

# **Response to Ofcom's consultations on the BBC's public services activities**

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# I Executive summary

- I.