lower rates of growth in spending, the proportion of commissions from the main terrestrial broadcasters is likely to decrease further in the future.
- 5.7 Second, commissions from digital services offer a significant opportunity for smaller producers to establish themselves in the market. Our data, as presented in Figure 4.10, suggests that multichannel commissions represent a significant source of income for the smaller producers. Multichannel commissions, excluding secondary digital services from the main terrestrial broadcasters, accounted for 27% of all commissions for companies with total turnover of £1m or less, compared to 9% of commissions for companies with turnover between £20m and £50m.
- 5.8 However, the data does not suggest that multichannel services commission primarily from smaller producers. In fact, Figure 4.9 showed that 27% of all multichannel commissions reported in the census were for companies with turnover between £4m and £12m and an additional 27% for companies with turnover between £20m and £50m. Only 7% of multichannel commissions reported were for companies with turnover of £1m or less.
- 5.9 The data in Figure 4.9 reflects the fact that programming value at multichannel services has increased significantly. Prime time budgets at the major digital channels are quite ambitious, and regularly exceed £50k per hour. This is, however, still below the budgets of the main terrestrial broadcasters. High costs of production continue to prevent multichannel services from commissioning new content in some of the most successful genres – such as comedy and drama – although a number are attempting to do so through co-productions.
- 5.10 The rapid growth in demand from multichannel services has been driven both by an increasing number of digital services available to viewers, and by creative competition between channels. As the research undertaken for Ofcom's PSB Review indicated, UK audiences place a high value on original programming on TV. Hence, investment in originations is likely to be important for any digital service seeking to achieve significant market share in the UK.
- 5.11 The demand for original programming from multichannel services is likely to continue to grow in the future. A strategy of relying on low cost acquisitions rather than investing in original commissions may offer greater financial rewards in the short term, but may hinder the channel's long term growth prospects. The interviews with digital channels conducted in the course of the review suggest that, in the near term, demand from multichannel services is likely to continue to grow at a rate similar to that of the recent past – namely around 20% per year.

Demand from the main terrestrial channels

- 5.12 Turning to the main terrestrial broadcasters, we believe that their demand is likely to continue to grow in the future – albeit at a slower rate than that of multichannel services.
- 5.13 The demand from the BBC has grown at a faster rate than that of the other main terrestrial broadcasters, growing at 4% per year. Its overall level of programming spend going forward will be partly dependent on its licence fee settlement with Government, but we expect that the BBC's demand for commissions will continue to grow above inflation over the next five years.
- 5.14 Additionally, the BBC's plans for the WOCC and the consequent reduction in in-house capacity will further boost the size of the market for external production companies, while still leaving the BBC with a substantial in-house production base. The external production sector currently accounts for 30% of the BBC's qualifying programming in terms of value, and 25% in terms of hours. If external producers were to win a half of the WOCC, that is a further 12.5% of programming, this could equate to around an additional £125m of commissions value at today's levels of production. This would amount to a significant increase in demand for external production, while still leaving in-house production as a major source of programming at the BBC.
- 5.15 Total programming spend at ITV1 was at approximately the same level in 2004 as it was in 1999, reflecting a decline in the amount of regional programming. Going forward, we expect the total spend to remain relatively flat as ITV1 addresses revenue pressures brought about by audience fragmentation and the associated decline in advertising revenues. In terms of the sources of programming, recent changes at ITV Productions suggest that the broadcaster is unlikely to reduce the contribution of in-house production in the near future – the changes have arguably aligned ITV's production and broadcast businesses more closely together.
- 5.16 Channel 4 faces the same revenue pressures as other commercial broadcasters, although its unique status in the broadcasting ecology and remit with respect to the independent production sector mean that the channel will remain an important source of demand for external commissions. We anticipate that Channel 4 will continue to grow its programming budget over the next few years at a similar rate to the recent past.
- 5.17 In percentage terms, programming spend at Five has increased more rapidly in recent years than has been the case at the other commercial main terrestrial broadcasters. Five has therefore made an important contribution to total demand for external production. As it continues to establish its position, spend is expected to grow – although Five's programme spend is expected to remain relatively small in absolute terms (when compared with the other main terrestrial broadcasters).
- 5.18 In short, the main terrestrial broadcasters are likely to continue to account for the vast majority of all first run originations. Even if we assume that their demand for programming is likely to either remain flat or to grow at a similar rate as over the past five years, and even if – in the extreme – demand from multichannel services continues to grow at a rate of 20% per year for the next five years, the main terrestrial channels are still likely to account for around 80% of the originations market in five years' time.

New sources of demand

- 5.19 In addition to demand from UK broadcasters, new sources of demand are emerging. In our discussions with producers over the course of this review, we noted significant optimism about the future – arising from opportunities in new international markets and on new distribution platforms. Our analysis in this area suggests that there are genuine prospects in these areas, and that the sector is undergoing significant change. But these sources of demand are in their very earliest stages – and are starting to emerge from a low base. Nonetheless, we believe that they can only become more important in the future.
- 5.20 There is already evidence that the UK production sector is increasingly a supplier to customers on an international basis. Respondents to the Ofcom PACT Census reported £79m of commissions exclusively for non-UK broadcasters, while co-productions involving non-UK broadcasters totalled a further £80m. Total turnover from the sale of the international broadcast or format rights to original UK commissions were reported at £52m.
- 5.21 The British Television Distribution Association (BTDA) collects annual information from its members on the value of exports from the UK production industry. This information includes the value of commissions and co-productions for non-UK customers, the licensing of programmes for TV and DVD distribution, and the sale of format rights. The BTDA suggest that the total value of these sources of income from outside the UK has increased at an average rate of 16% a year between 2001 and 2004. However, given that a high proportion of programme sales are to the highly competitive US market, such a rate of growth may not be sustainable going forward.
- 5.22 Finally, we believe that new media and alternative distribution platform players will also be an important source of future demand for commissions. The demand is expected to grow in a number of different areas:
- On-demand distribution of new programmes as well as exploitation of the full library of produced content
 - Re-versioning of programming for distribution on new media platforms, such as mobile devices for example
 - Commissioning of content specifically for new media platforms.
- 5.23 The value of turnover associated with new media platforms that was reported in the Ofcom PACT census was relatively low – around £6m in total. This may be explained partly by the fact that the data reported to us does not yet reflect the full effect of changes in the terms of trade. However, it may also be reflecting the fact that business models in this area are still being developed. Platform operators and producers are still trying to understand the nature of customer demand in this area and develop content propositions that maximise the value of programming.
- 5.24 There are strong indications already about broadcaster and producer interest in the opportunities provided by new media. Some broadcasters have introduced dedicated commissioners for new media content and are experimenting with new programme formats, including interactive programming. The development of opportunities in this area will depend to some extent on how the content rights are owned and exploited – we discuss these issues further in Section 6 of this document.

Conclusions

5.25 Overall, therefore, our analysis suggests the following:

- The sources of demand in the external production sector will continue to expand – thereby driving growth in the sector
- However, the main terrestrial broadcasters will remain the main source of demand for external production – possibly still accounting for 80% of the market for originated programming around the end of the decade
- In-house production is likely to remain of significant importance, and there is no evidence that external production is likely to grow to exceed the size of in-house production in the near future.

Future size and structure of the external production sector

5.26 The barriers to entry into television production are low, and so we expect that opportunities will remain for new entrants to come to the market, especially at the smaller end of the scale. But a more significant question for the future is the extent to which the sector is likely to consolidate.

5.27 The consolidation of the sector has been widely predicted in the past. Indeed, the number of PACT members has declined from around 1000 in 2001, to 704 in 2005. Although our analysis shows that the sector still remains fragmented, with a very large number of small companies in operation, there are some signs that the conditions may be right for consolidation on a larger scale than in the past. For instance:

- There has recently been an unprecedented amount of consolidation activity in the sector. To name but a few examples, All3Media has acquired Lion, Company and Mersey TV; Ten Alps has acquired 3BM, Brook Lapping and Blakeway; RDF Media has acquired IWC Media; and Shed Productions has acquired Ricochet.
- Changes in the terms of trade appear to have made investors more confident about the asset bases of production companies, and external finance has started flowing into the sector. During 2003/04, private equity houses made investments in All3Media, Zenith, Hat Trick and Mersey TV. In addition, over the course of 2005, Shed and RDF Media floated on the Alternative Investment Market (AIM).

5.28 These trends are leading to the development of large-scale producers, often referred to as “super-indies”. Such producers are likely to derive significant benefits from economies of scale and scope – benefits that are likely to contribute to further consolidation in the sector. We discuss the nature of these benefits below.

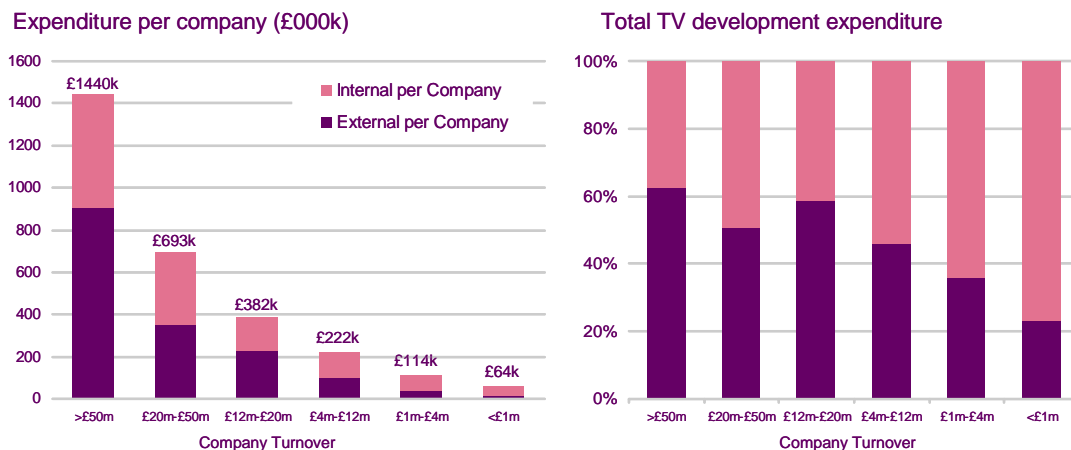
Strengthened ability to fund development

5.29 Data from the Ofcom PACT census indicates that larger companies have an advantage over smaller companies in terms of their ability to fund development, a fact highlighted by Figure 5.1 below. The amount of development funding is directly linked to company size. For example, companies with turnover between £20m and £50m spend on average £693k on development. In comparison, companies with turnover between £1m and £4m spend on average £114k on development.

5.30 Larger companies also appear better-placed than smaller companies to attract external development funding. External development funding accounted for 51% of

the average development spend of companies with turnover between £20m and £50m, compared to 36% of the average development spend of companies with turnover between £1m and £4m. The data from the census suggests that the largest companies use only 1% of their turnover for development, whereas for the smallest companies that level rises to 17% of turnover. The fact that smaller companies have to devote a larger share of their internal resources on development has a direct impact on their profitability.

Figure 5.1: External production – 2004 reported internal and external TV development expenditure



Source: Ofcom Pact Census

Access to commissioners

- 5.31 The census data presented in Section 4 suggests that larger production companies (with turnover in excess of £12m) account for a significantly larger proportion of commissions at most major broadcasters than do smaller companies. We recognise that the census data is skewed towards larger companies and may, therefore, underestimate the extent of commissions for smaller companies – as a result of which we presented an adjusted picture (using broadcaster data), which suggested a higher proportion of spend with smaller companies. Nevertheless, the analysis is at least partly indicative of the differences in commissioning structures at the main terrestrial broadcasters.
- 5.32 Our analysis shows that Channel 4 and the BBC tend to commission from a larger number of external production companies than do ITV1 and Five. For example, in 2004, Channel 4 used 240 external suppliers and the BBC 185 external suppliers – while ITV1 and Five commissioned from 92 and 75 external suppliers respectively.
- 5.33 These figures suggest that commercial pressures incentivise some broadcasters to keep the size of the commissioning teams down, and consequently result in a smaller supplier base. For example, while Channel 4 maintains 58 commissioners, ITV1 currently has around a dozen. A smaller supplier base may in turn deliver advantages to larger external production companies, as commissioners seek to build longer-term relationships and ensure security of supply.
- 5.34 Creative pressures are unlikely to lead to further concentration of supplier bases at ITV1 and Five, but financial pressures could lead Channel 4 to consolidate the number of suppliers from which it commissions programming – which could have a substantial impact on smaller companies. The BBC, on the other hand, is seeking to increase the number of external production companies it deals with in order to meet

the commissioning demands of the WOCC – an issue which we discuss in more detail in Section 7. Hence, the BBC may become an increasingly important access point to the market for small producers.

- 5.35 There is some anecdotal evidence that external production companies are already under pressure from broadcasters to consolidate. For example, S4C has expressed concerns about the sustainability of external production companies in Wales and has taken a first step to encourage smaller producers to work together with larger companies – it has recently issued a development funding tender for £1m, with contracts offered to five groups of companies.
- 5.36 Similarly, the number of producers commissioned by Channel 4 has been slowly decreasing each year. While Channel 4 have made it clear that their innovation remit and creative success depends on a plurality of producers, both large and small, the business case for consolidating the supplier base may be strong.

Improved financing ability

- 5.37 The complexity of the financing process favours larger companies, who are able to cover the overheads of a dedicated in-house finance team. The issue of financing may not have been very significant to date, as the primary licence fee still appears to cover the full production costs in the great majority of cases. For example, only 4% of the projects detailed in the census reported the use of gap financing, including self-financing. However, changes in terms of trade may in the future lead to a greater diversification of programme funding sources, which would make deficit funding a much more important issue for production companies.
- 5.38 For example, it is anticipated that the exploitation of programmes on alternative distribution platforms will assume greater significance in programme funding. Although the models for value creation on alternative distribution platforms are still emerging, it is likely that producers would be expected to take on a greater share of risk through revenue sharing arrangements with the broadcaster.
- 5.39 In such a situation, larger producers – with the capacity to sustain risk and develop a broader portfolio of projects – could be at an advantage over smaller producers. Census data suggests that larger companies are already benefiting from access to financing: 56% of the gap financed projects and 67% of deficit investment reported in the census was accounted for by companies with turnover of over £20m.

Lack of economies of scale in production

- 5.40 While the above factors may drive consolidation in the sector, there are also some characteristics of the production sector that may counter the incentives to consolidate.
- 5.41 In most other industries, economies of scale provide the most significant economic benefits that drive companies to consolidate. It may therefore be expected that larger production companies would be able to produce at a lower cost per hour than smaller companies with little or no production infrastructure – and so consolidation could be sensible. In content production, however, the evidence does not suggest that larger production companies have significant competitive advantage in cost terms over smaller companies.
- 5.42 We analysed the average value of primary TV rights per hour of production for companies with turnover of more than £12m, and for those with turnover of less than

£12m. We found no direct relationship between the size of the company and the cost per hour. In some genres, larger production companies appeared to have a cost advantage, while in other genres it was the smaller companies that were producing at a lower cost per hour.

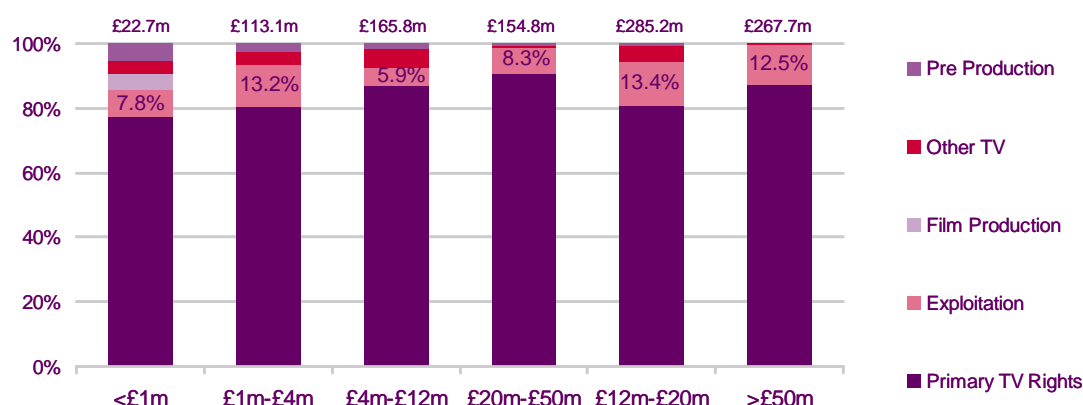
- 5.43 Our analysis revealed that the cost of production varies more directly with project duration than it does with size of producer. In almost all genres, the average cost per hour was lower for projects of more than four hours in duration, compared to projects of less than four hours in duration. This finding may explain why one way of keeping production budgets down is by commissioning longer runs of programmes.
- 5.44 There is a number of possible explanations why production does not seem to offer economies of scale to larger companies. The production sector is predominantly a freelance-based industry, which relies on outsourcing at almost every stage of production. The reliance on outsourcing means that larger companies have no particular advantage over smaller companies. But the longer projects allow talent and production resources and facilities to be procured at a lower cost. Longer projects also allow the relatively fixed development and pre-production costs to be amortised over a greater number of hours of output. Some areas, such as post-production, do offer potential benefits from the use of in-house facilities – but the rapid pace of technological change discourages high levels of investment in post-production equipment.
- 5.45 The second reason why production does not necessarily offer advantages to larger companies is because programmes are not commodity products. Commissioners are incentivised to seek out the programmes that are most likely to be successful in terms of their on-screen performance, especially for the peak time schedule. This means that price is not the most significant determining factor in commissioning – the high levels of creative competition amongst broadcasters mean that commissioning decisions are unlikely to come down solely to price in the near future.

Rights exploitation

- 5.46 The changes in terms of trade were introduced to enable production companies to realise the full value of their rights over programmes they make. As rights exploitation becomes a more important source of income for production companies, it may be thought that larger companies would be better-placed to capitalise on the opportunities presented, through their ability to sustain vertically-integrated distribution and licensing businesses.
- 5.47 We examined this by looking at the proportion of turnover generated from rights exploitation and distribution by companies of different sizes. As Figure 5.2 shows, we found that there was no direct link between the producer size and the proportion of their turnover generated from rights exploitation. Notwithstanding any possible difference in how rights exploitation turnover may be defined by different companies, our data suggests that companies of all sizes are still generating the bulk of their turnover from primary TV rights.
- 5.48 The proportion of turnover generated from rights exploitation ranged from 5.9% of total turnover for companies with turnover between £4m and £12m to 13.4% for companies with turnover between £20m and £50m. Smallest companies, with turnover under £1m, generated 7.8% of their total turnover from rights exploitation.

Figure 5.2: External production – 2004 reported turnover by source and rights exploitation turnover as proportion of total turnover

(£million)



Source : Ofcom Pact Census

- 5.49 The analysis presented in Figure 4.12 earlier suggested that the potential for generating additional turnover from secondary rights exploitation may be related more to genre of production than to producer size. At the moment, the number of projects that generate significant additional turnover is still very small. Only 19% of the nearly 1000 projects reported in the census generated any additional turnover, and only 8% of projects generated additional turnover which represented 10% or more of the total project turnover.
- 5.50 The full effect of the changes in terms of trade is unlikely to have been reflected in the data reported in the census, and we anticipate the producers' ability to exploit the programme rights will increase significantly in the future. However, we do not expect that all programmes will have equal potential in terms of opportunities for additional income, with the most significant differences being in genre and the extent to which the programme is catering for the specific interests and characteristics of UK audiences. Therefore, the advantage enjoyed by specific producers with respect to rights exploitation in the future may relate more to their mix of genres and programme characteristics, rather than to their overall size. In any event, we expect the smaller producers to continue to have access to ancillary income through relationships with third party distributors.

Conclusions

- 5.51 Larger production companies do benefit from some economies of scale, most notably in development and financing. As Channel 4 and the BBC continue to offer a point of entry to the market for smaller producers (as does ITV1's non-network output in the Nations and Regions), and as creative competition in broadcasting continues to prioritise the potential for on-screen success, smaller production companies are able to remain competitive. However, their businesses are likely to have more volatile profitability, as our analysis in Section 4 indicated (See Figure 4.15).
- 5.52 Going forward, the main potential threat to the survival of smaller production companies may be business complexity rather than scale economics. For as long as primary TV rights value continues to meet the costs of production, creative talent and strong commissioning relationships are likely to be sufficient to sustain smaller production companies.

- 5.53 However, if production budgets were to become augmented and derived from multiple sources, smaller companies are likely to need to respond to change. A more complex funding process would require companies to develop a range of financial and business affairs skills, as well as resources to maintain relationships with financiers. Smaller production companies would find it more difficult to secure the required resources without risking lower margins. Although rights funds are already emerging and will help fill the skills gap, smaller companies are likely to find themselves operating at a financial disadvantage to larger players, and may therefore seek out the benefits of consolidation.
- 5.54 The primary form of consolidation in the sector may not take the form of merger and acquisition (M&A) activity, but rather from a reduction in the number of companies in the sector. The external finance necessary for an acquisition strategy is likely to be available only to the limited number of companies who can persuade the investor that they have the management and infrastructure to cope with expansion. Additionally, investors will only be interested in a narrow range of genres which they believe have a real commercial potential. Our analysis of the profit margins of single-genre production companies, as presented in Section 4, suggests that the top three genres of interest to investors may be Hobbies & Leisure, Factual and Factual Entertainment – although we also recognise that genres such as drama are likely to have significant secondary value, thereby making them attractive to investors.
- 5.55 The specific characteristics of creative industries mean that consolidation in the sector may lead to the emergence of a greater number of larger companies – who may be able to counter the competitive advantage of vertically-integrated broadcaster-producers. Creative businesses often rely on the talents of a small number of key individuals without whom the business is likely to lose value and direction. This means that the M&A activity is likely to occur between companies with established creative asset bases, leading to the emergence of new “super-indies”. At the same time, a more significant reduction in the number of companies is likely to come about as smaller companies dissolve and their key staff take on roles within larger players.
- 5.56 Although we anticipate that the sector will consolidate in the future, low barriers to entry and high creative competition mean that the consolidation activity at the top end of the market will be offset by new entrants at the bottom end. As the sector matures, it is also likely to become more sophisticated with finance available to management teams to pursue a wide range of growth strategies.
- 5.57 The growing financial strength of the external production sector means that in the more commercial genres – like Drama, Entertainment and Factual – it will be in a strong position when competing with in-house production companies, both in terms of talent and commissioning. In-house production companies are likely to continue to have a competitive advantage in less commercial genres such as Current Affairs, Arts, Religion and Education – although Channel 4’s remit is likely to contribute to significant external production in several of these genres. Our analysis indicates that external production companies are already winning an above average market share of all commissions in Entertainment, Factual and Children’s.

Implications for negotiating strength and vertical integration

- 5.58 The two areas of market developments discussed above have implications for the future rationale for intervention in relation to negotiating strength and vertical integration. We consider these implications here. The future outlook for out of London production is assessed later in this section.

Negotiating strength

- 5.59 We saw above that, notwithstanding the observable increase in commissioning from digital channels, the main terrestrial broadcasters continue to provide the main sources of demand for external commissions. The situation has not changed materially since the ITC first proposed the introduction of the Codes of Practice, in order to mitigate these broadcasters' negotiating strength. Therefore, at this stage, the Codes continue to be an important intervention to protect producers, and therefore to safeguard the variety and availability of content which satisfies the interests of viewers.
- 5.60 Our analysis of future developments suggests that the prospects for withdrawal from intervention in this area, whilst limited in the near term, may be improving in the longer term. The factors which may improve the bargaining position of external producers – and so give rise to the eventual lifting of intervention – are the extent of growth in new sources of demand, and the growth in size of external producers.
- 5.61 As discussed in Section 3, the broadcasters' strong negotiating position arises from the fact that external producers have only limited routes to market – largely via the main UK terrestrial broadcasters. It follows, therefore, that the need for intervention would be reduced if producers had more routes to market. As discussed earlier, these expanded routes to market are starting to emerge: via commissioning from dedicated multichannel services, access to international markets, and the increasing ability to deliver content over new distribution platforms. If these become sufficiently important sources of demand, then the need for intervention could be significantly reduced. Based on the evidence we have collected, the key points to note are the following:
- Commissions from multichannel broadcasters are growing in importance – but from a relatively low base. Currently the evidence suggests that the bulk of the value in multichannel commissions are currently going to medium / larger size producers
 - International markets also represent a real opportunity – however, most producers lack the ability or the scale to produce programmes outside the UK. As such, the scale of the opportunity differs depending on the size of the production company in question. The greatest value is likely to accrue to larger producers, and to those producers who generate formats that are internationally transferable
 - The returns from secondary broadcast exploitation are still very limited. Broadcasters are increasingly trying to secure secondary exploitation rights on their own digital channels at the time of commissioning. Both the BBC and Channel 4 currently commission on terms which allow them multiple plays of programmes across a family of own branded channels. Where such rights are not secured, or the rights to secondary plays are not exercised, the existence of lengthy exclusive 'holdback' periods for brand protection purposes may limit potential secondary sales
 - New distribution platforms are very much in the earliest stages: some producers do not consider new media to be an important part of their plans for the near future, while others believe that online content delivery will become an important source of revenue within the next few years. Nonetheless, it is apparent that there is not yet a clear new media opportunity that has been seized by the sector as a whole. In part this may be because the Codes of Practice do not currently deal sufficiently with these sorts of rights issues. In Section 6, we discuss our views on the principles that could be adopted in relation to rights issues in this area.

- 5.62 Overall, therefore, we expect that these areas will become more important over time. However, they are not yet sufficiently well-developed as to allow a withdrawal from intervention in the near term.
- 5.63 In terms of the growth in size of producers, we have shown how the last few years have seen growth in the size of a number of external producers. It is useful to assess further whether the rise of a smaller number of large scale producers – the so-called “super-indies” – could help ameliorate the broadcasters’ strong negotiating position.
- 5.64 Whilst such producers could be effective in helping to develop strong negotiating positions in their own right, it is often argued that super-indies can only exist within certain genres and formats because of their reliance on alternative forms of funding. These forms of funding are only attractive to producers that make the most commercial of programmes in terms of primary and secondary rights value. This could limit their strong negotiating positions to specific types of programmes, with many other smaller external producers still subject to broadcasters’ strong negotiating position. This could also raise the question as to whether the rise of the super-indie may at some point in the future raise concerns about the prospects for entry by smaller producers into the market.
- 5.65 On the whole, we believe that the rise of the super-indie may be evidence that broadcasters’ strong negotiating position could be tempered in some cases, but that this strength is unlikely to be entirely eroded by market developments. Therefore, there is likely to remain a role for an intervention like the Codes of Practice – in order to safeguard smaller producers who provide important plurality and diversity to the production sector.

Vertical integration

- 5.66 We have seen that the BBC and ITV1 continue to source the majority of their original network content from their respective in-house production divisions. However, as long as Channel 4 and Five source their content externally, there continues to be a counterweight to the BBC’s and ITV1’s reliance on in-house production. This is important because it ensures that in-house producers at the BBC and ITV1 are subject to competition. This competition continues to arise from two sources:
- **Direct competition** with external producers for commissions from the BBC and ITV1 respectively. External producers have developed and grown into stronger businesses, and so are able to compete more effectively with in-house producers
 - **Indirect competition** arising from growing competition for audiences, as the number of broadcasters and channels increases. This drives commissioners to seek out the programmes most likely to attract audiences.
- 5.67 From a viewer’s perspective, this is a much improved situation – in terms of the efficacy of competition for quality and the diversity of suppliers of content – when compared to the situation when the BBC and ITV1 commissioned almost entirely from their respective in-house production bases.
- 5.68 However, the independent production quota (and the associated definitions of qualifying programmes and producers), as well as Channel 4’s position as a key publisher-broadcaster, still seem to be important in ensuring “direct” competition continues to be promoted – providing external producers with access to commissioners and certainty of a contestable source of commissioning funds.

- 5.69 For there to be effective indirect competition, commissioners need to be exposed to the competitive pressures in the broadcasting market. There is currently no explicit intervention to promote indirect competition, but broadcasters can take steps that go some way towards empowering external producers to overcome commissioners' potential bias to in-house production. For instance, broadcasters can ensure that external producers are fully informed about future channel directions, and have fair access to commissioners.
- 5.70 Our analysis above shows that, in the future, there is likely to be an improvement in the position of external producers as strong competitors to in-house production. For example:
- Growth in commissioning outside of the terrestrial broadcasters is increasing rapidly
 - There are an increasing number of firms within the sector who are building strong track records which point towards reliability in terms of delivery and quality.
- 5.71 In some cases this may allow external producers to duplicate some or all of the benefits of in-house production (as outlined in Section 3), as their scale and experience grow. However, we also noted above that the main terrestrial broadcasters are likely to remain the main sources of demand for external commissions – and so competition between the main terrestrial and commercial digital channels is currently marginal, but may develop further in future.
- 5.72 The withdrawal of intervention should only take place once the issues resulting in a need for intervention are no longer present. In order to meet this criterion, we would expect to see external producers competing effectively with in-house producers, which may mean the existence of a level playing field for competition between external and in-house producers, and/or evidence that external producers are able to develop into companies of comparable scale and scope compared to the in-house production divisions of today. This evidence would imply that direct and indirect competitive forces were effective, leading to the commissioning of programmes that are most likely to satisfy the interests of viewers as consumers and UK citizens.
- 5.73 Our analysis suggests that these conditions have not yet been met, and they are also unlikely to be met in the foreseeable future. As noted above, there is little scope of external producers growing to rival the scale of in-house production. Moreover, there is little evidence that a truly level playing field in competing for commissions has developed.
- 5.74 While vertical integration remains a significant issue, there is little scope for the withdrawal of intervention in this area. With this in mind, it is worth considering the appropriate regulatory policy in relation to concerns over vertical integration. We turn to this issue in Section 7.

Out of London production

- 5.75 Since 2002, the total value of network programming produced out of London has increased marginally above the rate of growth of programming made in London – growing at annual rates of 8% and 7% respectively. At the same time, the value of non-network programming has increased while the hours of programming have decreased – leading to an increase of around 60% in the cost per hour for non-network programming since 2002.
- 5.76 The most significant future development for out of London production is the BBC's planned relocation of Sports, Children's, New Media, Five Live and R&D departments

to Manchester, due to take place in 2010. The move would involve the relocation of 1800 staff at the cost of up to £600m. Although the BBC Board of Governors has approved the plans in principle, the plans may be contingent on the BBC's new licence fee agreement.

- 5.77 The BBC's move to Manchester would represent a significant new investment in production capacity out of London, with plans to close the current BBC Manchester studios and build a new "media zone". The current value of programming budgets for the designated departments is over £200m. The BBC's move would add to an already solid production base in Manchester – the BBC and ITV jointly employ around 2000 staff already, in addition to a number of external production companies based in Manchester.
- 5.78 In addition, the BBC has made a number of other commitments, including raising its out of London spend from £600m to £1bn and relocating 50% of its staff out of London by 2012; doubling the BBC's Regional Development Fund to £1m in 2007; and increasing the number of commissioners outside London.
- 5.79 Apart from the BBC's planned new investment in out of London production, there is little evidence that market forces on their own would naturally and consistently encourage production activity to gravitate away from London. Although significant production activity already exists in a small number of proto-clusters – such as Manchester, Glasgow and Leeds – the framework developed in Section 3 suggests that current market developments offer little prospect for sustainable creative clusters to develop out of London:
- **Factor conditions:** although the BBC's move to Manchester will increase the size of skilled workforce out of London, it is unlikely to lead to the creation of a labour force as wide and dynamic as that available in London
 - **Demand conditions:** the BBC's move to Manchester and wider out of London strategy will transfer some commissioning power out of London, but not to the same extent as – for instance – a channel move
 - **Related and supporting industries:** London will continue to be the home of the advertising, film and other creative industries, thereby driving innovation and employment opportunities
 - **Firm strategy, structure and rivalry:** the scale of new investment in out of London production is likely to attract a number of production companies to base around Manchester. However, it is unclear at this stage whether this will be sufficient to sustain creative competition around a new cluster and so encourage new points of market entry.

Implications for intervention for out of London production

- 5.80 In Section 3, we discussed the forces that explain the seemingly relentless pull of the London production industry. This showed that London's pre-eminence can be explained by a set of entirely rational economic forces. We have now seen that these forces are unlikely to change dramatically in the future.
- 5.81 In short, therefore, there is very little evidence to suggest that the market is poised to develop the factors necessary to deliver more production out of London. We now consider the implications of these findings for the future of intervention.
- 5.82 In the face of our analysis, it is not easy to see how market forces on their own will naturally and consistently encourage production activity to disperse from London and

into the Nations and Regions. In fact, the current state of play of production across the UK shows that there is no clear pattern of consistency or growth in out of London production.

- 5.83 Nevertheless, there are currently some examples of out of London external producers and clusters. There is a view that a truly sustainable out of London production sector could be built around existing regional centres or clusters rather than through a fragmentation of activity. Building on the framework set out in Section 3, this would seem to be potentially the most successful and consistent approach.
- 5.84 However, and as noted above, it is not clear how this “clustering” would develop further from today’s position. With this in mind, it is useful to consider the balance between in-house and external production. As discussed in Section 3, ITV, with its federal structure, was historically the bedrock of out of London production in the UK. However, the consolidation of ITV and a new approach at the BBC means that the BBC has an increasingly important role to play. In-house production, whether at the BBC or ITV, with its advantages of size and scale, has the ability to attract, sustain and grow talent outside London. Moreover, projects such as the BBC’s Manchester relocation will represent a significant contribution to sustaining and strengthening network production outside London.
- 5.85 Therefore, whilst we note that there are production bases outside London, and the likely impact on Manchester of the BBC’s planned move, none of the out of London bases are on the same scale as London. Moreover, based on the framework set out above, there seem to be two key barriers to the market-led dispersal of production:
- Commissioning power/decision-makers are concentrated in London: while we note the BBC’s plans to spread commissioning across the UK and Channel 4’s out of London strategy, the majority of mainstream channel commissioners and budget-holders are based in London. This means that producers tend to believe that they have a better chance of winning commissions if they are also based in London
 - In-house and independent producers are concentrated in London, especially the producers of scale. There continues to be a legacy of production and investment in London – which has led to extensive networks in infrastructure, labour and other suppliers of crucial inputs into the production process.
- 5.86 Changes to one or both of these factors may create the impetus to kick-start market forces so that intervention in the long term is not required. But these sorts of changes are relatively far-reaching compared to the current intervention, which – whilst undoubtedly a blunt instrument – seems to be a necessary intervention.

Summary

- 5.87 In short, the analysis in this section and Section 3 has suggested that the overall rationale for intervention remains valid. Our main findings are as follows:
- 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 strong growth, but we have 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”. We do not believe that this is a cause for concern – such producers are likely to bring to bear the benefits of scale and commercial experience. However, while we expect entry barriers to remain low, we recognise that Ofcom 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. We have analysed the factors that would be required to create sustainable production clusters outside London – and our 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.

5.88 Overall, this means that the prospects for the withdrawal for 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, we believe that intervention to secure out of London production will continue to be required.

Question 5: Do you agree with Ofcom’s understanding of the likely future developments in the sector? Are there other relevant developments Ofcom has not considered?

Question 6: Do you agree that the rationale for intervention – in terms of 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?

Section 6

The Codes of Practice

- 6.1 Ofcom has set itself the aim of being a light touch regulator, meaning that it will seek to take a deregulatory approach where appropriate. However, where a need for regulation is identified, Ofcom will seek to focus firmly on the underlying causes of concern. Earlier sections of this consultation document have highlighted the key issues in the development of the television production sector, and have established that the rationale for intervention in the sector remains valid – negotiating strength, vertical integration and geographic concentration remain important issues. Although significant change is underway in the sector, the conditions which would allow for withdrawal from regulation remain some way off.
- 6.2 This fundamental conclusion gives rise to a number of specific policy issues, to which we turn in the last two main sections of this document. This section focuses on the Codes of Practice. The other key policy areas are discussed in Section 7.

Background to the Codes of Practice

- 6.3 Section 285 of the Communications Act sets out Ofcom's remit in the regulation of programme commissioning and the purchasing of rights by the public service broadcasters. In particular, Section 285 of the Act sets out a provision for the regulatory regime to include Codes of Practice that set out:
- What appears to Ofcom to be sufficient clarity, when an independent production is commissioned, about the different categories of rights to broadcast or otherwise to make use of or exploit the commissioned production
 - What appears to Ofcom to be sufficient transparency about the amounts to be paid in respect of each category of rights
 - What appears to Ofcom to be satisfactory arrangements are made about the duration and exclusivity of those rights.
- 6.4 The Codes therefore seek to set a transparent basis for commissioning deals to mitigate the exercise of broadcasters' negotiating strength.
- 6.5 Section 285 of the Act also gives Ofcom the discretion to decide whether the main terrestrial broadcasters' Codes of Practice satisfy the requirements of the Act. At the same time, Section 285(7) also obliges Ofcom to issue general guidance on the Codes of Practice that cover these requirements. However, the guidance issued by Ofcom is specifically required to be 'general guidance' and cannot specify 'particular terms to be included in agreements'. Following consultation with industry, Ofcom issued its guidance to broadcasters in December 2003¹⁷.
- 6.6 The Codes were introduced by broadcasters at the beginning of 2004. A relatively short period of time has therefore elapsed since the Codes were introduced – and so it is difficult to provide a comprehensive assessment of the financial and economic impact of the new arrangements. Nonetheless, as far as is practicable to do so, we have conducted an assessment as part of this review. Annex 8, along with elements of Annexes 5 and 6, summarise the input into this assessment, and the current section highlights the key policy issues raised in our engagement with stakeholders.

¹⁷ Ofcom: "Guidelines for broadcasters in drafting codes of practice for commissioning programmes from independent suppliers." (December 2003)

- 6.7 Our general view – through discussions with independent producers and other industry participants – is that the Codes of Practice (and the associated new terms of trade) are generally regarded as working well in relation to scheduled broadcast television. The Codes have been described as instrumental in shaping a more mature industry, and in introducing more constructive and professional relationships between broadcasters and producers. It is also felt that the new environment will make production companies more attractive to investors. As such, the Codes have helped to underpin the growth in the sector discussed earlier.
- 6.8 There were, however, a number of concerns voiced by some of the companies we spoke to. In particular, we have been asked to consider two main areas:
- **The prices paid by broadcasters for programming**
Concern has been expressed about production budgets and prices paid by broadcasters for programming. Several independent producers have suggested to us that budgets have been frozen or reduced. This was attributed partly to greater competition in an increasingly fragmented media environment, and partly to broadcasters apparently squeezing producers in response to the new terms of trade
 - **New media rights – specifically the distribution of TV programmes on alternative distribution platforms**
The question of new media rights has been the one raised most consistently in our interview programme and wider external engagement. Both broadcasters and producers have told us that this issue has not been suitably resolved by the new Codes and terms of trade. There appears to be a lack of consistency and clarity in the approach to ownership and control of new media rights. At the time the Ofcom guidelines for broadcasters were issued, it was anticipated that this could be an issue – and the guidelines indicated that this was an area that Ofcom would keep under review¹⁸.
- 6.9 We discuss our assessment of each of these issues in turn.

Programme Prices

- 6.10 As noted above, a number of producers have argued to us that the prices paid by broadcasters are being squeezed and that this is taking place on a widespread basis.
- 6.11 We have looked into this issue and considered a number of different aspects of pricing – for instance, whether the prices paid by broadcasters were in line with their indicative tariff ranges; whether broadcasters were commissioning a range of programming within those tariff ranges; the prices paid for commissions relative to in-house production; and prices paid for returning series.
- 6.12 We did not find any *prima facie* evidence that broadcasters were systematically reducing the prices they paid for programming. Specifically, we note the following:
- The data received from broadcasters suggests that there is no clear pattern of squeezing tariffs to the bottom of published tariff ranges. Rather, independent commissions are priced across the tariff range and – where relevant – there is no obvious discrimination between in-house and external producers
 - We have not received any clear systematic evidence from PACT, or individual producers, to support the argument that significant tariff reductions are taking place.

¹⁸ Ofcom Guidelines para 19: “Given the inclusion of new media rights into the definition of primary rights is a new and developing area, this is an issue that Ofcom proposes to keep under review”.

- 6.13 We recognise that this data represents a snapshot of the industry in the first year of the operation of the Codes of Practice. We therefore propose to keep the situation under review as part of the regular monitoring of the operation of the Codes of Practice – but we are not proposing to take any action at this time.
- 6.14 We note, however, the concerns from producers that prices have not been adjusted to reflect production cost inflation. This is not specifically a matter for Ofcom: Ofcom's powers relate to monitoring the transparency of pricing, with actual prices set through negotiation between broadcasters and producers – not by Ofcom. Nonetheless, we recognise that there may be an argument for prices to be reviewed by the industry to reflect cost inflation. At the same time, however, efficiency considerations may suggest that cost savings should be sought – rather than simply increasing prices in line with inflation. We also note that, where producers generate value from a programme in a variety of places and at different points in time, it may not be appropriate for the primary commission to fully fund the programme in all cases. Ofcom would nevertheless still expect the indicative tariff ranges published by broadcasters to be capable of accommodating the full production cost of programmes that might have little or no secondary value.

The treatment of new media rights

- 6.15 In the course of the current review, both broadcasters and producers have raised issues relating to 'new media' rights. By this, we mean the distribution of television programmes on platforms other than the traditional broadcast platforms (analogue and digital terrestrial, cable, and satellite) and also the extent to which rights for such distribution should be included within the primary rights licence¹⁹. For example, the relevant rights categories might include the following:
- Simulcast distribution of the programme on digital channels across different platforms (e.g. internet, mobile, as well as traditional broadcast platforms)
 - Time shifted distribution – on traditional broadcast, as well as alternative distribution platforms
 - On-demand services – via free to view, pay per view or subscription
 - Re-purposing and re-versioning of content (defined and discussed in more detail below).
- 6.16 The Ofcom guidelines set out its position in relation to new media rights in the following terms:
- “Primary rights might also be defined to include certain new media rights, including simulcast streaming on the internet and interactive and on-line applications. Where such rights are not included in a primary “bundle”, it may be acceptable for broadcasters to impose a delay in the use or sale of rights for distribution of programmes over other media, such as the internet, in order to protect the value of at least the initial broadcasts on the television networks” (Para 18).
- 6.17 The issues raised by broadcasters and producers have mainly concerned the lack of clarity about the definition of new media rights, and also issues around ownership versus control of new media rights – e.g. to what extent can a broadcaster exercise control over the exploitation of rights, even if it does not own them?

¹⁹ The primary licence sets out the rights generally acquired by the broadcaster that commissions the programme.

- 6.18 In response to an invitation to comment on the operation of the Codes of Practice in relation to new media rights, the BBC expressed a concern that the existing Codes of Practice system might not be sufficiently flexible to deal with rapid technological and market changes, and argued that the next phase of regulation needed to recognise that a flexible approach was needed. Similarly, Channel 4 argued that the current Codes of Practice limited its ability to extend programming to new media platforms to meet audience expectations. For its part, PACT expressed a concern that broadcasters were trying to bundle new media rights into the primary licence in a way which went further than provided for in Ofcom's guidance. Annex 8 summarises the respective positions of the different broadcasters in relation to the different packages of primary and other rights as set out in their Codes of Practice, and also sets out their views and the views of the producers' organisations on the operation of the Codes in more detail.
- 6.19 These concerns about clarity, flexibility and control were echoed in discussions we have had not just with individual producers and broadcasters, but also with third party operators that provide alternative networks for the distribution of content.
- 6.20 We consider that there is a general view that the current approaches to new media rights set out in the Codes of Practice have been overtaken by market and technological developments, and that there is a genuine risk that arrangements put in place through Codes of Practice originally drawn up at the end of 2003 do not have sufficiently flexibility to accommodate these developments. There is also a general view that Ofcom has a role to play in trying to find a way forward for the industry. It is against this background that we are proposing to consult on the issues around the treatment of new media rights – i.e. we are responding to issues raised by the industry.
- 6.21 We are therefore considering the options for addressing these issues and the best means of moving towards a more flexible framework for commissioning, in the light of changing distribution technologies and rapidly developing market conditions. We should make clear at the outset that we are not seeking to prescribe a solution to this issue. Rather, our intention is to put forward a set of core principles, and thereby to set out a potential framework for negotiation. The final details of any solution – including specific terms – should be the subject of commercial negotiation, rather than regulatory intervention.
- 6.22 The purpose of this consultation is therefore to discuss the issues and to initiate a debate within the industry about potential high-level options. One important aspect of that debate is the extent to which changes to the current guidance and Codes of Practice are actually needed – as part of the consultation process, we are keen to explore the extent to which potential options actually require changes to the framework created by the existing Codes of Practice. We recognise that the existing Codes of Practice reflect a certain balance between broadcasters and producers, and we wish to avoid disturbing that balance unless absolutely necessary. Our strong preference is for the industry to resolve these issues by negotiation if possible. Therefore, one question is whether the industry can find a negotiated solution without the need for intervention by Ofcom. But if a negotiated solution is not found, Ofcom will have little choice but to intervene in this area.
- 6.23 If, as a result of responses to this consultation, it was felt necessary to change Ofcom's existing guidance in order to bring about changes in broadcasters' current Codes of Practice, then we are required to consult on any proposed changes to that guidance which – as set out above – would articulate the principles to be implemented via the Codes of Practice. Consequently, this consultation can only

establish whether any changes to Ofcom's guidance in relation to the Codes of Practice are required and, if so, what general form and direction these changes should take.

Ofcom's objectives in relation to new media rights Issues

- 6.24 The focus of this discussion is on the rights relating, either in their entirety or a substantial proportion thereof, to programmes originally commissioned for television broadcast on the public service channels (the BBC, Channel 3, Channel 4, Five and S4C).
- 6.25 It is important to highlight that we have not been asked to intervene in the market for content commissioned specifically for new media platforms – this issue is outside the scope of the current review. This is principally because the market for specially commissioned new media content is a diffuse market, and the issues requiring intervention in television production do not generally arise. As a result, the commissioning of entirely new content for distribution on other platforms is not subject to the same regulation as commissioning for television broadcast. Section 285 of the Communications Act specifies that the Code for programme commissioning applies only to 'licensed public service channels'. The Code does not extend to the commissioning of content for any non-PSB licensed television service, or indeed for services that do not require a broadcasting licence.
- 6.26 We take as a starting point the position that the area of new media rights offers opportunities for both broadcasters and producers – and that these opportunities could deliver significant benefits to viewers. There is, however, considerable uncertainty about the value of the opportunity created by new media distribution. We have reviewed the limited research and information currently available on the market for distribution of TV programmes via alternative platforms. From this analysis, we note:
- The size of the market for new media rights is currently small – payments for primary rights are the largest source of revenue for producers, and indeed new media rights currently only account for around a fifth of all non-TV production turnover. However, there is general recognition of the potential for this area to grow and develop in the future
 - Most of the current financial value from the distribution of TV programmes – and hence the basis of their funding – is likely to remain at the point of first TV transmission
 - The financial value of TV programmes outside the primary licence period varies considerably according to the format or genre of programme, and the scale and incentives of the producer and broadcaster involved. Under current market conditions, many programmes – in fact the majority – may have only limited secondary value
 - Going forward, there is considerable uncertainty around both the potential size of the market for distributing TV programmes over alternative platforms, and the impact of this on consumption of TV programmes via established broadcast and retailed outlets.
- 6.27 Given the above, both producers and broadcasters may face opportunities but also threats to their existing business models as the market develops. In our view, viewers are likely to benefit from a proliferation of means of accessing television programmes

– and so broadcasters and producers should seek innovative approaches to growing new markets and exploiting new platforms. However, we also recognise that, in the near term at least, viewers' interests are likely to be met primarily through content delivered via traditional broadcast platforms. It is therefore important to develop a framework that meets the needs of viewers, by balancing the interests of different platforms – whether traditional broadcast, or new distribution platforms – and different stakeholders – whether producers, broadcasters, platform operators, or new service providers.

- 6.28 In discussions with Ofcom, some broadcasters have expressed the view that the exploitation of new media rights threatens the entire business model for scheduled broadcast television, i.e. that any revenue generated from the exploitation of new media rights generally represents a diversion of finances away from traditional spot advertising or sponsorship that currently funds scheduled broadcast television.
- 6.29 We recognise that broadcasters are concerned that the exploitation of new media rights by producers might have the potential to affect their ability to maintain and develop their brand and channel proposition. We also recognise that broadcasters are concerned that, where exploitation of new media rights in programmes they have originally commissioned takes place outside their control, there could be important implications for their underlying business models: broadcasters continue to fully fund or mostly fund a significant proportion of all television programming.
- 6.30 Moreover, we recognise the significant contribution that broadcasters play in relation to commissioning original content. We are conscious of the need to safeguard the £2.6bn that is currently spent each year on original production in the UK, particularly in light of the fact that the Codes of Practice are generally regarded as working well in relation to scheduled broadcast television. At the same time, however, we also recognise that part of the rationale for intervention in the production sector is to provide producers with a degree of protection against the negotiating strength of the main terrestrial broadcasters. As set out in the previous section, the main terrestrial channels account for 87% of spend on first run originations and we expect that they may well still account for 80% of this spend in five years' time. Negotiating strength therefore remains a significant issue.
- 6.31 We do not consider that models for new media rights and for "traditional" broadcasting can only represent a zero-sum game – we do not consider that revenue from the exploitation of new media rights can only be at the expense of advertising or sponsorship for scheduled broadcast television. We consider that it should be possible to allow the development of new media rights in a way that supplements existing funding models²⁰. Moreover, the exploitation of TV programmes on new media platforms is likely to deliver benefits – from opening up new markets for rights,

²⁰ Many of the discussions in this area have focused on the use of clips on mobile services. These are new markets, and there is a lack of concrete evidence as to whether consumers will in fact substitute viewing of mobile content for viewing of the full programme on linear TV. Ofcom is aware that in a number of other contexts, where competition authorities have considered the extent of substitution between mobile services and linear television services, they have concluded that mobile services are not close demand-side substitutes and thus do not form part of the same economic market. For instance, most recently in the context of a sector enquiry into 3G sports rights, the European Commission competition directorate (DG COMP) concluded that – based on different characteristics of delivery and consumption, it was possible to define separate product markets as between mobile sports services and TV sports services. The sorts of factors that DG COMP took into account included: screen size, quality of images and sound, comfort of viewing, mobility of viewing, cost of usage and ability to personalise the viewing experience. DG COMP also commented on the fact that TV and mobile services were consumed in very different ways for both technical and social reasons.

and expanding the routes to audiences. We note that the film industry has been able to develop the concept of a windowing system which has different release windows for different means of distributing content: e.g. starting with theatrical release before moving to DVD/video purchase and rental, before moving to television exploitation. The film industry has successfully used this system to prevent excessive cannibalisation of revenues, although we also note that over time the differences between release windows have tended to shorten.

- 6.32 The main terrestrial channels will retain a significant amount of negotiating strength going forward, and we do not consider that broadcasters should automatically own and control *all* new media rights exploitation as part of the primary licence. We recognise several of the concerns expressed by producers that broadcasters may use their negotiating strength to impose lengthy holdback periods – this may impede the development of new markets, or may impose particular commercial models on producers for the exploitation of new media rights.
- 6.33 It is certainly the case that broadcasters should be able automatically to acquire a package of “core” rights as part of the programme licence which reflects their PSB role. It is also the case that the nature of the “core” rights package could change over time with changes to PSB remits, and this could raise issues for a PSB broadcaster if it then had to negotiate separately to acquire such rights. However, there also needs to be greater flexibility to allow producers to innovate and develop new uses for programme material, and broadcasters should not be able to stifle this creativity through trying to lay claim to rights to all new means of distribution or through making use of excessive holdback periods. A delicate balance will need to be struck in order to further viewers’ interests.
- 6.34 We are keen to explore with the industry how the potential for new media rights exploitation can best be managed. As is the case with production in general, we do not consider that there is a unique model that will deliver the widest range of benefits in terms of creativity and innovation. It is not axiomatic that the only way for these opportunities to be realised is for the broadcaster to be able to own and control new media rights. In some cases, the broadcaster may be best placed to exploit certain types of content, but the producer may have the advantage in other instances. Indeed in certain instances, it may be possible for third party intermediaries to set up to exploit market opportunities. Ofcom is looking to provide a structure in which different business models can develop. Again, resolution of these issues should generally be possible through negotiation rather than by regulatory intervention.
- 6.35 Based on the above discussion, Ofcom considers that its approach to developing options for dealing with new media rights issues should:
- Be in keeping with overall approach to the Codes of Practice – that is, the principle that the rights reside with the producer unless sold to the broadcaster
 - Not be considered in isolation from other rights in the primary licence, due to the potential impact on the existing funding and revenue models that underpin these
 - 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
- Ultimately aim to 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.

Options for the treatment of new media rights

- 6.36 As set out above, we are reviewing the issue of new media rights because we have been asked to do so by the industry, and because we consider disagreement in this area to be a function of the negotiating strength of broadcasters. The views expressed not just by broadcasters and producers but also by other third parties indicate that the existing Codes of Practice are not working as well in the area of new media rights as they are in relation to scheduled broadcast television.
- 6.37 We have also considered whether it might be possible to focus specifically on the issues around new media rights and leave other aspects of the Codes of Practice untouched.
- 6.38 We have a number of reservations about such an approach. We consider that such a targeted approach is not likely to be “future proof” and it would also involve considering specific sets of rights in isolation. We are conscious that a number of parties have indicated that any changes to the current system should aim to develop a more flexible structure that could accommodate technological and market developments. We are also conscious that the current Codes of Practice/terms of trade arrangements generally represent a balance which has been negotiated between broadcasters and producers. There is thus the possibility that focusing on a specific set of rights would run the risk of destabilising this position, and also would not necessarily take into account the potential impact on the funding and revenue models that underpin the commissioning and exploitation of content.
- 6.39 We are also aware that some of the main terrestrial broadcasters have been keen to seek distribution of their core PSB service across a number of platforms, and also to increase the number of services – or “family” of channels – that they operate as a means of continuing to reach as wide an audience as possible. These broadcasters have argued that they need to ensure that programmes commissioned for scheduled broadcast on their core service are also available via alternative platforms and via alternative services, in order to protect audience size and with it their relevance as a public service broadcaster. However, the current Codes of Practice only cover commissioning of programmes for distribution on the licensed public service channels.
- 6.40 Under its existing Code of Practice, the BBC is currently able to commission across its licensed public service channels. Channel 4 has been able to reach a commercial agreement with PACT (with the latter acting on behalf of independent producers), to

cover the use of programming on More4²¹. ITV1's Code of Practice relates just to commissioning for the ITV Network – commissions for the other ITV plc channels (ITV2-4) are subject to different arrangements.

- 6.41 If Ofcom were to focus on solutions specifically for new media rights, we would not be able to take into account these other issues. They would remain a matter for the broadcasters and PACT to negotiate over, and – in the context of commissioning for the licensed public service channels – broadcasters would be prevented from making commissions conditional upon securing distribution rights for additional channels.
- 6.42 For the reasons set out above, we do not consider that it is possible to consider options for addressing new media rights in isolation. However, we are prepared to return to this issue if, in response to this consultation, proposals are put forward which would enable the issues around definition and ownership/control of new media rights to be tackled specifically.

A move to rights windows – e.g. “when, not where”

- 6.43 Ofcom has discussed with both broadcasters and producer representatives how the framework created by the existing Codes of Practice might be updated and clarified to reflect the treatment of alternative distribution *within* the primary licence. From these discussions, Ofcom notes that there is a degree of support for moving to a system in which the primary rights package becomes a time-based window that includes distribution of original commissioned TV programmes via any platform, followed by a shortened holdback period.
- 6.44 The current packaging of rights set out in the Codes of Practice tends to be platform specific. It therefore may not be flexible enough to meet changing requirements and circumstances over time. At one extreme, the current treatment of rights to linear TV distribution grants extensive ‘holdback’ control over secondary exploitation of a programme. At the other extreme, the current treatment of rights to retail distribution gives relatively swift access to the producer to a distribution format (DVD), which is likely to be relevant to the most popular – and therefore the most valuable – programming.
- 6.45 Changes in the market and technology suggest that there could be scope for a solution which recognises the need for increased flexibility on the part of the broadcaster, and at the same time considers mechanisms for allowing earlier secondary exploitation of content. As stated earlier, Ofcom's preference is for the industry to resolve these matters through negotiation. To assist that process, we set out an alternative approach that Ofcom might adopt were it required to intervene – we consider that this could assist the industry, in terms of stimulating debate and acting as a catalyst for stakeholders to take this debate forward themselves. To that end, we consider the principles that would be relevant to a “when, not where” approach to the exploitation of rights. The key principles that would underpin such an approach would be based on defining a package of “core” rights which could comprise:
- A “primary” window in which the rights acquired by a public service broadcaster included:

²¹ We recognise that the agreement between Channel 4 and PACT is currently an interim arrangement.

- **Any distribution platform**²²: this would break the link between specifying rights according to the means of distribution, and provide the flexibility to accommodate new distribution technologies going forward
 - **Any wholly-owned channel**: the primary right would allow broadcasters to commission material to be exploited across wholly-owned channels (e.g. Channel 4 and More4; ITV1 and ITV2)
 - **For a specified duration**: broadcasters have exclusive first transmission of a programme. They would also be able to offer a 'catch-up' window around the first transmission of the programme for a specified duration agreed between broadcasters and producers. This catch-up service could be offered either on the same channel or on other wholly-owned channels
 - **Free-to-view UK distribution**: to prevent any advance pay-per-use exploitation unless the producer is able to participate
 - **A holdback against exploitation of other ancillary rights within the primary window.**
- A second window in which the broadcaster is able to apply a "holdback" in relation to the subsequent exploitation of rights by the producer based on:
 - **A shorter period than the current 5-year licence period** – recognising that the primary window may involve more intensive exploitation of the programming than is currently the case
 - **Holdback against the transmission of the whole or any part of the programme on a scheduled broadcast in the UK**: to preserve the exclusivity of first broadcast of all material. There are important questions about the extent to which this holdback period might apply to on-demand services – an issue to which we return later in this section
 - **The option to extend the holdback period on further payment**: to allow for broadcasters to preserve exclusivity of content and brand, following appropriate compensation to the producer.
- 6.46 At the end of this holdback period, the ability to control exploitation of the programme would then revert to the producer.
- 6.47 The above primary and holdback windows essentially refer to the full, scheduled broadcast version of the programme. These windows could also include the use of 're-versioned'²³ material from broadcast programmes on a non-commercial²⁴ basis and also programme clips or highlights used across a broadcaster's services for support and promotion purposes. We would expect that the rights to "re-purpose" the

²² By distribution platforms, we refer to both traditional broadcast (analogue and digital terrestrial, satellite and cable) and alternative (e.g. mobile, broadband) means of transmitting content to end-users. However, this does not refer to modes of retail distribution, such as DVD.

²³ We recognise that the terms re-versioning and re-purposing can have different interpretations across different media. For the avoidance of doubt, in this context we are using the term "re-versioning" to mean relatively minor editing of programmes. By "re-purposing" of material we mean more fundamental changes to the structure of a programme e.g. to convert it into short clips; to include alternative camera angles; to include material not already broadcast etc.

²⁴ Non-commercial use is distribution on a 'free to use' basis where there is no direct payment by the consumer for access to the material.

linear programme (e.g. into shorter episodes for mobile platforms) could then rest with the producer, but there would be limits on their ability to exploit such material before the end of the primary window. Earlier exploitation could take place if the broadcaster and producer were able to agree commercial terms.

- 6.48 In respect of exploitation of other ancillary aspects of the programme – such as ringtones and video games – there would be a presumption that such rights rest with the producer. It could be the case that the broadcaster could retain a degree of exclusivity for the primary window, but that could be linked to the duration of the primary window. Retail and other merchandising rights (e.g. DVD) and international distribution rights would remain with the producer as at present.

Key issues arising

- 6.49 It should be stressed that Ofcom is consulting on the *principle* of moving to a windowing system made up of a primary window and a holdback period. As set out earlier, if Ofcom wanted to move to a specific proposal to introduce such a system, it would need to consult on amending its Codes of Practice guidance to broadcasters. The principles set out above should be viewed as setting out a framework on which we are seeking views in the formal consultation. We consider the above proposals to make up a package. Specifically, considering the “when, not where” approach involves a consideration of a range of related issues – including flexibility for a broadcaster to distribute programming across all platforms and all wholly-owned channels; and the appropriate role of holdbacks in terms of encouraging the exploitation of new media opportunities.
- 6.50 Pre-consultation discussions with broadcasters and producers have indicated that such an approach is likely to raise detailed issues of implementation. As set out above, we are looking to establish a framework for negotiation which will provide clarity and flexibility going forward. In the context of moving to a system based on the principle of time-based rights windows, we have attempted to set out some suggestions as to how such a system might operate. However, as well as consulting on the principle of a windowing system, the purpose of the consultation is to establish where practical issues might cause significant problems of implementation. We are therefore inviting comments on how issues around implementation might be addressed.
- 6.51 Against that background, we consider that there are five main areas where further discussion and debate is required in order to establish how a windowing approach might be implemented. Those issues are:
- The duration of the primary window and the holdback period
 - The treatment of repeats
 - The treatment of Video on Demand (VoD) rights
 - The treatment of re-purposed content
 - The treatment of returning series.
- 6.52 These issues are discussed in turn below. As part of the discussion below, we have attempted to set out options which would provide an incentive for both broadcasters and producers to come together to discuss and negotiate the early exploitation of

rights. We consider that providing such incentives could benefit viewers, through their positive effects on the stimulation of innovation and creativity.

Duration of the primary window and the holdback period

- 6.53 As set out above, Ofcom would be limited in its ability to prescribe the duration of any primary rights window, and so is seeking the views of the industry. Ofcom is aware that there has been much discussion around the duration of a “catch-up” window. For instance, the BBC has been able to negotiate a 7-day catch-up window with PACT. Ofcom also understands that PACT has been developing proposals for other broadcasters based around the concept of a 7-day window. In contrast, Ofcom notes that Channel 4 has stated that it considers a primary window of 30 days to be more appropriate for its purposes.
- 6.54 In relation to the duration of the holdback period, Ofcom would again be limited in its ability to prescribe the duration of any holdback period – it is therefore seeking the views of the industry. Ofcom notes the holdback policies developed voluntarily by both the BBC and Channel 4 envisage shortening the existing 5-year holdback period to a period in the range from 6 months to 2 years – depending on the nature of the programming. In the case of the BBC, its policy explicitly recognises that the public service value it derives from a programme can be used up within a relatively short time frame across all distribution platforms.
- 6.55 We note that currently, where the broadcaster voluntarily waives the five year holdback, the broadcaster usually retains some control over issues around scheduling and branding and also enjoys an enhanced share of the backend. Such issues could still be accommodated within and after the holdback period.
- 6.56 We also recognise that a broadcaster without a multichannel or multi-platform strategy may realise value from programming over a longer period. Such circumstances could be recognised within this framework by linking the length of the holdback period to the extent of exploitation within the primary window. A longer holdback – allowing for exclusive repeats – might be appropriate if a programme has not been so extensively exploited in the primary window.
- 6.57 We would welcome views about the appropriate interplay between the duration of the primary window, and the length of the holdback period. It appears to us that, within a windowing system comprising primary and holdback windows, there could be the flexibility for different broadcasters to negotiate different durations for the primary and holdback windows according to their requirements. A move to a windowing system does not mean that there would need to be a “one size fits all” approach across all main terrestrial broadcasters.
- 6.58 It might be argued that a potential shortening of the period of exclusivity could fundamentally affect the value of what broadcasters are prepared to pay for the primary licence. At present it can be argued that, since a broadcaster funds most of the production cost, it is also taking on the majority of the risk in a programme and should be entitled to extract most of the primary value in a programme. Against this, however, the broadcaster would benefit from the more intensive exploitation of the programme within the primary window across different distribution platforms and wholly-owned channels. To the extent that value is generated largely around the primary transmission, the move to a windowing system which included primary transmission across all wholly-owned channels might not have an immediate impact on prices paid for programming. However, if broadcasters are acquiring rights that

are less valuable, then it would be reasonable for them to pay less in future. Equally the reverse should also apply.

- 6.59 We also note that, if an extended period of exclusivity were important to a broadcaster, it should be able to negotiate with the producer to extend the holdback period in order to safeguard it. Broadcasters would have to approach this issue on a case by case basis but it would allow them to focus on, and pay appropriately for, instances when exclusivity was genuinely important to them. From our discussions, Ofcom understands that broadcasters accept that control is likely to be important for specific programmes or categories of programming, rather than across the board.

Treatment of repeats

- 6.60 In relation to the treatment of repeats, Ofcom is aware that – as part of the primary licence – broadcasters have developed contracts for a specified number of transmissions of the programme, e.g. the main transmission plus two repeats, or in some cases unlimited transmissions in return for the payment of repeat fees. Under the framework outlined above, Ofcom envisages that a broadcaster would still be able to acquire a specified number of repeat transmissions, which would be subject to commercial negotiation. It is possible that unlimited transmissions in return for repeat fees could also be accommodated within this system. As the requirements of broadcasters evolve, so might the specifications in the agreements.
- 6.61 One option would be for the current practices to continue. The BBC and Channel 4 have negotiated a ‘package’ of transmissions across channels in the primary licence. While this could continue, an alternative would be for the repeats within the holdback period to be available only to the primary commissioning channel.
- 6.62 The degree of exclusivity a broadcaster enjoyed in relation to repeats would depend on how quickly the programme was repeated. If the programme were repeated within the holdback period, then that would be an exclusive repeat. Outside the holdback period, the broadcaster could still retain the right to make use of any repeats not already used – but it would at that point be on a non-exclusive basis. For instance, when the holdback period has elapsed, the producer may have sold the programme to another broadcaster. Trailers/promotional clips could also be accommodated within this structure – either being exclusive or non-exclusive depending on whether or not they fall within the holdback period.

Treatment of Video on Demand (VoD) rights

- 6.63 The proposed primary window would allow a broadcaster to exploit the non-commercial (“free”) VoD rights in a programme – and so help deliver on viewers’ interests by allowing new ways of accessing television programming. This would allow for distribution in the context of the primary catch-up window, which could either be as part of a free-to-use service or as part of a catch-up service within a general subscription service. This would only be practical where the broadcaster or platform provider can make appropriate Digital Rights Management (DRM) provision, in order to ensure that the programme cannot be viewed or further distributed outside of the primary window. Our expectation is that only a broadcaster would be interested in exploiting free VoD rights.
- 6.64 Other types of VoD rights – e.g. subscription VoD or pay-per-view (PPV) VoD rights – have more potential to act as substitutes for conventional viewing of scheduled broadcast programming, and thus could pose more of a threat to broadcasters that rely on advertising and sponsorship revenue. To the extent that such rights represent

a direct substitute for conventional viewing patterns, then they could also have an impact on audiences for licence fee funded services. In both cases, extensive switching to VoD services has the potential to undermine the amount which a broadcaster might be prepared to pay to commission original programming.

- 6.65 Conversely, certain VoD services could have the potential to generate additional viewing of programming. For instance, there could be an analogy with DVD rights²⁵ where viewers have demonstrated a willingness to purchase DVDs of programmes which have proved popular with audiences to watch the material again after it has been broadcast on TV. In such circumstances, VoD services would represent an additional source of revenue.
- 6.66 We note that the BBC's Code of Practice makes a distinction between the rights to exploit commercial downloads (e.g. where a viewer pays for content downloaded over the Internet) and rights to on-demand TV services. In the case of commercial downloads, the rights sit with the producer; whereas for on-demand TV services, the BBC retains the rights.
- 6.67 As referred to earlier, the extent to which VoD services will represent a significant threat to established business models is not clear, although we do recognise the potential threat they could pose. To the extent that VoD services do represent a direct substitute for scheduled broadcast TV programming offered by the broadcaster, then it would seem appropriate for the broadcaster to have some degree of control over the timing of exploitation. At the same time, extensive exploitation of VoD rights could impact on producers' revenues from DVD sales. There would therefore appear to be some common ground between producers and broadcasters about the need to manage the exploitation of VoD rights.
- 6.68 One option would be a requirement that programming could not be exploited in this way within the holdback period without the agreement of the broadcaster. Alternatively, another option would involve making a distinction between the exploitation of different categories of VoD rights, e.g. that the rights for pay per view exploitation could be exploited after the end of the primary window, but that subscription VoD rights – if they are a closer substitute to scheduled broadcast programming – could not be exploited within the holdback period without the agreement of the broadcaster.
- 6.69 We recognise that these are complex issues, and seek views from stakeholders during the consultation on how these issues might be addressed within a windowing framework.

Treatment of re-purposed content

- 6.70 As set out above, there is an expectation that the rights to *re-purpose* the linear programme (or material that does not form part of the scheduled broadcast) – e.g. into shorter episodes for mobile platforms – would rest with the producer. At the same time, however, there are potential issues about the impact on broadcasters' funding models and on their brands.
- 6.71 In the past, broadcasters have argued that they need the ability to own and control the exploitation of re-purposed content on other services which may be substitutable for their scheduled broadcast services. While Ofcom recognises that a degree of protection in respect of the exclusivity around the primary window is necessary, it is

²⁵ DVD rights currently rest with the producer, although the broadcaster typically has a degree of exclusivity around the primary transmission.

possible that broadcasters have overstated the extent of substitution from scheduled broadcast TV programmes to re-purposed content. Broadcasters have also expressed concerns about the way in which programming closely associated with the broadcaster's individual brand might be exploited in the context of such services, and where the broadcaster has little or no control over such exploitation.

- 6.72 One option would be to maintain the understanding that rights rested with the producer unless explicitly sold to the broadcaster, but to allow the broadcaster to prevent exploitation until after the primary window unless commercial terms had been agreed with the broadcaster. This would be in keeping with the principle that rights remain with a producer unless explicitly sold to a broadcaster. Again, Ofcom would expect that such an arrangement would provide an incentive for both producer and broadcaster to reach agreement about the early commercial exploitation of the right – given that the greater part of the value of re-purposed content is likely to be in proximity to the first transmission of the programme.
- 6.73 As with VoD rights, Ofcom recognises that these are complex issues and seeks the views of stakeholders as to how these issues might be addressed within a windowing framework.

Treatment of returning series

- 6.74 As under the current Codes of Practice system, returning series clearly present a further complexity within the framework proposed. The basic issue for broadcasters is that a shortened holdback period could mean that, at the same time that a new series is being aired on one of the broadcaster's channels, repeats of an earlier series could be being shown on another channel altogether. Indeed, if the other channel were in competition for viewers with the originating channel, the series could even be scheduled competitively. This concern applies to both returning series and also long-running series.
- 6.75 There are a number of options in relation to such programmes. One option would be to provide for the broadcaster to have the right to purchase additional periods of exclusivity which would enable a broadcaster to ensure that such a situation did not arise. Another option might be for a broadcaster to have a longer holdback period where a series is re-commissioned but, as is current practice, to agree to release the rights sooner when a series is not. A third option would be for the producer to have to obtain the agreement of the commissioning broadcaster for the secondary sale of any series still under commission, even if the original holdback period has elapsed. Ofcom would welcome suggestions as to how returning series might be accommodated within a new framework.

Summary and next steps

- 6.76 As set out above, Ofcom stresses that it is consulting in the first instance on a move to a framework for commissioning of television programming that is based on the principle of a windowing structure (i.e. a primary window followed by a holdback period). Ofcom would emphasise that it recognises that there are important issues of implementation around such a framework, and the discussion above is an attempt to illustrate some of the potential options. However, the discussion has stopped short of attempting to group together different options into actual proposals.
- 6.77 The purpose of the consultation process is to provide stakeholders with an opportunity to raise issues with Ofcom and to debate the above options – or indeed to propose alternative ways of achieving the objectives which Ofcom has set out.

Through this process, it is possible that the industry may decide that it can resolve these matters through negotiation. If this is the case, we expect stakeholders to inform Ofcom by the end of the consultation period that they will take forward these issues for themselves – and so intervention by Ofcom is not needed. We would also expect stakeholders to define a reasonable timetable within which these issues will be resolved.

- 6.78 Following publication of this consultation document, we envisage that the next steps in this area will involve further consideration of the possible approaches to the distribution of television programmes on alternative platforms. We would be interested in exploring the extent to which the principles of a “when not where” approach could be accommodated within the existing Codes of Practice/terms of trade framework – we recognise the need to build on the existing Codes of Practice approach, rather than undermining it. Specifically, Ofcom recognises that the Codes of Practice are still bedding down, and that it would not be desirable to change the existing Codes of Practice guidance unless absolutely necessary. There is already much uncertainty around new media rights – our concern is that an early change to the guidance would delay resolution of these issues into 2007, and could reopen broader debates between broadcasters and producers. As such, we are reluctant to impose any change unless required.
- 6.79 In addition to reviewing formal consultation responses on this subject, we will continue to engage with industry stakeholders through discussions and workshops. As set out above, as part of these discussions Ofcom will be looking to the industry to decide whether it is likely to be capable of resolving these issues for itself, without the need for regulatory intervention.
- 6.80 If, by the end of the consultation period, stakeholders conclude that they cannot resolve these issues, Ofcom will have little choice but to intervene by recommending changes to the guidance and Codes of Practice. Under this outcome, a separate process would follow the conclusion of this review. Specifically, before the Codes of Practice could be changed, Ofcom would need to issue new guidance on the Codes. Ofcom would therefore need to consult separately with stakeholders on any proposed changes to the guidance. If required, we envisage that the initiation of this process could coincide with the publication of our policy statement in 2006.
- 6.81 In terms of timetable, it is currently anticipated that our policy statement would be issued sometime in spring 2006. If Ofcom were to consult on changes to its guidance at that point, the separate consultation would run through to the summer, with revised guidance then being issued in early Autumn. At that point, broadcasters would be required to amend their Codes of Practice to bring them into line with Ofcom's new guidance, and to submit them to Ofcom for approval. Ofcom envisages that this process would probably take until the end of 2006.
- 6.82 This means that, if it is decided as a result of this consultation that intervention is needed, it would not be until the beginning of 2007 that the new system would come into operation. If it is decided that changes to the existing arrangements are required, then as part of the evaluation process Ofcom would also carry out an Impact Assessment in order to identify the impact of different options.

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?

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?

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?

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?

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 are 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 account of the legitimate concerns of broadcasters?**
- **How might returning series be treated within this framework?**

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?

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

Section 7

Other key policy issues

7.1 This section sets out our conclusions and propositions for consultation in each of the following areas:

- **Vertical integration and the independent production sector** – the future of the independent quota, and the BBC’s plans for a Window of Creative Competition
- **The future of production outside London** – the out of London (OOL) production quota, and the possible need for additional steps to secure out of London production for the future
- **Definitions of independent producers, qualifying programmes and out of London productions** – whether there is a need for change in any of these areas.

7.2 In thinking about proposals for the future of intervention in the television production sector, Ofcom has considered its views in the context of its relevant duties under the Communications Act – we summarised these duties in Section 3. Section 7 of this document – when read in conjunction with the discussion of Ofcom’s duties and the rationale for intervention set out in Sections 3 and 5 – represents an Impact Assessment as defined by Section 7 of the Communications Act.

7.3 Impact Assessments provide a valuable way of assessing different options for regulation, and showing why the preferred option was chosen. They form part of best practice policy-making and are commonly used by other regulators. This is reflected in Section 7 of the Act, which means that generally Ofcom has to carry out impact assessments in relation to proposals that would be likely to have a significant effect on businesses or the general public, or when there is a major change in Ofcom’s activities. In accordance with Section 7 of the Act, in producing the impact assessment in this document Ofcom has had regard to such general guidance as it considers appropriate, including its statement, *Better Policy Making: Ofcom’s approach to Impact Assessments*, (“Ofcom’s impact assessment guidelines”). Ofcom is of the view that the assessment contained within this document is consistent with the approach outlined in Ofcom’s impact assessment guidelines.

Vertical integration and the independent production quota

7.4 In thinking about the future of intervention to address concerns over vertical integration, there are two key issues to consider: the general issue of the independent production quota, and the more specific issue of the BBC’s plans for a Window of Creative Competition (the WOCC).

7.5 We discuss the WOCC first, since it has a bearing on our overall view regarding the quota. It is also worth highlighting that the definition of a qualifying independent producer is also relevant to the question of vertical integration – however, we defer discussion of this issue until later in this section, alongside our review of the other key regulatory definitions.

The BBC’s planned WOCC

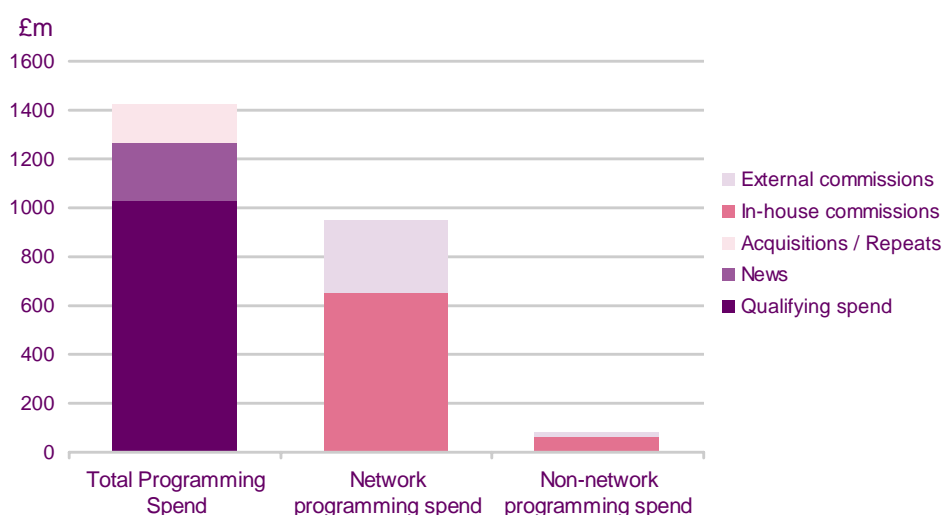
7.6 The BBC has made proposals to improve access for external producers to the BBC commissioning structure. Specifically, the BBC has proposed that in future it will:

- Operate with an in-house guarantee, whereby 50 percent of its qualifying hours will be commissioned from its in-house production base
- Commit to the statutory quota for independent production of 25 percent of qualifying hours
- Retain the remaining 25 percent of hours as the contestable WOCC – i.e. the hours for which both in-house and all external producers (whether qualifying or non-qualifying independents) can compete.

7.7 The BBC has explained to us the basis for the calculation of the in-house guarantee. This has been defined using a disaggregated approach that models the in-house / external supply mix on a genre-by-genre basis and across the schedules of all BBC channels taken together. The BBC has indicated that a high proportion of the in-house guarantee will be comprised of ongoing or returning series (e.g. EastEnders) and genres where scheduling, commissioning and production are logically combined (e.g. Sports coverage).

7.8 Figure 7.1 below, breaking down the BBC's programme spend for 2004, gives an indication of the scale of the opportunity presented by the WOCC.

Figure 7.1: BBC programme spend, 2004



Source: Data from broadcasters. Programming spend excludes expenditure on sports rights.

7.9 On the basis of the numbers for 2004, it is apparent that the WOCC has the potential to create a significant opportunity for external producers. Specifically:

- External producers will be able to compete for around £500m of commissions (i.e. 50 percent of BBC's qualifying programme spend)
- This represents around £200m over and above the BBC's current external commissioning spend.

7.10 Ofcom welcomes the principle of the WOCC – we support the BBC's intention to enhance creative competition and create a more level playing field for external producers. We also note that PACT has welcomed the WOCC in principle, although it has raised some questions about how the WOCC might work in practice.

7.11 We also believe that the key issue going forward is to ensure that the WOCC works effectively. In particular, we believe that more clarity is still needed to ensure that the WOCC achieves its aims of enhancing creative competition, and also to ensure that

the BBC's plans gain the full confidence of the industry as a whole. In our view, more work is needed in two areas – ensuring a commissioning process exists which provides a sound platform for competition for the WOCC to thrive; and in making the WOCC work outside London. We deal with the out of London issue later in this section, and focus our consideration here on the question of commissioning.

- 7.12 The key issue to consider here relates to the structure of BBC commissioning, especially in relation to the separation of roles of BBC commissioning and BBC production. The BBC has suggested that there will be some separation, and a model akin to the ITV Network Centre will be created. We believe there is a need for more clarity on the nature of this separation – it needs to work in such a way as to ensure that independent producers have access to BBC commissioning that is equivalent to that of BBC in-house producers. Only through clear equality of access can the BBC ensure that the best ideas are most likely to reach our screens.
- 7.13 Some of the specific issues in this regard include the following:
- The operational separation of commissioning from production is only partial – for instance, these functions will remain integrated in children's and sports programming. Therefore, an external producer may in some cases have to access the BBC via an integrated commissioning / production team. The separation may also be incomplete for network programmes commissioned against the BBC's own increasing Nations & Regions targets. However, the BBC has indicated that it expects the upper limit on the in-house guarantee, combined with the move of certain genre commissioners and budgets out of London, to improve direct access for external producers. We believe that the BBC should ensure that it has effective safeguards in place to allow external producers fair access to these genres
 - It is important to ensure that neither in-house nor external producers are disadvantaged when competing for the WOCC. For instance, the large number of returning series for BBC in-house production (relative to returning series for external producers) may mean that the in-house guarantee is filled before the independent quota. This should not mean that in-house producers are allowed to fill the WOCC capacity before external producers have an opportunity to compete for access. On the other hand, the relatively large number of returning series for in-house production may also mean that in-house producers are disadvantaged in genres with few returning series. We understand from the BBC that proposals for the WOCC will be submitted by both in-house and external producers from the start of the commissioning cycle – if effective, this approach should prevent either party gaining an unfair advantage. We believe that the BBC should ensure that it has effective safeguards in place to guard against any potential unfair advantage
 - There is a danger that the BBC's plans may create a great deal of complexity. In particular, if every slot is designated as independent, in-house, or WOCC, this could inadvertently act against the delivery of a meritocracy of ideas. If the WOCC is meticulously allocated by schedule slot (with channel, day-part, budget, genre and location of production prescribed), then genuine creative competition will be limited. However, if at the other extreme the WOCC is merely a target to be reported across all BBC channels taken together, there is the risk of creative competition being marginalised to less popular and less resourced programming. We suggest that the BBC aims to create as flexible a system as possible, ensuring that its basis is well communicated to all competing producers at the outset, with a view to maximising creative competition and programme quality.
- 7.14 More generally, we believe that the BBC should ensure that it adopts a commissioning structure that allows barriers to entry to remain low for smaller

companies, and also enables the BBC to commission from a relatively large number of suppliers. This issue is also relevant to Channel 4, which currently commissions from a large number of suppliers in order to meet its remit with regard to innovation, and also to ensure that it meets its out of London production quota.

- 7.15 More information is also needed on how the WOCC will be monitored, and on the criteria that would define success for the WOCC. The BBC has proposed that the BBC Trust will review the operation of the WOCC every two years. However, the BBC has not yet confirmed the nature and scope of this review – we believe that this is an area in which greater clarity is needed.
- 7.16 Moreover, the setting and monitoring of production quotas are areas in which there will be some overlap of responsibilities between Ofcom and the Trust²⁶. Given this overlap, we recommend to Government that Ofcom should be asked to work with the Trust to define the terms of the review of the operation of the WOCC; and Ofcom should also be asked to conduct the review jointly with the Trust – this would help to ensure that the wider sectoral perspective is fully reflected in the review.

The future of the independent production quota

- 7.17 Given that vertical integration remains a significant issue for the BBC and ITV1, the independent production quota and Channel 4's position as a publisher-broadcaster remain important interventions. Our industry interview programme has highlighted that the quota has helped to drive growth in the independent sector. And almost all practitioners to whom we spoke – whether producers, broadcasters, distributors or investors – agree that the independent production quota is still needed to ensure access to commissioners at the main terrestrial broadcasters.
- 7.18 If we were to consider revisions to the independent production quota, we believe that there are four possible options:
- **Option 1:** reduce (or remove) the independent production quota
 - **Option 2:** maintain the quota at the current level of 25 percent of qualifying hours
 - **Option 3:** increase the independent production quota for some or all public service broadcasters, to enforce greater access to commissioners
 - **Option 4:** increase the independent production quota (to, say, 50 percent) in order to help the independent sector become self-sustaining – with a view to removing the quota entirely at a subsequent stage.
- 7.19 In our view, it would be potentially dangerous to consider reducing the independent production quota at this time. As we have seen, vertical integration remains a significant issue – reducing the quota would therefore serve only to enhance the potential negative impact of vertical integration, and would create uncertainty in the sector. It is also interesting to note that, throughout the course of this review to date,

²⁶ At present, the responsibility for Tier 2 regulation of the BBC is split between Ofcom and the BBC Governors in the following way. The Government's Charter Review Green Paper suggests that this division will remain – with the BBC Trust taking on the Governors' current responsibilities:

- The BBC must obtain Ofcom's agreement to quotas for original productions (total and in peak); out of London production; the amount, range and expenditure of network programmes made outside the M25; and the range of production centres outside the M25
- The BBC Governors are responsible for setting all other quotas. They are, however, obliged to consult Ofcom and have regard to its comments. They also have to obtain Ofcom's agreement before allowing the quotas to fall below 2002 levels.

we have not been presented with a case for a reduction in the quota. As such, we reject Option 1.

- 7.20 At the same time, we have also not been presented with a real case for general increase in the quota for any broadcaster, including the BBC. The BBC has privileged access to direct public funding – as a result of which the licence fee, to adopt the terms used in the Government’s Green Paper on BBC Charter Review, should act as “venture capital for the creative economy”²⁷. Given this position, it is possible to argue that the BBC is a special case, and that it should commission more programming from the independent sector.
- 7.21 However, we do not think it would be reasonable to propose an increase in the BBC’s independent production quota, provided that the WOCC works effectively to enhance creative competition. Specifically, if the BBC’s processes become fully meritocratic, such that a more level playing field is created, then there would be no need to increase the BBC’s quota.
- 7.22 Nevertheless, we propose that – if the WOCC does not achieve its aims – then the Government and Ofcom should revisit the option of increasing the BBC’s independent quota. But we recognise that the WOCC may need time to bed down before it is possible to reach a conclusion about its success. We therefore reject Option 3, subject to this caveat.
- 7.23 By the same token, we do not support Option 4: we believe that this would create significant uncertainty, without necessarily achieving the stated aim of making the independent production sector self-sustaining. Specifically, we cannot be confident that a 50% quota will create the conditions that will allow the removal of intervention – for instance, independent producers may still lack sufficient scale, and the problems associated with vertical integration are likely to remain for the foreseeable future.
- 7.24 In our view, regulatory certainty is more important than regulatory withdrawal: as such, we would only support Option 4 if, at some point in the future, we could be confident that this measure could achieve its aims within a specified timetable.
- 7.25 Overall, therefore, we support Option 2: we believe that the independent production quota should be held constant at current levels – it is likely to remain an important source of certainty for the independent production sector for at least the next five years.

Question 14: What do you see as the key issues in relation to the operation of the BBC’s proposed Window of Creative Competition (the WOCC)?

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

The future of production outside London

- 7.26 As discussed in previous sections of this document, regulatory intervention has been an important driver of production outside London. Therefore, while the quota for production outside the M25 is undoubtedly a blunt instrument, it seems to have been a necessary intervention.

²⁷ Paragraph 7.6 of Government Green Paper – Review of the BBC’s Royal Charter: *A strong BBC, independent of Government*. Published on 2 March 2005

7.27 Going forward, therefore, there would appear to be three options for the future course of intervention in this area:

- **Option 1:** Retain the intervention at current levels
- **Option 2:** Reduce intervention for production outside London
- **Option 3:** Increase the degree of intervention, or supplement current measures with further policy tools.

7.28 We have seen earlier that the current intervention has helped to deliver production outside London. Option 1 therefore remains the default position, unless we can establish that either of the other options can deliver greater benefits to viewers.

7.29 For instance, Option 2 would be appropriate in one of two circumstances:

- If the costs of the current intervention outweigh the benefits – and so a reduction in intervention would deliver net benefit to viewers
- If production outside London is economically self-sustaining, and so no longer needs as much (or any) regulatory support.

7.30 We do not believe that the first of these criteria applies. We established earlier in this document that there are diversity benefits associated with the dispersal of production across the UK. And our external engagement programme has found strong support for out of London production from both producers and broadcasters.

7.31 The second criterion also appears invalid. We have already seen in earlier sections that production outside London is unlikely to be self-sustaining in the longer term. Moreover, it is worth noting here that the prospects for out of London production – particularly from external producers – could actually become more challenging in future in the run-up to digital switchover and beyond.

7.32 This means that the role of the BBC in out of London production will become even more important in the future – and that a reduction in intervention is likely to damage the prospects for diversity of production across the UK. As such, we reject Option 2.

7.33 However, the fact that the prospects for out of London production may become more challenging in the future suggests that Option 3 could be appropriate. For instance, new measures may be needed to protect Channel 4's out of London contribution; and, as the two primary public service broadcasters, there may be an argument for considering the role of the BBC and Channel 4 together – and separately from the commercial public service broadcasters.

7.34 Nonetheless, before considering any further measures, it is vital to reiterate the point made earlier in this document – that too much emphasis on diversity could actually act to the detriment of viewers. Therefore, the purpose of any further measures should be to maximise the net benefit of out of London production. In addition, and in line with Ofcom's regulatory principles, we believe that any additional measures should be implemented so as to be as unintrusive as possible.

7.35 In our discussions with industry stakeholders, a number of options have been put to us. These are in three general categories:

- Regulatory: relating to quotas, and the wider relationships between broadcasters and out of London external producers

- Institutional: relating to the location of channels, commissioners and in-house production bases
- Financial: investment by Government or other public agencies.

7.36 These measures are summarised in Box 7.1 below.

Box 7.1: Options for further measures to secure production outside London

Regulatory

- Increase levels of out of London spend for C4, Five and the BBC towards Channel 3 levels
- Require broadcasters to hold regular meetings or pitching sessions with out of London external producers around the UK
- Require broadcasters to apply the out of London quota by genre rather than across all genres taken together
- Introduce a quota specifically for out of London independent producers
- Introduce an Out of England (in addition to the out of London) quota
- Ensure that the BBC's WOCC works to deliver on the objectives for production outside London

Institutional

- C4 and / or a mainstream BBC channel moves out of London
- Require broadcasters to base some commissioners outside London, and / or appoint dedicated champions for producers in the Nations and Regions
- Establish a Public Service Publisher (PSP) outside London

Financial

- Government invests in development of creative clusters in specific locations through RDAs or Screen Agencies
- RDAs / Screen Agencies could provide match funding for out of London commissions to reduce perceived risk on the part of broadcasters

7.37 In our view, many of these options may not be suitable, for a number of reasons:

- A number of them sit outside Ofcom's regulatory locus – and so we do not have the power to make them happen. For instance, we do not have the power to dictate the application of the institutional measures noted above – decisions about the locations of channels, commissioners or production capacity are outside Ofcom's remit

- We do not support the idea of introducing additional layers of production quotas (e.g. an out of England quota): these have the danger of creating additional bureaucracy. Moreover, detailed quotas, associated with small volumes of production, could act against commissioning the best ideas and have the effect of stopping the best ideas from reaching our screens. We also do not have the power to create a formal link between the independent quota and the out of London production quota – these are separate statutory instruments
- We note that requiring a major broadcaster or channel to move out of London would be a very large-scale intervention – and is a decision that would need to be taken by Government, not Ofcom. However, the argument has been made that moving a broadcaster or commissioning decision-makers out of London would attract producers to relocate close to them. As part of the formal consultation on this issue, we welcome views on whether there are strong arguments for such a proposal, or alternatively whether this might be too intrusive
- At the same time – while we note that RDAs and Screen Agencies are contributing financing to out of London initiatives – we remain unconvinced that there is a case for mandating or requiring defined amounts of such investment in out of London commissions.

7.38 There are two areas in which we may be able to develop, or help develop, further measures:

- Increasing levels of out of London spend for Channel 4, Five and BBC towards Channel 3 levels: we believe it is most feasible for the BBC to take on such an obligation – since it has significant in-house production bases outside London (and will expand these bases in the future, as noted below). In contrast, Channel 4 and Five rely on external production, and so are likely to find it more difficult to increase their out of London commissioning significantly
- Requiring broadcasters to apply the out of London quota by genre rather than across all genres taken together: we are reluctant to impose such a solution on broadcasters, since creating what are effectively micro-quotas may act against the overall objective of securing quality content. We note, however, that Channel 4 has had success with a model in which individual genre commissioners have been incentivised to deliver out of London production by genre – and so we encourage other broadcasters to consider whether such a model could also be appropriate for their businesses.

7.39 Overall, we believe that there are strong arguments for asking the BBC to make a greater contribution to production outside London, given its privileged access to public funding. While we welcome the BBC's Out of London review, we are concerned about some of the possible implications of the BBC's plans. Specifically, and despite the BBC's intentions, there is a possibility that the BBC's plans might risk an adverse impact on the diversity of production across the UK. For instance:

- Following the BBC's planned move of sports and children's programming to Manchester, its in-house capacity outside London will increase. This might enable the BBC to meet its out of London production quota largely through in-house production
- Following the implementation of the WOCC and the move to Manchester, the BBC may be able to meet its independent production quota largely through London-based independent producers

- Too rapid a transfer of high volumes or types of commissions to out of London production may lead a dependence on established centres and sources of production in the short term, rather than encourage a wider diversity of production base over time.
- 7.40 More work may therefore be needed to ensure that the BBC's plans work to secure production outside London for the future – especially given that the BBC's role is likely to become even more important going forward. We recommend that, as part of the current Charter Review process, the Government takes steps to ensure that the BBC's contribution to out of London production is both maintained and strengthened. In particular, we recommend the following:
- We echo our 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. We believe that the BBC should aspire to achieve a similar position to ITV1 – with 50% of network production by volume and value produced outside London. We do not necessarily see this as a short-term target, but one that could be achieved over time. We invite views on the appropriateness of such a target
 - At the same time, we suggest that Government puts 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 commissions from such producers should increase over time to increase the diversity of programme supply.
- 7.41 As noted in Section 5, we recognise 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. We therefore note that the BBC's current plans may indeed achieve the aims set out above. As such, we will closely follow the BBC's actions in this area, and will seek a continuing dialogue with the BBC on these issues.

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

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?

The key definitions

- 7.42 The final area of policy proposals relates to the key definitions – which we have reviewed in three areas:
- The definition of **qualifying independent producers** – namely, those producers whose programming counts towards fulfilment of the independent production quota
 - The definition of **qualifying programmes** – the hours that can be used to count towards all production quotas
 - The definition of **out of London productions** – the hours that count towards quotas for production outside the M25.

Qualifying independent producers

- 7.43 Of the three areas, the definition of qualifying independent producers is the issue on which we have received most representations over the course of this review. It should be noted that Ofcom does not make decisions on changes to the definition of qualifying status – decisions regarding change are a matter for Government, although Ofcom has a role to play in making recommendations to Government.
- 7.44 The independent production quota requires public service broadcasters to commission 25 percent of qualifying output from independent producers. But a producer cannot meet the qualifying independent definition if it shares common ownership with a UK broadcaster in excess of 25 percent of equity. A producer also cannot qualify if two or more UK broadcasters together own more than a 50 percent interest in its business.
- 7.45 A number of different parties have argued that the way in which qualifying status is currently defined (i.e. solely in terms of ownership) affects the efficient operation of the production sector as a whole, and creates perverse incentives. As such, we have been told that Ofcom needs to act to address this issue.
- 7.46 However, it is important to note at the outset that any change in this area may only have a relatively limited impact on the commissioning of independent producers by the main terrestrial broadcasters:
- Channel 4 and Five already commission from external producers significantly in excess of the independent production quota
 - As discussed earlier, the BBC's proposals seek to increase access for external producers – whether qualifying or non-qualifying
 - Therefore, the market most likely to be impacted by any change would be independent commissions for Channel 3.
- 7.47 An indirect impact of the definition as it stands is to limit a producer's ownership of any UK licensed broadcast channels to 25% of equity if the producer wishes to maintain qualifying independent status.
- 7.48 A number of parties have argued for change, with several options being presented for revising the definition of qualifying independent producers. We emphasise that no parties have suggested that the qualifying definition should be revised so as to remove all restrictions on common ownership between broadcasters and producers. Rather, it has been argued that the existing common ownership restriction could be supplemented by an additional dimension.
- 7.49 Specifically, it has been proposed that a production business sharing significant common ownership with a broadcaster could qualify as an independent producer if one of the following four options were implemented:
- **Option 1:** Introducing a test of **economic dependence** on the parent (or co-owned²⁸) broadcaster. For instance, one organisation has presented us with a proposal for a "double-lock" test – under which a co-owned producer would qualify as an independent as long as both of the following conditions are met: the proportion of the producer's turnover generated from the co-owned broadcaster

²⁸ We use the term "co-owned" to refer to the circumstance where there is significant common ownership between a broadcaster and a producer – specifically, where a broadcaster has a significant ownership stake in a production business; or, vice versa, where a producer has a significant ownership stake in a broadcasting business.

does not exceed a defined threshold; and the producer's share of the co-owned broadcaster's overall commissioning does not exceed a defined threshold

- **Option 2:** Changing the **restriction on ownership**. The most common version of this option would be for a co-owned or vertically-integrated producer to be classified as a qualifying independent when supplying programming to any broadcaster other than the one with which ownership is shared
- **Option 3:** Revising the **definitions of relevant broadcasters**. It has been suggested, for instance, that the restriction of co-ownership should only apply to English language broadcasters; and / or that a distinction could be made between PSB and non-PSB broadcasters – with the restriction applying only to the public service broadcasters
- **Option 4:** Introducing a **size dimension** to the qualifying definition. Under this proposal, a producer and broadcaster could share common ownership, but the producer could still be classified as a qualifying independent as long as a pre-defined size threshold is not crossed by the producer and / or the broadcaster. This option could also allow already qualifying independent producers to merge with or acquire small broadcasters, while still retaining their qualifying status.

7.50 In considering the arguments in relation to these options, we have thought about a number of important factors. Specifically, we believe that it would only be sensible to revise the definition of a qualifying independent producer if a revised definition:

- Helps to further the ultimate objective of securing the interests of viewers as consumers and UK citizens. In particular, we noted in Section 3 that the definitions of qualifying independent producers seek to mitigate against the potential problems associated with vertical integration, while also ensuring a diversity of production
- Is consistent and readily applicable across the industry – and should not benefit a small number of producers to the exclusion of, or at the expense of, all others
- Is practical to implement both now and in the future, especially since some definitions may result in companies crossing the threshold from qualifying to non-qualifying status (and vice versa) – possibly quite regularly.

7.51 In reviewing these options for the purpose of this consultation, we recognise that the current definition of a qualifying independent producer may not be perfect – but the current definition benefits from being a clear, practical rule which has to a great extent withstood the test of time. We believe it is not possible to develop a perfect definition – i.e. one in which no perverse incentives are created.

7.52 We are therefore minded to recommend no change to the definition of a qualifying independent producer at present. However, we would be willing to recommend change to Government if we were convinced that a revised definition would be superior to the current one.

7.53 We have not reached a firm view on these issues, but are at present minded to conclude that the revisions proposed to us do not meet the above criteria. For instance, our preliminary analysis suggests Options 1 and 2 could have a negative market impact by crowding out producers that already have qualifying status. We would be concerned about any such market impact, not because we are interested in protecting the financial position of these producers – but because crowding out of these producers could act against viewers' interests, by damaging diversity and enhancing the relative market position of vertically-integrated producers. Such approaches could therefore benefit some producers who would qualify for

independent status for the first time, at the expense of the wider diversity of production.

- 7.54 Our preliminary view is that Option 3 could create perverse incentives for non-English language public service broadcasters to develop in-house production with qualifying independent status (therefore damaging the prospects for diversity of, e.g., Welsh-language production); and that the variant of Option 3 could run contrary to Ofcom's role in maintaining and strengthening the quality of PSB, since it might create perverse incentives for commercial public service broadcasters to retreat from PSB status.
- 7.55 Finally, Option 4 potentially raises significant practical and data collection complexities – and there is a danger that its implementation would create further bureaucracy and uncertainty. For instance, it appears difficult to define a size threshold that is set in such a way as to ensure that it does not create further concerns about diversity of supply or vertical integration; and which would be practical to implement both now and in the future. In particular, if a company is positioned at the margin of the relevant threshold, it may cross the threshold quite regularly. This could create uncertainty, and broadcasters may find it difficult to monitor performance against the independent production quota over the course of the commissioning cycle.
- 7.56 In short, therefore, we are minded to recommend no change to the definition of a qualifying independent producer at this time. However, as part of the formal consultation on this issue, we welcome input from stakeholders – supported by detailed argument and evidence – on whether, and if so how, it is possible for the benefits of any of the above Options to outweigh – or ideally avoid any – downsides, and on how the practical considerations might be addressed. In addition, we will consider other options and proposals for change in this area that address the considerations set out in the above discussion. We will take account of comments received as part of the consultation, and will reach a conclusion in our policy statement in 2006 about whether to recommend change to Government.

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.

Qualifying programmes

- 7.57 In contrast to the definitions of qualifying independents, the definitions of qualifying programming hours are largely uncontroversial.
- 7.58 According to the Broadcasting (Independent Productions) Order 1991, a programme qualifies for contributing to the fulfilment of production quotas if it is within one of the following categories:
- (a) A programme which has been made either by the relevant broadcaster or by a person commissioned by them
 - (b) A programme which has been made by the relevant broadcaster together with any other person or by a person commissioned by the relevant broadcaster together

with any other person, provided that not less than 25% of the actual cost of the production of the programme has been borne or provided by the relevant broadcaster; and

(c) a programme including images or images and sound which have been provided by a person other than the relevant broadcaster or a person commissioned by him where –

(i) the images and sounds so provided consist of live coverage of an event

(ii) they do not exceed 75% of the duration of the programme, and

(iii) the remainder of the programme (including any sound commentary added to those images or images and sounds) has been made by the relevant broadcaster or a person commissioned by him.

7.59 There are also some specific exclusions. Qualifying hours do not include any programme which falls within any of the following descriptions:

(a) a programme which has previously been shown in substantially the same form on the relevant television broadcasting service;

(b) a programme which consists, wholly or mainly, of news;

(c) a programme constituting part of a series of programmes which-

(i) consist, wholly or mainly, of news or items relevant to news,

(ii) are presented live, and

(iii) are usually shown on at least four days in each of the weeks when they are shown;

(d) a programme provided by or on behalf of the Open University or Open College; and

(e) a broadcast on behalf of a political party or any statement by a Minister of the Crown within the meaning of the Ministers of the Crown Act 1975.

7.60 In short, the definition of qualifying programmes has been drawn widely, so as to capture as much origination as possible – while excluding acquisitions, repeats, news and non-commissioned programming.

7.61 We have had no representations from stakeholders on this subject, and so propose no change to the definition of qualifying programmes.

Out of London productions

7.62 New definitions of out of London production were introduced in 2004, and are now largely in operation. Under these definitions, a programme is defined as an out of London production if at least two of the following three conditions are met:

- The programme is made by a company with a substantive business and production base outside London
- 70% of the programming budget is spent outside London
- 50% of the talent contributing to the programme is based outside London.

7.63 In our programme of interviews and external engagement, some London-based producers argued that implementing the definitions was proving costly and complex.

- 7.64 However, on the whole, the general view has been that the new definitions are working well – and are aiding the prospects for production outside London. As such, we do not propose any changes to the definition of out of London productions.

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

Summary of our proposals

- 7.65 In summary, this document has presented the following policy proposals:

- Despite rapid developments in the television production sector, concerns remain in the key areas that drive the need for intervention – negotiating strength, vertical integration and geographic concentration of production. As such, the rationale for intervention remains valid
- The Codes of Practice have generated optimism, but concerns have been raised by producers about the prices paid by broadcasters. Our analysis suggests there is no systematic problem here, but there is a case for reviewing the tariff ranges in the light of inflation – although efficiency considerations should also be reflected in any such review
- Ofcom has sought to bring more clarity to the position regarding the rights for distribution of television content over alternative platforms. We have developed initial principles and options for a new approach to the definition of rights windows
- The independent production quota is likely to remain an important source of certainty for the production sector for the next five years at least – we therefore propose no change to this quota
- The BBC's plans for a Window of Creative Competition are critical to the future of the independent production sector – but more may need to be done to ensure meritocracy in commissioning, and to ensure that the operation of the WOCC is properly monitored
- The quota for production outside London is a blunt instrument, but seems to be a necessary intervention. Additional measures may also be needed to secure out of London production for the future, and we believe that the BBC needs to play a key role here
- We are willing to consider proposals for change to the definition of a qualifying independent producer, but are currently unconvinced that there is an alternative preferable definition
- We propose no change to the definition of qualifying programmes and out of London productions – these definitions are working well.

As noted at the outset of this document, these proposals are now subject to formal consultation. The instructions for responding to the consultation are attached at Annex 1, with the specific consultation questions set out at Annex 4.

Annex 1

Responding to this consultation

How to respond

Ofcom invites written views and comments on the issues raised in this document, to be made by **5pm on 21 March 2006**

Ofcom strongly prefers to receive responses as e-mail attachments, in Microsoft Word format, as this helps us to process the responses quickly and efficiently. We would also be grateful if you could assist us by completing a response cover sheet (see Annex 2), among other things to indicate whether or not there are confidentiality issues. The cover sheet can be downloaded from the 'Consultations' section of our website.

Please can you send your response to khalid.hayat@ofcom.org.uk.

Responses may alternatively be posted or faxed to the address below, marked with the title of the consultation.

Khalid Hayat

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Note that we do not need a hard copy in addition to an electronic version. Also note that Ofcom will not routinely acknowledge receipt of responses.

It would be helpful if your response could include direct answers to the questions asked in this document, which are listed together at Annex 4. It would also help if you can explain why you hold your views, and how Ofcom's proposals would impact on you.

Further information

If you want to discuss the issues and questions raised in this consultation, or need advice on the appropriate form of response, please contact Khalid Hayat by email.

Confidentiality

Ofcom thinks it is important for everyone interested in an issue to see the views expressed by consultation respondents. We will therefore usually publish all responses on our website, www.ofcom.org.uk, ideally on receipt (when respondents confirm on their response cover sheet that this is acceptable).

All comments will be treated as non-confidential unless respondents specify that part or all of the response is confidential and should not be disclosed. Please place any confidential parts of a response in a separate annex, so that non-confidential parts may be published along with the respondent's identity.

Ofcom reserves its power to disclose any information it receives where this is required to carry out its legal requirements. Ofcom will exercise due regard to the confidentiality of information supplied.

Please also note that copyright and all other intellectual property in responses will be assumed to be licensed to Ofcom to use, to meet its legal requirements. Ofcom's approach on intellectual property rights is explained further on its website, at http://www.ofcom.org.uk/about_ofcom/gov_accountability/disclaimer.

Next steps

Following the end of the consultation period, Ofcom intends to publish a statement in the early part of 2006.

Please note that you can register to get automatic notifications of when Ofcom documents are published, at http://www.ofcom.org.uk/static/subscribe/select_list.htm.

Ofcom's consultation processes

Ofcom is keen to make responding to consultations easy, and has published some consultation principles (see Annex 2) which it seeks to follow, including on the length of consultations.

If you have any comments or suggestions on how Ofcom conducts its consultations, please call our consultation helpdesk on 020 7981 3003 or e-mail us at consult@ofcom.org.uk. We would particularly welcome thoughts on how Ofcom could more effectively seek the views of those groups or individuals, such as small businesses or particular types of residential consumers, whose views are less likely to be obtained in a formal consultation.

If you would like to discuss these issues, or Ofcom's consultation processes more generally, you can alternatively contact Vicki Nash, Director, Nations – Scotland, who is Ofcom's consultation champion:

Vicki Nash
Ofcom Scotland
Sutherland House
149 St Vincent Street
Glasgow G2 5NW
Tel: 0141 229 7401
Fax: 0141 229 7433
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Annex 2

Ofcom's consultation principles

A2.1 Ofcom has published the following seven principles that it will follow for each public written consultation:

Before the consultation

A2.2 Where possible, we will hold informal talks with people and organisations before announcing a big consultation to find out whether we are thinking in the right direction. If we do not have enough time to do this, we will hold an open meeting to explain our proposals shortly after announcing the consultation.

During the consultation

A2.3 We will be clear about who we are consulting, why, on what questions and for how long.

A2.4 We will make the consultation document as short and simple as possible with a summary of no more than two pages. We will try to make it as easy as possible to give us a written response. If the consultation is complicated, we may provide a shortened version for smaller organisations or individuals who would otherwise not be able to spare the time to share their views.

A2.5 We will normally allow ten weeks for responses to consultations on issues of general interest.

A2.6 There will be a person within Ofcom who will be in charge of making sure we follow our own guidelines and reach out to the largest number of people and organisations interested in the outcome of our decisions. This individual (who we call the consultation champion) will also be the main person to contact with views on the way we run our consultations.

A2.7 If we are not able to follow one of these principles, we will explain why. This may be because a particular issue is urgent. If we need to reduce the amount of time we have set aside for a consultation, we will let those concerned know beforehand that this is a 'red flag consultation' which needs their urgent attention.

After the consultation

A2.8 We will look at each response carefully and with an open mind. We will give reasons for our decisions and will give an account of how the views of those concerned helped shape those decisions.

Annex 3

Consultation response cover sheet

- A3.1 In the interests of transparency, we will publish all consultation responses in full on our website, www.ofcom.org.uk, unless a respondent specifies that all or part of their response is confidential. We will also refer to the contents of a response when explaining our decision, without disclosing the specific information that you wish to remain confidential.
- A3.2 We have produced a cover sheet for responses (see below) and would be very grateful if you could send one with your response. This will speed up our processing of responses, and help to maintain confidentiality by allowing you to state very clearly what you don't want to be published. We will keep your completed cover sheets confidential.
- A3.3 The quality of consultation can be enhanced by publishing responses before the consultation period closes. In particular, this can help those individuals and organisations with limited resources or familiarity with the issues to respond in a more informed way. Therefore Ofcom would encourage respondents to complete their cover sheet in a way that allows Ofcom to publish their responses upon receipt, rather than waiting until the consultation period has ended.
- A3.4 We strongly prefer to receive responses in the form of a Microsoft Word attachment to an email. Our website therefore includes an electronic copy of this cover sheet, which you can download from the 'Consultations' section of our website.
- A3.5 Please put any confidential parts of your response in a separate annex to your response, so that they are clearly identified. This can include information such as your personal background and experience. If you want your name, address, other contact details, or job title to remain confidential, please provide them in your cover sheet only so that we don't have to edit your response.

Cover sheet for response to an Ofcom consultation

BASIC DETAILS

Consultation title: Review of the television production sector

To (Ofcom contact): Khalid Hayat

Name of respondent:

Representing (self or organisation/s):

Address (if not received by email):

CONFIDENTIALITY

What do you want Ofcom to keep confidential?

Nothing	<input type="checkbox"/>	Name/contact details/job title	<input type="checkbox"/>
Whole response	<input type="checkbox"/>	Organisation	<input type="checkbox"/>
Part of the response	<input type="checkbox"/>	If there is no separate annex, which parts?	

If you want part of your response, your name or your organisation to be confidential, can Ofcom still publish a reference to the contents of your response (including, for any confidential parts, a general summary that does not disclose the specific information or enable you to be identified)?

DECLARATION

I confirm that the correspondence supplied with this cover sheet is a formal consultation response. It can be published in full on Ofcom's website, unless otherwise specified on this cover sheet, and I authorise Ofcom to make use of the information in this response to meet its legal requirements. If I have sent my response by email, Ofcom can disregard any standard e-mail text about not disclosing email contents and attachments.

Ofcom seeks to publish responses on receipt. If your response is non-confidential (in whole or in part), and you would prefer us to publish your response only once the consultation has ended, please tick here.

☐

Name

Signed (if hard copy)

Annex 4

Consultation questions

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. 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?
3. Do you agree with Ofcom's understanding of the reasons why intervention has been warranted – namely negotiating strength, vertical integration and geographic concentration?
4. Does our representation of the current position of the television production sector accord with your experience and understanding of the sector?
5. Do you agree with Ofcom's understanding of the likely future developments in the sector? Are there other relevant developments Ofcom has not considered?
6. Do you agree that the rationale for intervention – in terms of 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?
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?
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?
9. To what extent could new media rights issues be addressed through negotiation within a reasonable timeframe, without the need for intervention by Ofcom?
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?
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 are 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 account of the legitimate concerns of broadcasters?
 - How might returning series be treated within this framework?

- 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?*
- 13. Are there any other aspects of the Codes of Practice that require further consideration by Ofcom?*
- 14. What do you see as the key issues in relation to the operation of the BBC’s proposed Window of Creative Competition (the WOCC)?*
- 15. What are your views on the options for the future of the independent production quota?*
- 16. What are your views on the options for the future of intervention to secure production outside London?*
- 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?*
- 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?*
- 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.*
- 20. Do you agree with our proposals for no change to the definitions to qualifying programmes and out of London productions?*

Annex 5

Industry interview programme

- A5.1 As part of the Television Production Sector Review, Ofcom conducted a series of interviews with producers, distributors and the investment community. The aim of this exercise was to collect views from the industry on market trends. The production companies interviewed were selected to reflect the diversity of the industry as a whole, and the sample included a wide range of companies differing in size, geographical distribution, revenue streams and genre specialties.
- A5.2 The UK production sector is fragmented in size, strategy and opinion but analysis of the interviews revealed a number of common key themes and concerns. These are summarised below.

The terms of trade

- A5.3 As a rule, the independent production companies interviewed for the Television Production Sector Review welcomed the new terms of trade. These were described as being instrumental in shaping a more 'mature' industry, and it was felt that the new environment would make production companies more attractive to investors. There were, however, a number of concerns voiced by some of the companies we spoke to. The main areas of concern were:

- **New media rights**

One of the issues that was raised most consistently throughout the interview programme was the question of new media rights. Many of the producers interviewed believed that this issue had not been suitably resolved by the terms of trade. There was a lack of consistency in the broadcasters' approaches to new media rights and producers believed that the broadcasters' desire to capture new media rights was contrary to the aims of the terms of trade (i.e. to transfer value to the producer). There was a further fear that exploitation by the broadcasters of new media rights could cut across those secondary rights currently exploited by the producer (e.g. DVD sales).

Some of the larger producers who had been able to negotiate favourable terms prior to the introduction of the new terms of trade believed that their position in this area had been weakened.

- **Programme tariffs**

Concern was expressed about budgets and programme tariffs. Several of the interviewees claimed that budgets had been frozen or reduced (returning series were mentioned as a case in point). This was attributed partly to greater competition in an increasingly fragmented media environment, and partly to broadcasters apparently squeezing producers in response to the new terms of trade.

- **The holdback on secondary rights**

Some producers complained that broadcasters were 'warehousing' UK secondary rights in order to exploit them on their associated channels. As a result they claimed that their ability to sell programming to the UK non-terrestrial channels had been restricted.

- **The future of some genres of programming**

A significant minority of those interviewed claimed that certain genres of

programming benefited more from the new terms of trade than others. Some external producers voiced concern that the new economic environment would encourage producers to concentrate on developing marketable formats or exploitable programmes at the expense of 'rights-light' genres e.g. one off documentaries or current affairs programming.

- **Who benefits**

A common theme in discussions about the new terms of trade was that it was the larger and more forward-looking companies who were best placed to extract value from the new environment. Smaller independent production companies tended not have the resources or expertise to exploit their programmes overseas or in new markets. Some specialist producers believed that – as their genres did not lend themselves to exploitation – they were unlikely to benefit from the new terms of trade.

In contrast, a few of the larger production companies also felt that their position had been weakened since the introduction of the new terms of trade. In the past they had been able to enter into negotiations with the broadcaster, but they were now 'tied to the same mast' as the rest of the independent production sector.

The role of non-terrestrial channels

- A5.4 External producers believed that the growth in the number of digital channels had led to an increase – but not a dramatic increase – in the demand for content.
- A5.5 Those interviewed were divided about the importance of the non-terrestrial market. Larger production companies in particular did not see digital channels as a realistic alternative market to terrestrial commissions. They noted that digital channels tended to have smaller budgets and, as they were not required to operate under the same terms of trade, they often demanded a larger share of the rights. On the other hand, there was a perception that some digital channels were increasing their programme budgets and moving towards parity with the new terms of trade in order to attract content providers.
- A5.6 Producers of some high end genres (specifically children's programming and drama) noted that most digital channels had smaller production budgets than the main terrestrial broadcasters and were more inclined to acquire rather than commission their programmes. As a result, they viewed the UK digital channels as a secondary market rather than a source of commissions.
- A5.7 Digital channels were seen to offer a good route of entry to newer production companies. Some regional external production companies felt that – as the amount of regional programming on the public service broadcasters decreased – non-terrestrial channels offered a potentially valuable replacement market.

The international market

- A5.8 The international market is regarded as an ancillary source of revenue for the UK production sector. Despite recent high profile successes in the US market (e.g. Wife Swap and Supernanny), the UK external production sector is still cautious about the significance of the international market in its future. Expansion into overseas markets is not seen as a realistic option for the majority of small or midsize producers, as it requires substantial investment and resources. Even producers who

have successfully sold formats to the US and elsewhere were keen to stress the importance of the UK terrestrial showing as a 'shop window'.

Super-indies

- A5.9 The producers interviewed for this review recognised that there had been – and would continue to be – consolidation in the industry. Yet most believed that there was little danger of small producers disappearing from the market altogether. Some producers felt that the term “super-indie” was a misnomer as even the largest independent production companies were still relatively small businesses compared to the production arms of the broadcasters, or to equivalent companies in other industries such as advertising. As a result, few of the producers we interviewed supported regulatory intervention to protect small external production companies.
- A5.10 There were, however, words of caution expressed about the rise of a group of dominant companies. A number of those interviewed claimed that super-indies were in a position to monopolise talent and that, as a rule, the largest production companies tended to be more ‘risk adverse’ and to concentrate on exploitable genres at the expense of ‘rights-light’ programming, a trend that might lead to homogenisation and a dearth of innovation and creativity.
- A5.11 However, on the plus side, some producers felt that super-indies were able to offer greater job security and training, and that they were responsible for bringing better and more businesslike management into the independent sector.

Regulatory Intervention – the independent production quota

- A5.12 Many of the independent production companies interviewed for this review described themselves as instinctively ‘free market in theory’. Despite this, there was substantial support for the independent production quota. The terms of trade were considered to be an important step towards creating a ‘mature’ market and allowing production companies to function as ‘proper’ businesses. However, the general consensus was that the independent production quota remained important, not just as a source of certainty of demand for content, but also to attract continued investment into the sector. There was a general belief that, without the independent production quota, the industry would be far less attractive to investors and that terrestrial broadcasters would tend to rely more on in-house producers.
- A5.13 Vertical integration was seen as the greatest impediment to a genuinely competitive market. Some producers believed that the independent production quota would remain necessary until there was genuine structural separation between production and broadcasting.
- A5.14 If the independent production quota was removed, some of the producers believed that it would signal the “death knell” of the independent sector. Others felt that the super-indies and niche boutique external producers would survive.

The out of London quota

- A5.15 Most of the producers interviewed saw the out of London production quota as:
- Integral to creating programming that reflected the UK
 - An important point of entry for new companies

- A vehicle for creating ‘talent pools’ across the UK.
- A5.16 The out of London quota was also generally supported by national and regional production companies although some of those interviewed believed that they would be able to win commissions on merit without the quota. Some national producers called for the introduction of an ‘out of England quota’.
- A5.17 A number of London-based independent production companies considered the out of London quota to be necessary for the ‘greater good’. They believed that if the quota were removed, production would quickly become London-centric. Other London production companies saw the out of London quota as a hurdle that meant they had been required by broadcasters to incur extra expense by taking productions outside London. There was a belief that Ofcom’s new definitions had decreased the amount of ‘brass plating’ that had previously occurred.
- A5.18 Some producers argued for the removal of the out of London quota, claiming that it did not fulfil its purpose of reflecting regional ‘voices’ on screen and that it should be left to the market to determine regional output.
- A5.19 Most of those interviewed believed that the out of London quota would continue to be a necessary market intervention as long as the commissioners remain predominantly London-based.

Revenue streams

- A5.20 Prior to the implementation of the terms of trade, a number of the larger and more forward looking external producers were already investigating new revenue streams and new media. But the majority of smaller companies continued to concentrate on winning UK commissions. Post the terms of trade, this divide is still apparent. Some producers are actively pursuing DVD sales, international markets and new media opportunities but there is still a large proportion of the independent sector that comprises ‘low margin’ companies who rely solely on production fees for revenue.
- A5.21 A number of the larger production companies interviewed saw the potential in new distribution platforms and were actively involved in trials of broadband or mobile content. However, they noted that the future of these new markets as significant revenue streams was still in doubt, due to the current debate over the ownership of new media rights.

The Commissioning Process

- A5.22 The consensus among the companies we interviewed was that personal relationships are key to the commissioning process. Face to face meetings with commissioners were seen as very important and a number of out of London producers felt disadvantaged by not being in the same town as the commissioner. There was also general consensus that some of the terrestrial broadcasters were more straightforward to deal with than others.
- A5.23 The WOCC was cautiously welcomed. Some independent production companies were cynical that the WOCC merely formalised the fact that the old quota was a ‘ceiling not a floor’. But, in general, the sector has adopted a ‘wait and see’ approach.

Annex 6

Consultation events around the UK

A6.1 During September 2005, Ofcom held roundtable discussion sessions with external producers in Cardiff, Bristol, Glasgow, Belfast and Manchester, along with a seminar in London for external producers, broadcasters and others involved in the television production sector. Summaries of the key themes emerging from the Nations and Regions roundtables and the London seminar are set out below.

The Nations and Regions Roundtables

A6.2 The purpose of the Nations and Regions roundtable events was to gather the perspectives of external producers working outside London, particularly in relation to the out of London quotas and the definition of out of London productions, and to present and discuss the findings of the PACT/Ofcom Production Census.

A6.3 Over forty external companies based outside London were represented, ranging from small start-ups to large, established national and regional players. In all, fifty people attended the out of London sessions, including representatives from screen and development agencies, and trade bodies such as PACT and TAC, the Welsh Producers Association.

A6.4 At each roundtable, we sought views on the case for and the reality of production outside London, including a discussion around the new terms of trade. Participants also discussed the future of production in the Nations and Regions, and assessed the continuing case for interventions such as the out of London quotas.

Roundtable discussion - the case for production outside London

A6.5 We asked producers to assess the benefits of production being dispersed around the UK, and the potential downsides of a sector exclusively concentrated in London.

A6.6 There was broad agreement as to the main benefits of out of London production, which included:

- Ensuring a diversity of voices, viewpoints and talent
- Cultural reflection of the different parts of the UK
- For the BBC – reflecting the fact that people across the UK pay the licence fee
- Dispersal of jobs and other economic benefits around the UK.

A6.7 It was suggested that having production dispersed around the UK means that non London-centric viewpoints are included and taken into account, resulting in a diversity of voices on TV that fully reflects the UK population. Most external producers argued that, if production were concentrated solely in London, viewers would not have access to programmes that were influenced by a sufficiently wide range of different perspectives, and television would become more homogenous.

A6.8 For example, a producer at the Manchester roundtable told us “it’s a creative industry and your inspiration comes from your life experience. Having producers based outside London means you have a range of different life experiences, so you get diversity.” A producer in the Nations told us “it’s important for social inclusion, for democracy, that different voices across the country are heard, so that we know and

understand each other better. It can't just be London speaking to us – that would be divisive. Citizens have a right to have their issues and perspectives aired.”

- A6.9 Alongside ensuring a diversity of ideas and viewpoints, production outside London was also said to be beneficial in terms of providing entry points for talent across the UK enabling the Nations and Regions to “grow people in their own nurseries”. It was suggested that a production sector based entirely in London would result in a less diverse talent pool.
- A6.10 External producers at the roundtable sessions told us that it is important that the different cultures and parts of the UK are represented on network television, and that producers based outside London have a key role to play in ensuring this.
- A6.11 Many producers were clear, however, that they do not want to be tied to making programmes only about the Region or Nation where they are based. A Belfast producer told us “London indies don’t just make programmes about jellied eels, and we can make programmes about more than the Giant’s Causeway or the Troubles”.
- A6.12 Several external producers argued that the BBC’s production strategy should reflect the fact that people across the UK pay the licence fee. One producer told us “millions of people outside London pay for the BBC – it’s only fair that they feel the benefit, both culturally and economically.”
- A6.13 There was a view from most (although not all) external producers at the roundtables that the cultural arguments for out of London production are more important than the economic ones. Nevertheless, producers told us that television production does also have a role in boosting regional and national economies, by providing jobs and investment.
- A6.14 Producers said they believe that production centres outside London have the capacity to make a real contribution to local economies, providing employment both directly, in the programme production process, and indirectly in areas such as catering, marketing, new media, transport and hospitality.
- A6.15 It was also suggested that production outside London can have price advantages over London-based production – for example cheaper studio space, edit suites or local production talent – although it was acknowledged that if talent has to be imported, this inevitably drives costs back up.

Roundtable discussion - the reality of production outside London

- A6.16 We asked producers to tell us about their experience of being external producers outside London and to explore why production is concentrated in London.
- A6.17 It is clear that there is no single “reality of production” outside London; experience differs depending on a producer’s location, size, and markets. However, a number of common themes and concerns emerged, which are summarised below:
- Talent retention is an important issue outside London, particularly “high end” talent
 - Relationships with commissioners are seen as crucial and being based outside London is perceived to be a potential barrier to forming and maintaining those relationships
 - Digital channels do not have an out of London quota, but this was not perceived as a barrier by most Nations and Regions producers

- The presence of a local broadcaster can support production centres, but there are concerns around this leading to over-reliance on local markets and around whether decision-making power is sufficiently devolved to commissioners outside London
 - While clusters are perceived as important drivers of sustainability by some, not all external producers want to be part of a cluster or a designed sector.
- A6.18 The problem of attracting and retaining talent was raised at all the roundtable discussion sessions, even those in the largest production centres outside London, such as Glasgow and Manchester. Producers told us that because the industry is centred on London – with broadcasters, commissioners and producers concentrated in the capital – it can be difficult for production centres in the Nations and Regions to achieve the critical mass necessary to attract and support talent, particularly at the high end.
- A6.19 This in turn was seen as increasing the perceived risk on the part of commissioning editors, thus creating potential barriers to them commissioning programmes from outside London.
- A6.20 There was a strong consensus that relationships with commissioning editors are crucial for all producers, whether based in or outside London. Geography was still seen as a potential barrier to forming those relationships, although many of the external producers at the roundtables felt they had worked hard to build good relationships with London-based commissioners.
- A6.21 We were told “you just have to work that much harder because you’re not on the door step, you don’t bump into these people every day in the way that the London indies do”. However, producers also made the point that good ideas must come first and that creative ideas can transcend the issue of location, especially in a digital world.
- A6.22 Several of the producers at the roundtables produced for digital channels, and it was suggested that the absence of any out of London quotas in this area was not an obstacle to producers based outside London. Some felt that the digital channels tend to be less London centric than some of the main PSB channels.
- A6.23 The effect of having a local broadcaster base was discussed at the sessions. This was seen by many producers as helping to sustain out of London clusters, particularly in the Nations where the level of bespoke non-network production is higher. However, it was also suggested that over reliance on local broadcasters has caused some producers to stand still rather than looking to expand into other markets.
- A6.24 Mixed views were expressed on the importance of being part of a cluster or centre of production outside London. Many producers felt that clustering was important in terms of helping to achieve sustainability, attract and retain talent and share resources. Others, however, took the view that external producers by their nature act independently and that it is important not to place too much importance on cluster intervention. A Leeds based producer told us “We’ve chosen to live where we live. We’re not going to up sticks to Manchester just because someone thinks it’d be a good idea to have a cluster there. In the end we’re indies and we want to be independent.”

Roundtable discussion - the future of production outside London

A6.25 A variety of views were expressed about the future of production in the Nations and Regions, and about possible interventions going forward. These are summarised below:

- There was a consensus that the removal of the out of London quotas now would result in production “shrinking” back to London
- The new definition of out of London production was welcomed by most producers although there are some concerns over London-based producers opening up transient regional offices, and over the time it appears to be taking for the BBC to adopt the new definition
- Calls by some producers in the Nations for an “out of England” quota, although others argued strongly against this
- The suggestion that the BBC should be encouraged to increase its out of London target to be more in line with ITV1’s 50% quota
- Concern that the BBC’s Window of Creative Competition (WOCC) might benefit large London-based producers more than producers in the Nations and Regions
- Debate over whether more commissioners should be based outside London, with some strong views expressed on both sides of the argument
- A suggestion that the out of London quota should be applied by genre and that commissioners might be incentivised to hit specific targets
- Agreement that the screen and development agencies have an important role to play in supporting the out of London production sector.

A6.26 Producers at all the roundtables told us that the removal of the out of London quotas at this stage would result in there being less production outside London, and that it will be some time before production centres in the Nations and Regions are sufficiently well established for the quotas to be rolled back.

A6.27 Most external producers outside London welcomed the out of London definition for providing clarity, although some felt that London-based independent companies should be required to set up long term bases outside London in order to qualify, rather than being able to meet the requirements on a production by production basis via out of London spending and employment targets.

A6.28 There was some concern expressed about the Hatch definitions used by the BBC to define where a programme is made, and several producers suggested that the BBC should move to the Ofcom definition as soon as possible.

A6.29 Some producers in the Nations, particularly in Wales and Northern Ireland, told us that they would like to see out of England quotas established within the existing out of London quotas, in order to raise the level of representation on the networks from the Nations. A Welsh producer told us “there is a tendency for people in England to think that they are the norm and that everyone else is an aberration.”

A6.30 However, others in the Nations argued that out of England quotas risked creating a “victim culture” where the quality of an idea came second to the requirement to fill a quota, something that – it was suggested – might damage the production sector in the Nations in the longer term.

- A6.31 Several external producers suggested that the BBC should be encouraged to raise its out of London targets to be more in line with ITV1's 50% quota. Some also raised concerns about the BBC's WOCC, suggesting it might benefit the larger, London-based companies more than the small out of London producers unless it was applied on equal terms inside and outside London.
- A6.32 The importance of the location of commissioners was discussed at most roundtable sessions. There were some strong calls for more commissioners to be based outside London, particularly in the Nations. However, some producers expressed the concern that this might fragment the sector. For example a producer in Belfast told us "at least when I get on the plane to London I know I can see three or four key people in one day. If they were based all over the country that would make things harder."
- A6.33 In addition, producers told us that unless decision-making and sign off power is devolved to those commissioners who are based outside London, the process can become cumbersome, with Nations and Regions commissioners becoming another tier in the bureaucracy. Furthermore, some producers suggested that commissioners outside London might be more likely to commission from their local in-house departments rather than from external producers in their area.
- A6.34 Out of London producers told us that they would welcome more opportunities to meet commissioners in their Nation or Region, and that the appointment of regional champions by the broadcasters – intended to broker relationships – might prove effective. External producers also called on commissioners to spend more time outside London, enabling them to get to know the sector in the Nations and Regions better.
- A6.35 It was suggested that broadcasters might apply specific out of London targets by genre, and that commissioners should be incentivised to achieve their targets via bonus schemes, as already happens at Channel 4. In addition, it was argued that Ofcom might question the broadcasters on the detail of how they apply the out of London quota, engaging at a strategic level rather than focusing on the outputs of spend and hours across all genres taken together.
- A6.36 The role of screen and development agencies was discussed at the roundtables. Most producers felt that these agencies have an increasingly important role to play in terms of funding company and ideas development, alongside innovative schemes such as helping talent to relocate outside London or providing match funding to reduce the perceived risk on the part of commissioners.

Roundtable discussion - the new terms of trade

- A6.37 The new terms of trade were broadly welcomed as providing an opportunity for the sector to grow, although some producers suggested that the companies that would benefit the most were the larger, mainly London-based ones because of their dominance of the PSB marketplace.
- A6.38 Specific concerns were raised over pricing, new media rights and broadcasters' holdback policies.
- A6.39 On pricing, producers at some of the roundtables told us they believe they have seen budgets fall following the introduction of the new Codes of Practice. It was suggested that broadcasters are squeezing prices to the lower ends of the tariff ranges.

- A6.40 Producers were also concerned that new media rights were being “bundled” into primary rights, and therefore retained by the broadcasters. It was suggested that clear definitions are needed in order to clarify the position with regards to new media, both in terms of distribution of the primary broadcast on new platforms, and relating to the exploitation of intellectual property on new media platforms.
- A6.41 The holdback policies of some of the broadcasters was seen as reducing producers’ ability to exploit secondary rights to their full potential. The problem of broadcasters “warehousing” programmes was raised by producers keen to exploit what they see as dormant rights.
- A6.42 There was no widespread concern over the fact that distributors are mostly based in London, and this was not seen as an obstacle to independent producers based in the Nations and Regions in exploiting rights.

The London Seminar

- A6.43 As mentioned above, alongside the roundtables in the Nations and Regions, Ofcom also held a seminar in London in September 2005. Over 80 representatives from the production sector attended to discuss the broader structural issues impacting on the development of the sector.

Presentation of the PACT/Ofcom survey

- A6.44 Ofcom presented the full findings of the PACT/Ofcom survey commissioned from Digital-i (see www.ofcom.org.uk). We asked if the picture of the production sector presented was one they recognised. A number of themes emerged:
- Agreement that the health of the sector had improved but that it was still fragile. Even the largest of external producers were small businesses in terms of market capitalisation
 - Consensus that the new terms of trade had made a significant difference
 - Retention of rights was central to profitability as primary production often generated little or no profit and overall margins were low. Rights arrangements should not change in a way which might undermine the independent sector
 - The main terrestrial broadcasters remain the most significant buyers from the external production sector and this defined and affected the relationship between producers and broadcasters
 - New media revenues were growing, but from a low base. It was suggested that the survey underestimated the total new media market. It was noted that the presentation only offered a historical “snapshot” in time
 - Out of London production could benefit from more development initiatives such as Channel 4’s Creative Cities model. It was felt by some that the focus should be on location of production activity rather than location of the production company. Some producers argued that the focus should be on assisting producers based outside London, rather than forcing London-based producers to make out of London productions.

Perspectives on the UK production sector

- A6.45 In this session, we heard views on the television production sector from the broadcaster, producer and financial perspectives. Broadcasters Sara Geater, Head

of Business Affairs Channel 4 and Bal Samra, Business and Finance Director BBC Television spoke from the perspective of the broadcasters. ITV and Five were also invited to put forward their views. In summary the main points raised by the broadcasters were:

- The Codes of Practice have had a positive impact on the relationship between the broadcaster and independent sector, although ITV expressed concern over the combined impact of the Codes of Practice and the Networking Arrangements
- Channel 4 favoured a new definition of primary rights to cover all platforms for a specific length of time, in order to help maximise the impact of its PSB proposition and defend a fragmenting revenue base. Primary rights should be defined in terms of time rather than platform use – “when, not where”. Channel 4 felt that it would be in danger of facing an “unacceptable economic disadvantage” relative to vertically-integrated broadcaster-producers if Channel 4 did not secure rights for use across platforms
- Some other participants endorsed this approach, and other views on rights also emerged:
 - Increased competition from digital channels and ITV’s regulatory position meant it could not get secondary rights. With convergence, other platforms may therefore hit ITV’s revenues. ITV is not operating on a level playing field
 - Rather than focusing on primary vs. secondary rights, ITV favoured a debate around the appropriate windows through which the broadcaster can protect revenues, while also helping the external producers to exploit secondary rights
 - Five was the smallest public service broadcaster, and competed with digital channels, but had to abide by the Codes of Practice – whereas digital channels did not.
- In terms of the regulatory approach, Channel 4 accepted there should be an out of London independent quota. The BBC stated that Ofcom’s review should look at in-house and external production as a mixed ecology; that Ofcom should clarify the objectives of regulation in the production sector; that there should be consideration of how intervention will be expected to support the delivery of PSB; and that intervention should be sufficiently flexible to deal with rapidly changing market conditions.

A6.46 In response a number of themes arose:

- On new media rights there was a need for regulation to strike a balance between giving broadcasters a fair primary right whilst ensuring that broadcasters do not warehouse rights and put up barriers to entry against new consumer propositions
- There was concern as to whether the broadcasters would move secondary rights into the primary rights package. Channel 4 clarified that the change required was about the redefinition of primary rights in the digital age
- The BBC Trust would take an independent view on the WOCC, reviewing its operation every two years
- There was a perception of a growing gap between the tariffs paid by broadcasters and the cost of production. The broadcasters all stated this was not the case and that prices remained largely within the tariff ranges and in some cases had increased.

A6.47 Mathew Horsman of Mediatique presented a financial analysis of the independent production sector. In summary:

- The UK independent sector was growing rapidly. Future consolidation would continue to be a key theme and there was likely to be more flotations in 2006
- City interest and consolidation could conspire against innovation at the top end
- Regulatory intervention was still required, even with the WOCC in place, but there was a question as to how long this would continue to be the case and whether the current regulatory environment is adequate to protect the “long tail” of small external producers
- As long as the first window drove ancillary revenues, there was a question as to whether the share between broadcasters and external producers was reflective of the value each contributed.

A6.48 Andrew Zein, Managing Director of Tiger Aspect, presented the independent production perspective. In summary:

- The sector had adapted to the Codes of Practice, and secondary channels had benefited
- The new rights arrangements had generated value for the distribution arms of the main terrestrial broadcasters – BBC Worldwide and C4 International were more profitable than ever before
- Data collected by PACT on reduction in tariff rates paid by broadcasters would be provided to Ofcom
- Ofcom’s review should look at in-house production but more clarity was needed on the actual price the BBC pays for programming sourced from its in-house base. External producers were cheaper than in-house
- The size of companies in the independent sector is a red herring. The new terms of trade have delivered more benefit to smaller companies than to large (smaller companies have seen a greater percentage increase in revenues from rights exploitation)
- Access to commissioners remained critical, especially for smaller external producers, as the larger ones have always been able to gain access
- The new media rights issue was important since almost all programmes have a potential new media element
- As well as “when, not where”, the rights debate needed to distinguish between commercial and non-commercial use of rights.

A6.49 A number of points arose from the floor, as summarised below:

- On innovation, it was suggested that smaller producers were not necessarily more innovative than larger producers. The presence of external investors does not change the fact that innovation is required to succeed
- It was suggested that, although smaller digital channels were commissioning more, access to secondary rights remained the mainstay of their businesses. The future prospects for smaller channels could be hit if the main terrestrial broadcasters have a “stranglehold” on secondary rights
- In terms of protecting intellectual property, it was suggested that the TV production sector could learn the lessons of the music industry. Rather than “fighting over

rights”, broadcasters and producers should seek to work together in order to protect intellectual property, and derive value. The important question should not be who controls the rights, but how to get value out of them.

Annex 7

Creativity and innovation

A7.1 In Ofcom's view, the interests of viewers are furthered through the provision of innovative and creative content. The PSB Review defined one of the characteristics of PSB content as being:

- **Innovative** – breaking new ideas or re-inventing exciting approaches, rather than copying old ones.

A7.2 A healthy, competitive production sector offering a plurality of supply to the public service broadcasters is considered to be an important factor in delivering innovation to the screen. In conducting this review, Ofcom has examined the relationship between innovation and the television production sector through analysis of the following issues:

- What factors help encourage innovative production?
- What type of production sector is best placed to deliver innovation?
- What impact would the consolidation of the external production sector have on innovation and creativity?
- What effect might the new terms of trade have on encouraging innovation and creativity in the independent production sector?

What factors encourage innovation in the production sector?

A7.3 During Phase 2 of the PSB Review, Ofcom undertook preliminary research into the factors that drive innovation. A series of interviews were conducted with a number of broadcasting professionals (programme-makers and commissioners) to find out what factors they considered encouraged innovation and what militated against it. This research was published in Phase 2 of the PSB Review. Section 2 of the main body of this document summarised the key findings of this research – setting out the key factors that were thought to act to encourage or discourage innovation.

A7.4 The results of this research indicate that broadcasters and producers both play an important role in delivering innovative content, with broadcasters responsible for creating an appetite and a market for creativity and innovative programming.

A7.5 For this review, Ofcom has further investigated the connection between the production sector and innovation to examine whether any one production sector model was more or less likely to deliver the public service broadcasting characteristic of innovative and creative content. Our overall finding is that no one model is best placed to deliver creativity and innovation.

Is there a connection between innovative programming and the external production sector?

A7.6 Historically, one of the key arguments for the development and maintenance of a strong external production sector has been that diversity of supply can help to deliver

innovative content to the public service broadcasters and that external production companies are inherently innovative in nature.

- A7.7 For our research into innovation for the PSB Review we conducted a straw poll of broadcasting professionals (from the main terrestrial channels, cable and satellite channels and the independent production sector), asking these individuals to nominate what they considered to be the three most innovative programmes on television over the last few years. The top three programmes were all external productions: *Wife Swap* (RDF), *Who Wants To Be a Millionaire* (Celador) and *Big Brother* (Endemol).
- A7.8 For the current review, we continued this examination of the role that external production companies play in delivering innovation to the main terrestrial broadcasters. As part of the interview programme for the current review, we asked a wide range of independent production companies (London-based and out of London), non-qualifying production companies, distributors and investors to consider if there was a connection between innovation and the external production sector.
- A7.9 A number of cultural, structural and economic theories were posited as to why external producers might be well placed to deliver innovative programming:
- The external sector is highly competitive and only the best and freshest ideas will win through and be commissioned
 - External production companies tend to be founded by entrepreneurial individuals who reject the comparative security of working within a broadcaster in favour of working in the independent sector. These individuals have historically instilled a risk-taking culture into their companies
 - The management style of external production companies encourages entrepreneurial behaviour
 - External production companies are primarily staffed by freelancers who bring a steady influx of new ideas
 - Freelancers strive to make as strong an impact as possible in the limited time they have with a company
 - Innovation can arise out of necessity. For example, the need for small producers to deliver content cheaply and quickly
 - Some external producers are prepared to 'put their production fee on screen'
 - Small external production companies are prepared to work on 'riskier' ideas as they do not need to justify the investment this entails to shareholders
- A7.10 The above factors generally apply to the external sector as a whole. There was, however, some disagreement between producers about whether different types/sizes of external production company were equally likely to produce innovative programming.

Innovation – Origin of production

- A7.11 For a research report commissioned by Granada Media,²⁹ DGA Metrics endeavoured to devise a less subjective means of measuring innovation. The objectives of DGA Metrics' report were:

²⁹ Designed and written by David Graham & Associates Ltd. Assisted by TAPE Consultancy Ltd. Commissioned and Funded by Granada Media.

- To develop a method for defining and measuring rates of innovation in TV programming
- To apply this methodology to a range of programming in order to assess the level of innovation in certain genres of new programming on UK terrestrial channels.

A7.12 DGA Metrics devised a methodology to create a list of potential titles from which sample programmes would be selected. The starting point was all network programmes broadcast on the five main terrestrial channels between 1 January 1999 and 31 December 2003. From these, they removed all repeat transmissions, single transmissions and returning series, sports and news programmes and all those programmes whose midpoint fell out of peak time. From the resulting 2000 titles they then used a system of performance measures to select the top 25 titles by channel and genre, resulting in a group of around 350 titles.

A7.13 Out of the 350 titles that went forward for further analysis, 147 were produced by broadcasters' in-house production departments, and 203 were made by external production companies. DGA Metrics' report therefore concluded that levels of innovation appeared to vary little depending on the origin of production.

A7.14 To further examine successful innovation, DGA Metrics devised a matrix of eight innovation elements to assess each of the titles in the above group. These were:

- Genre – did the production create a new genre or develop a 'hybrid' genre?
- Format – did it have unique elements that enabled it to be sold overseas as a format?
- Technical – was technical innovation visible on screen?
- Thematic – did it involve a new topic or subject?
- Character/presenter – were there unique characters (fiction) or new on-screen talent (factual)?
- Influence – did it inspire imitations?
- Scheduling – was it originally scheduled?
- Audience – did it attract a different audience compared to the genre's usual demographic profile?

Using these matrixes DGA Metrics drew up a list of the Top 15 innovative programmes on the main terrestrial channels from January 1999 to December 2003 – as set out in the table below:

	Title	Channel	Producer
1	Top Ten...	Channel 4	All 3 Media
2	The 1900 House	Channel 4	Wall to Wall
=3	Location Location Location	Channel 4	Ideal World

=3	Popstars	ITV1	Granada
5	Big Brother	Channel 4	Endemol UK
6	Walking With Dinosaurs	BBC	BBC
=7	I'm a Celebrity...	ITV1	Granada
=7	The Games	Channel 4	Endemol UK
9	The Office	BBC	BBC
10	Banzai	Channel 4	Radar
=11	Rat Trap	ITV1	Granada
=11	SAS: Are You Tough Enough	BBC2	BBC
=13	The Kumars At No 42	BBC2	Hat Trick
=13	Creature Comforts	ITV1	Aardman Animations

A7.15 It is interesting to note that this table comprises both in-house and external productions. Therefore, and as noted above, DGA Metrics found that different origins of production did not result in significantly different levels of innovation.

Innovation - does size matter?

A7.16 In discussions about the consolidation of the production sector, a common concern raised was that the dominance of a small group of “super-indies” could cause an increase in homogenous programming and a corresponding decrease in the amount of innovation on screen.

A7.17 With this in mind, it is interesting to note that the three ‘most innovative’ programmes nominated by the straw poll conducted for PSB Phase 2 (*Big Brother*, *Wife Swap* and *Who Wants To Be a Millionaire?*) were all produced by production companies that could fall into the category of super-indies.

A7.18 It is, therefore, apparent that creativity and commercial success are not mutually exclusive. Many of the production companies described as “super-indies” have developed on the back of successful and innovative programming.

A7.19 A number of stakeholders interviewed for this review supported the position that super-indies – and similarly in-house producers – were well placed to deliver innovative content. Several arguments were put forward suggesting that the development of large, external production companies could increase the amount of innovative and creative programming produced by the external production sector. These are summarised below:

- Super-indies are better placed to invest in research and development than small production companies

- Financially secure production companies can afford to take creative and financial risks
- Financially stable production companies are able to develop, attract and retain talented staff
- Large, well-established production companies usually have a strong production track record and a tried and tested relationship with commissioners. These credentials could encourage broadcasters to allow super-indies to take bigger risks
- Super-indies are in a better position to negotiate with broadcasters. This leads to financial benefits but also allows the company to stand its ground creatively.

A7.20 Some of the interviewees suggested that there were economic factors that might cause smaller producers in particular to shy away from innovation:

- Small producers lack the resources to invest significantly in research and development
- The need to secure 'bread and butter' programming in order to stay afloat could militate against taking creative risks.

A7.21 Despite the potential benefits of the development of a number of large production companies, many of the producers interviewed for this review expressed concern that, in the long term, this trend might in fact lead to a decrease in creativity and innovation on screen. The following reasons were put forward to support this position:

- Increased bureaucracy and the development of a 'monoculture' in large companies could inhibit creative risk-taking
- There can be a tension between 'creatives' and management
- Super-indies tend to have obligations to shareholders that could discourage them from developing innovative programming in order to concentrate on creating more reliably profitable content
- High target margins could militate against risk taking.

A7.22 In debating the connection between "super-indies" and innovation and creativity a number of the practitioners interviewed for this review believed that the way a large independent production company was structured influenced its ability to create innovative programming.

A7.23 Although most super-indies have grown by acquiring smaller production companies, Ofcom's interview programme identified two distinct structural models of super-indie. These were 'Centralised' super-indies (with a hierarchical line management) and 'Federal' super-indies (where different divisions retained a significant amount of control). In general, it was felt that the 'federal' model of a super-indie was more likely to be foster innovation than the centralised model.

A7.24 The reasoning behind this argument was that centrally dominated super-indies ran a greater risk of creating a monoculture and resulting in homogeneous programming than a federally structured production company that allowed acquired companies to operate as cells and to retain much of their unique brand, identity and creativity.

A7.25 This was reiterated in an interview with a production company that had been acquired by a larger indie. The interviewee noted that although they benefited from the management experience and financial expertise of the umbrella company, they continued to operate creatively much as they had done before the buyout.

What impact could the new terms of trade have on innovation?

A7.26 The new Codes of Practice and terms of trade were welcomed in principle by most of the production companies interviewed by Ofcom for this review. Some producers though expressed the following concerns about the impact of the new economic environment on innovation and creativity:

- The new terms of trade could fail to deliver high-risk programming as the pressure is on to deliver returnable series and exploitable formats. 'Rights-light' genres could become less attractive to producers who make money by exploiting rights, thereby reducing the plurality of supply in some types of programming
- Broadcasters are less willing to take risks on experimental programming under the new terms of trade, as they are no longer in a position to reap the same financial benefits if the risk pays off.

Annex 8

Operation of the Codes of Practice

Summary

- A8.1 In our engagement with industry stakeholders, there was broad consensus that the Codes of Practice were working well in respect of scheduled broadcast TV and that both broadcasters and producers could see specific benefits that flowed from the introduction of the Codes.
- A8.2 In a number of areas it was still too early to measure the precise impact of the Codes of Practice, but there was a general recognition that the Codes had succeeded in terms of changing behaviour and putting the sector on a more secure footing.
- A8.3 Among the specific benefits that were cited by broadcasters were:
- A more stream-lined commissioning process, including more greater use of fixed price deals
 - A new constructive (and more professional) relationship with producers
 - Deals were simpler and quicker to conclude.
- A8.4 The broadcasters commented that the introduction of the Codes of Practice had not resulted in any decrease in the prices that are being paid for commissions.
- A8.5 Broadcasters did express concerns that, in the area of new media rights, the existing framework created by the Codes lacked clarity, not just in terms of what a broadcaster was entitled to secure as part of the primary licence but also the extent to which they were able to exercise a degree of control over rights held by the producer (e.g. through the use of the holdback period). These concerns were echoed by PACT.
- A8.6 A number of the broadcasters made comments about the need for the framework put in place under the auspices of the Codes of Practice for dealing with new media rights issues to be flexible to adapt to the development of alternative systems for distributing content to viewers in the future.
- A8.7 PACT raised concerns about the ability of broadcasters to warehouse rights and so to restrict or prevent exploitation by producers. PACT expressed the concern that, whereas the Codes of Practice were intended to address the bundling of rights in a scheduled broadcast TV environment, broadcasters were now attempting to re-create bundles of rights involving new media rights instead.
- A8.8 PACT also indicated that there was a perception in the industry that broadcasters were seeking to drive down the prices that they paid to producers.
- A8.9 In Wales, S4C and TAC had developed a different approach from PACT and the other main terrestrial broadcasters. They had put in place arrangements to allow for a closer monitoring of the operation of the Codes of Practice so that, where issues around implementation of the new Code had emerged, they were addressed speedily and efficiently. In relation to issues around new media rights, S4C and TAC have in

place a system which allows the arrangements to be adapted to changing circumstances.

A8.10 In relation to new media rights issues, Section 6 of the main document sets out in detail Ofcom's analysis of the issues and also develops a number of principles which set out a potential framework for dealing with new media issues going forward. Ofcom is now consulting on these principles.

A8.11 In relation to pricing issues, Ofcom has considered a number of different aspects of pricing: e.g. whether the prices paid by broadcasters were in line with their indicative tariff ranges; whether broadcasters were commissioning a range of programming within those tariff ranges; the prices paid for commissions relative to in-house production; and also prices paid for returning series. We did not find any *prima facie* evidence that broadcasters were systematically reducing the prices they paid for programming.

A8.12 However, we recognise that this data represents a snapshot of the industry in the first year of the operation of the Codes of Practice. We therefore propose to keep the situation under review as part of the regular monitoring of the operation of the Codes of Practice – but we are not proposing to take any action at this time.

Introduction: the current Codes of Practice

A8.13 The Codes of Practice which were drawn up by the main terrestrial broadcasters towards the end of 2003 and then approved by Ofcom at the beginning of 2004 reflect very different perspectives in terms of the role and importance of different sets of rights. Table A8.1 below summarises the different positions that the main terrestrial broadcasters have set out in their respective Codes of Practice. The table sets out what each broadcaster expects within the 'primary' licence, split out by the following categories:

- **Licence scope:** i.e. platforms for distribution; the extent of "new media applications" on these platforms; and the extent to which re-versioned material is specified by the broadcasters as being included in the primary licence
- **Licence terms:** i.e. the duration of the primary licence and any 'holdback' period in relation to the exploitation of other rights
- **Revenue participation:** i.e. where revenue participation is specified either for the broadcaster in exploitation of non-primary rights or for the producer in primary rights.

A8.14 It is apparent from this that there are significant differences of approach between the broadcasters, in areas such as:

- The differing interpretations of Ofcom's guidance for the Codes Practice concerning the definition of the primary licence
- The degree of specification of which services and platforms fall within the primary licence
- The definition of 'new media' rights within the primary licence, if any is given at all, and whether these rights go beyond the synchronous 'simulcast' of the TV service over alternative platforms
- The 'holdback' policy on the further exploitation of a TV programme via a non-broadcast TV platform within the primary licence period

- Whether re-versioned or re-purposed material – such as promotional ‘clips’ or highlights – should have the same status as a full-length ‘as broadcast’ programme
- The expectation of a share of revenues between the broadcaster and producer from exploitation of rights both within and outside the primary licence.

Table A8.1: Ofcom summary of broadcaster Codes of practice on primary licence

	BBC	ITV	Channel 4	Five	S4C
Licence scope					
Platforms	Exclusive UK licence across all licence fee funded television services however distributed	UK TX on ITV1 on ‘all platforms and delivery systems’	First UK TX on ‘the core C4 service, howsoever distributed’, including simulcast online	Exclusive licence ‘to transmit on Five service, howsoever delivered’	Exclusive right to transmit Welsh language version in UK on S4C services by means of TV
New Media	Online, on-demand and interactive rights for simulcast and on-demand use for 7 days from first TX	Right to acquire ‘interactive services and websites’ rights for agreed revenue share	PRTS / Mobile / secondary online / Interactive TV / Teletext rights retained where required to ‘support programme’	Online, interactive on-demand, PRTS and streaming rights	Webcast or download Welsh language version adjacent to TV broadcast. Right to create/ maintain related websites / interactive apps
Re-version	Use of extracts on specific and generic websites	Clips for promotional use and on websites	Clips for promotion / synopsis purpose	Pre and post TX ‘clip rights’ in all media and , subtitle / dubbing for UK TV	Use of broadcast material and extracts on non-exclusive, non-commercial basis.
Licence terms					
Duration	5 year duration Automatic 2 year extension option in return for payment	5 years duration Automatic 2 year extension option	5 years duration Automatic 2 year / 2 TX extension option	5 years duration Automatic 2 year / 2 TX extension option	5 years duration Automatic 2 year extension option
Holdback policy	Holdback on all UK television exploitation during exclusive licence period. This may be released ‘on a case-by-case where exploitation in the UK television market would not conflict with exclusive rights’ licensed to the BBC	Holdback on all exploitation rights (including clips) until end of first TX or end of series.. Merchandising, DVD and publishing holdback released thereafter. Holdback on international sales until after first ITV1 UK TX (with provisions).	Holdback on exploitation for duration of licence ‘on any platform aimed at secondary TX market’ – including VOD / PPV / online and broadband. No holdback on international and consumer products post-TX	All secondary TV rights in licence period. Five ‘will consider... requests for UK secondary exploitation’. Holdback on exploitation of non-primary rights until first TX. Further ‘consent’ needed for	Holdback on non-Welsh language version for TV broadcast in the UK. No holdback on non-TV or ex-UK distribution following first Welsh version broadcast on S4C.

		Holdback on UK secondary TV and on-demand for licence term	UK format rights released after 12 months if not re-commissioned	commercial new media exploitation Ownership of all rights returned to producer where not exploited for period of 24 months	
Revenue participation Broadcaster / non-primary	BBC share of net revenue from commercial exploitation; including commercial new media rights.		C4 share in programme sales to other channels or 3 rd party pay use. C4 share of net revenue from international and consumer products	Five 'expect' share in revenues from 'non-primary rights on occasions where Five has added value'	Expect to share in revenues from non-Welsh version in licence period
Producer / primary	Good faith discussion of share of revenue to producer in connection with any interactive element of a programme with commercial revenue by consequence	PRTS and interactive revenue shared with producer		Clip and PRTS revenue share agreed on a case by case basis	Incidental income from interactive apps shared equally with producer

A8.15 The fact that there are important areas of difference in part reflects the different PSB remits of the main terrestrial broadcasters but also reflects the fact that different broadcasters had different views about the role and importance of new media rights issues.

Ofcom's review of Codes of Practice – outline approach

A8.16 Ofcom's review focused on the operation of the Codes as they related to: the BBC, ITV Network, Channel 4, Five, and S4C. In order to provide an opportunity for formal representations, Ofcom wrote to the main terrestrial broadcasters and the relevant industry associations for independent producers – i.e. PACT (representing independent producers in England, Scotland and Northern Ireland) and TAC (representing independent producers in Wales).

A8.17 The main terrestrial broadcasters and producers' representatives were invited to make submissions commenting on the overall operation of the Codes of Practice and how the Codes had actually influenced the broadcaster-producer relationship from the point of view of that organisation. The parties were invited to submit comments not just on those areas where the Codes had had a beneficial effect, but also on those areas the Codes were not functioning as well as possible – or indeed were causing difficulties for the commercial relationships.

A8.18 In addition – reflecting the concerns expressed at the time of negotiations over the terms of trade which implemented the Codes of Practice – the parties were asked to comment on three specific areas, namely:

- Negotiations over new media or multimedia rights
- The impact on prices paid by broadcasters for commissions, either overall or for particular genres
- Negotiations over the share of back-end revenue.

A8.19 Broadcasters and producers were also invited to comment on the extent to which the distribution sector had begun to adapt to changes brought about by the Codes of Practice.

A8.20 In considering the operation of the Codes of Practice, Ofcom also took into account the comments and issues which had been raised in the course of individual interviews with both broadcasters and producers.

A8.21 As a result of responses received by Ofcom and also the issues raised with Ofcom in the course of these discussions, Ofcom focused on issues around pricing and new media rights issues. The issues relating to new media rights and options for developing a more flexible framework to handle such issues have been set out in detail in Section 6 of the main document. The remainder of this section sets out Ofcom's analysis of pricing issues and also provides a summary of the responses Ofcom received.

Pricing Issues

A8.22 Given that PACT had raised a number of concerns in relation to changes in pricing practices, Ofcom conducted a number of pieces of analysis in order to assess whether there was evidence that broadcasters were not complying with the terms of their respective Codes of Practice.

A8.23 The base data available to Ofcom consisted of data on commissions falling within the scope of the broadcasters' respective Codes of Practice in the course of 2004. In all, the data related to over 400 hundred commissions by the BBC; over 300 commissions by Channel 4; over 150 commissions by ITV; and over 1000 hours of commissions by Five.

A8.24 First of all, Ofcom considered the extent to which the prices paid by broadcasters for commissions were within the broadcasters' indicative tariff ranges. The analysis indicated that the prices paid for the overwhelming majority of commissions were contained within the broadcasters' respective indicative tariff ranges. Furthermore, where prices paid were outside the indicative tariff ranges, they were almost always above the upper end of the indicative tariff range. For instance, in the case of the BBC, there were 14 commissions that fell outside the indicative tariff ranges, all of which were above the upper end of the indicative tariff range for the relevant genre. In the case of Channel 4, 53 commissions fell outside the indicative tariff ranges for the relevant genres, with 47 of these being above the upper end of the range. In none of those instances did Channel 4 seek to take additional rights in the production.

A8.25 The main exception to this pattern was in relation to Five where commissioning in one particular programme genre appears to be at odds with the indicative tariff ranges. This issue is being pursued with Five. However, in other genres, where Five has commissioned outside its indicative tariff ranges, the prices paid have generally been above the indicative tariff ranges.

- A8.26 Ofcom also considered the extent to which broadcasters were commissioning a range of programming within the respective tariff ranges e.g. to ensure that the prices paid for programmes commissioned from independent producers were not clustered at the lower end of the indicative tariff ranges. Again, based on the data available to Ofcom, the prices paid for commissions appeared to be reasonably spread out across the different tariff ranges without any systematic bias towards the lower end of the tariff ranges.
- A8.27 Ofcom also considered data provided by some of the broadcasters about the prices paid for returning series, as a means of trying to establish a benchmark against which to assess whether prices had fallen over time. That data did indicate that, in some instances, the cost per hour paid for returning series had fallen. However, where this had occurred, there could be a variety of reasons. For instance, there were instances where there had been changes in the specification of the returning series. There were also instances where the number of programmes had been increased or the series had been re-commissioned as part of a multi-year deal so that the commission was now for a higher volume of programming. Equally there were also instances where the price paid (on a cost per hour basis) for returning series had increased.
- A8.28 Ofcom also compared prices paid by BBC and ITV for programming commissioned in-house with that commissioned from independent producers to establish whether there was any discrimination in favour of in-house production – e.g. whether broadcasters were tending to commission higher-priced programming in-house and using independent producers for cheaper programming. Again, there was no evidence of any systematic bias in favour of in-house production. In both cases, broadcasters tended to commission across the different indicative tariff ranges so that there was a spread of commissions.
- A8.29 Overall, Ofcom has not found any *prima facie* evidence that broadcasters have systematically been reducing the prices paid for programming, nor have we found any evidence that broadcasters are systematically favouring in-house production over external production. Rather, the evidence provided to Ofcom suggests that independent commissions are priced across the tariff range and that, where relevant, there is no obvious discrimination between in-house and external producers.
- A8.30 Nonetheless, we do recognise that this data represents a snapshot of the industry in the first year of the operation of the Codes of Practice. We therefore propose to keep the situation under review as part of the regular monitoring of the operation of the Codes of Practice – but we do not propose to take any action at this point in time.
- A8.31 It is possible that the views expressed by PACT members could stem from a situation in which the prices paid by broadcasters have increased at a slower rate than the underlying costs of production. Ofcom notes that broadcasters' Codes of Practice do include provision for the indicative tariff ranges to be reviewed but to date broadcasters have indicated that they do not propose to increase the indicative ranges. Ofcom recognises that the indicative tariff ranges are typically broad enough to allow for increased prices to be paid to producers, without necessarily needing to increase the overall tariff range.
- A8.32 We also recognise that there may be an argument for tariff ranges to be reviewed to reflect cost inflation. But, at the same time, efficiency considerations may suggest that cost savings should be sought rather than simply increasing tariff ranges in line with inflation. Regardless of which approach is adopted, we note that the matter of

programme-specific pricing is a matter for commercial negotiation between broadcasters and producers, and not specifically an issue for Ofcom.

Summary of Submissions

A8.33 The following is a summary of the main points raised in the written submissions received from the various parties on the operations of the Codes of Practice.

The BBC

A8.34 The overall impression of the BBC was that the process of defining the new Codes of Practice had created the conditions for a new, constructive relationship between the BBC and the independent sector. The BBC considered that the Codes had succeeded as an intervention designed to change behaviour, stimulate independent production and address competition concerns.

A8.35 The BBC had found that negotiations over the Code and its implementation had led to a more mature relationship with the independent sector, and the resulting agreements formed a robust foundation for dealings between the BBC and external producers – e.g. there was now greater clarity about the rights that the BBC needed in order to fulfil its public service obligations. The BBC also found that deals were becoming simpler and quicker to conclude and that individual transactions were becoming more efficient and less labour intensive – which was helping to reduce transactions costs on both sides.

A8.36 The BBC agreed that any revisions to the Code of Practice should preserve the assumption that producers should retain rights in their programmes unless they are explicitly sold to broadcasters. But the BBC wanted to explore the circumstances in which broadcasters should be able to enter into different arrangements for the balance of rights, price and risk.

A8.37 In respect of the exploitation of new media rights, the BBC believed that the next phase of regulation needed to recognise a flexible approach was needed. From the BBC's perspective, their concern was to ensure that the public service benefits of new media could be realised by its audiences in a way that offered the best possible value for the licence fee. The BBC is convinced that exploiting new modes of delivery will be key to maintaining the impact of PSB in a digital world.

A8.38 The BBC expressed the concern that the Codes of Practice system would not prove sufficiently flexible to deal with rapid changes. It argued that the next phase of regulation in the area of new media rights needed to recognise that the ability of broadcasters and producers to take full advantage of new media opportunities would require a flexible approach.

A8.39 The BBC's concern was to ensure that the public service benefits of new media could be realised by audiences in a way that offered the best possible value for the licence fee. The BBC restated its intention not to use new media rights for commercial exploitation: its aim was rather to secure free-to-air rights within a limited window to maximise public value, while protecting the on-going commercial value of content to rights owners. The BBC highlighted the need to keep the framework for new media rights laid out in the Codes of Practice under very close review to ensure that it was still relevant.

A8.40 In terms of pricing, the BBC commented that, although it accepted that the intention was that prices across the board would not be reduced as a result of the introduction

of the new Code, there was now a widespread perception amongst external producers that prices would never go down. The BBC thought that this was an unrealistic expectation. The BBC also felt that it was too early to conclusively demonstrate an upward or downward trend in underlying programme prices.

A8.41 In terms of negotiations over back-end revenue, the BBC's experience was that the agreement reached in the Code (an 85:15% split in favour of the producer) had been standard in agreements with producers. The BBC did however say that it felt that there was an issue about the speed with which the BBC would see the benefits of its share. The BBC argued that in some cases producers were choosing to put additional money into a production on top of the BBC's production fee. This meant that the finished programme ended up being more expensive than the BBC needed for a particular slot and also had the effect of pushing back the point at which the BBC might expect to benefit from a share of the back-end.

Channel 4

A8.42 Channel 4 reported that, in many respects, the Codes of Practice had had a positive effect on the relationships between Channel 4 and independent producers – e.g. in terms of a more professional relationship with producers. They identified three specific areas where there had been a positive effect:

- Streamlining of commissioning processes: reducing the amount of time taken to reach agreement on contract terms
- Published programme tariff ranges: Channel 4 believes that the published tariffs provide a transparent context for negotiating on price
- Wider use of fixed price deals: Channel 4 have implemented new procedures relating to fixed price deals. If producers meet certain criteria then Channel 4 may offer the producer the commission on a fixed price basis. This means less review of budgets by Channel 4, and the producer is left to manage the production budget.

A8.43 Channel 4 acknowledged that the Codes of Practice had put the sector as a whole on a more secure footing for growth, and they welcomed this development. They also stated that the changes brought about by the Codes had improved relationships with producers.

A8.44 In terms of other issues where the Codes of Practice had proved more problematic, Channel 4 identified two specific issues:

- Expectations about access to promotional airtime
- Revisions to the terms of trade.

A8.45 In relation to promotional airtime, Channel 4 indicated that it had only received two complaints from independent producers, and both related to the use of promotional airtime. In each case, the independent producer argued that Channel 4 was only prepared to promote consumer products produced by a 4Ventures company. Channel 4 indicated that it was developing a policy on promotional airtime in order to clarify its approach.

A8.46 In relation to revisions to the terms of trade, Channel 4 has made a supplemental agreement with PACT regarding the commissioning of programming for More4. In return for an agreement to allow programming commissioned for Channel 4 to be

repeated on More4, Channel 4 has relaxed the requirement on producers to use C4I for the exploitation of programming within Channel 4's five-year holdback period and also waived the sales commission that had previously been charged on Channel 4 commissioned programmes sold to E4 through C4I.

- A8.47 In respect of negotiations over new media rights, Channel 4 identified the fact that some new media rights – specifically relating to the delivery of on-demand delivery – were put into holdback at the time of the negotiation over the Codes of Practice. Channel 4 felt that the fact that they had to negotiate over these rights on an individual basis with each production company rather than being able to acquire them as part of the primary licence was causing problems – e.g. in terms of uncertainty about the supply of programming via new media platforms. Channel 4 argued that it was at a disadvantage compared to the BBC and ITV in terms of not having the output from in-house production for new media exploitation.
- A8.48 Channel 4 felt that the current Codes of Practice and terms of trade limited its ability to extend programming to new media platforms to meet audience expectations, and did not support Channel 4's aim of commercial self-help.
- A8.49 Channel 4 argued that they had not seen any significant changes in the prices paid for programming. Channel 4 also pointed out that the main change arising from the Codes of Practice had been a reduction in the rights included in that price.
- A8.50 Channel 4's basic position in relation to share of back-end revenue has moved from 70% to 50% in the secondary market within the licence period, and to 15% at all other times and in all other markets. Channel 4 argues that, as new platforms develop, new revenue streams will emerge and that there will need to be equitable arrangements for sharing those revenues to recognise Channel 4's role.

Five

- A8.51 Five raised the concern that – as the smallest of the main terrestrial broadcasters – the requirement to have in place a Code of Practice placed a disproportionate constraint on their ability to negotiate with producers and also put Five at a competitive disadvantage not only compared to their smaller competitors – i.e. the digital-only channels – but also in relation to the larger main terrestrial broadcasters. In respect of digital-only channels, Five argued that the digital-only channels were able to strike more favourable deals, in that producers did not have the leverage afforded by the Code of Practice to “acquire rights that the broadcasters would prefer not to surrender or share”. Five also argued that its competitive advantage in terms of offering better/more flexible terms to producers compared to the other main terrestrial broadcasters had been eroded by the Codes of Practice. Five also suggested that the Codes severely limited Five's ability to profit from the programmes it commissioned.
- A8.52 In relation to new media rights, Five stated that it had reached agreement on new media rights on much the same basis as the BBC. Five argued that they regarded it as important that “all rights to show programmes (or interact with their broadcast) via new media technologies within the same time frame as television transmissions should be treated as primary rights”. Five indicated it would be extremely resistant to the idea that video-on-demand rights were secondary rights.
- A8.53 On pricing matters, Five stated that the Codes had not resulted in a reduction in the prices paid by Five and, in negotiations, producers were in fact pointing out the higher prices paid by other broadcasters. Five stated that some producers were

seeking to improve on the position set out in its Code of Practice and also at the same time continued to expect Five to meet the cost of any overspends. Although such disputes were usually resolved through negotiation, Five felt that this was indicative of the mind-set of many producers: i.e. they were reluctant to take on risk. Under-spends of programme budgets were not being shared with Five as had previously been the case, although Five did not indicate why this was the case.

- A8.54 In relation to share of the net income from non-primary rights, Five have accepted as a starting point an 85:15% split in favour of the producer. However, Five reports that it is now more difficult to negotiate an improved position – e.g. in the event that Five was paying an above-tariff price. Where the revenue sharing position was not spelt out in the Code/terms of trade, Five reported that drawn-out negotiations were often needed. Five cited an example of PRTS as an instance where many producers expected at least an equal split in revenues.
- A8.55 Five commented that their perception is that production companies with established distribution arrangements (either in-house or contractual) have found it easiest to capitalise on the new arrangements. However, Five pointed out that it is not in a position to be party to distribution deals because of PACT advice to its members. Five regard this as unsatisfactory as Five have no oversight on whether the producer has been able to strike the best price or whether any terms might conflict with Five's interests.
- A8.56 Five concluded with the warning that any erosion of the primary rights held by a broadcaster would pose a real and increasing strain on the viability of programme commissioning and the fundamentals of its business.

ITV Network

- A8.57 ITV Network made a general statement that it believed that ITV was seriously disadvantaged in that it was the only broadcaster that was regulated in such a way that it was unable to acquire additional rights for associated channels at the point of commission; it was restricted in its ability to acquire new media rights; and it was not able to negotiate a revenue share at the point of commission, even if ITV Network and the producer agreed. ITV Network argued that this inequality of treatment impacted on the effectiveness of the implementation of the codes.
- A8.58 In terms of the operation of the Code of Practice, ITV Network stated that the Code did not change ITV's business practices substantially. However, ITV Network considers that the Code does not give ITV the flexibility to work with producers in the most effective manner, and that it was precluded from creative deal-making and sharing risk with producers. ITV Network considered that it should be able to be more involved in both the editorial and business dealings of its direct access commissions, in order to maximise its position in an increasingly competitive and fragmented broadcast landscape.
- A8.59 In relation to new media rights, ITV Network referred to the disagreement with PACT in their negotiations over terms of trade. ITV Network argued that PACT was interpreting the ITV Network Code of Practice in a restrictive manner and that ITV Network should be able to reflect current industry practice which would allow it to secure new media rights (interactive TV rights, online rights, new media clip rights together with PRTS and teletext rights) at the point of commission for exploitation by ITV as part of the primary rights over the term of its licence. ITV Network argued that, if it is not able to acquire these rights, it would put it at a competitive disadvantage when ITV Network had invested heavily in interactive services.

- A8.60 ITV Network stated that, in the absence of agreement terms of trade with PACT, ITV had operated its new media dealings on an ad hoc basis along the lines that it had outlined. It believed that PACT and the Code of Practice were out of step with the market, and were not necessarily reflective of the views of producers.
- A8.61 In terms of pricing, ITV Network stated that the prices ITV paid for programming had not reduced as a result of the new Code of Practice, and ITV had not changed its method for evaluating programme licence fees. However, it did indicate that if its viewing share continued to decrease it would have to review programme budgets more carefully. ITV Network stated that the Code and the lack of agreement on prices could have the effect of encouraging ITV to reconsider its position on pricing: the price paid for a fixed licence with limited new media rights and little or no ancillary revenue would inevitably have to reduce, when compared to other broadcasters with access to greater rights and revenues.

PACT

- A8.62 PACT's response focused on two of the issues where Ofcom was looking for specific comments: new media rights issues, and pricing and distribution revenues.
- A8.63 In relation to new media rights, PACT focused on the issue of clarity about the different categories of rights that are being commissioned. In PACT's view, broadcasters are trying to bundle further new media rights into the primary licence over and above those to which they are entitled under Ofcom's guidelines. PACT accepts that a broadcaster that has fully-funded or paid most of the licence should, in addition to exclusive transmission rights, be able to offer further propositions on other media platforms. Those should support the programme on transmission or for a short period before and after it is aired. Under such funding conditions, broadcasters are entitled to a series of limited holdbacks. Further uses could then still be obtained in return for additional payment.
- A8.64 PACT argued that, in practice, broadcasters have sought extensive new media rights as part of the primary licence with no additional or separate payment. In PACT's view, negotiations over terms of trade have made it clear that broadcasters are seeking to control more rights than are necessary in an attempt to leverage their position into new markets. PACT considered that it was critical that Ofcom intervenes to clarify the nature of the rights that a broadcaster needed, in order to protect its investment in the licence. All other rights should be the property of the producer and should not be – in effect – warehoused under restrictive holdbacks. PACT argued that it was crucial that a free market in content aimed at new media platforms was maintained.
- A8.65 In relation to pricing, PACT stated that it had collected evidence that suggested that broadcasters were forcing down prices and had fixed tariff and slot prices, although PACT then went on to suggest that this needed further detailed examination by Ofcom. – the evidence that PACT collected was based on returns from a sample of the PACT TV membership. Although PACT's research focused on the BBC and Channel 4, PACT stated that there was considerable anecdotal evidence that Five had also been reducing prices and that the tariff that it was operating bore little resemblance to the Ofcom-approved, published version.
- A8.66 PACT argued that the data it has collected in respect of the BBC and Channel 4 indicates that broadcasters are actively seeking to use third party funding to subsidise the prices they offer to independent producers. PACT did acknowledge that neither the BBC or Channel 4 had sought to force independents to make use of

in-house distributors nor had they insisted that as a condition of the commission that they be entitled to an increased share of any back-end revenue.

- A8.67 PACT's research also indicated that while producers are keen to negotiate a price, they would prefer to do this on a fixed price basis, i.e. where no budget is disclosed. PACT also suggest that it is the broadcaster that usually makes the initial offer price and does not move from that price – which could suggest that the broadcaster has “fixed” tariff and slot prices.

The situation in Wales: S4C and TAC

- A8.68 The approach adopted between producer and broadcaster in Wales was a very different approach to that adopted between other main terrestrial broadcasters and PACT.
- A8.69 In the case of S4C and TAC (the representative of the independent producers in Wales) efforts had already been made to review the operation of the Code of Practice, and there appeared to be a more collaborative approach. For instance, where there had been issues around implementation of the Code, both parties seemed to have been able to work through those issues to reach a solution which was acceptable to both sides. Furthermore, both sides seem to have been able to reach a modus operandi in relation to new media rights with both sides displaying a degree of flexibility.

S4C

- A8.70 S4C and TAC had themselves carried out a review of the terms of trade and are in the process of reviewing the position in respect of new media rights. S4C favour working in partnership with the sector to create enhanced opportunities for S4C, the producer and the end-user. To support the development of producers in Wales, S4C have introduced a new Development Scheme.
- A8.71 S4C had not seen any reduction in the amount paid as a result of the introduction of licence only commissions. In fact, S4C identified that the overall price paid by S4C had increased in 2004 compared to 2003, and the average cost per hour had risen as well. S4C anticipated that cost per hour in 2005 would be broadly similar to that in 2004.
- A8.72 S4C had not experienced any problems to date in respect of negotiations over the share of back-end revenue. A number of negotiations had centred on release of exclusivity or shortening of the holdback period in exchange for reduced fee and/or increased share of back-end revenue.
- A8.73 As a result of the review of the Code and terms of trade, S4C had proposed reducing the “in perpetuity” licensing of children’s programming down to a 10-year licence. S4C have also brought rights in returning series within the scope of the Code. S4C have also outsourced their distribution activities to an external company, and rights may be re-assigned to the original producers if the external company decides not to exploit them.

TAC

- A8.74 The comments from TAC focused on the practical operation of the Code of Practice and indicated that, although there had been a number of teething problems in introducing the new system of commissioning, it felt that senior staff at S4C had

successfully addressed these issues. In order to monitor performance against the Code, the frequency of the meetings between S4C and TAC to review the implementation of the guidelines had increased: they now took place on a quarterly basis. These meetings provide a forum for a full and frank discussion of matters relating to the commissioning process.

- A8.75 A particular issue that has arisen is in relation to S4C not meeting the timetable set up in the process for responding to programme ideas submitted by producers. S4C apparently accepted that the situation was unsatisfactory and responded in a pragmatic way. TAC reported that both were now working together to ensure a meaningful and realistic timetable, and that S4C was keen to expedite the commissioning process.

- A8.76 In addition to issues about timescales, there has also been a delay in the production of a "standard" licence and in fact in some cases programmes have been actually transmitted without a formal licence being in place. However, TAC report that they and S4C have been able to put in place a pragmatic solution to deal with what was a short-term issue.

- A8.77 TAC reported that another change for the good was in terms of S4C using staff with a more commercial approach in discussions with TAC. TAC felt that this approach reflected a general change in the organisational culture of S4C to recognise the commercial realities of the post-Communications Act situation.

- A8.78 In terms of new media rights, TAC reported that discussions had been coloured by S4C's short term aspirations, available resources and technical capabilities. The terms of trade provide for an annual review of the relevant provisions on new media rights so that they can be adapted to changing circumstances. TAC are happy with this position for the short-term. At present, TAC feels it is too early to draw any conclusions relating to the value of re-versioned content, particularly for the English-speaking market. But TAC considers overall that the provisions regarding alternative media set out in the terms of trade are not unduly restrictive.

- A8.79 TAC stated that it was not aware of any significant changes in the level of prices. It also reported that TAC and S4C had been able to reach agreement on a standard share of back-end revenue.

- A8.80 TAC also reported that there had been a recent review of S4C's standard holdback provision. The conclusion of the review was that the current holdback positions provided a flexible position responsive to the linguistic position that applied to Welsh language content and the re-versioning into English language content. TAC reported a successful conclusion to the situation in which these provisions were put to the test for the first time.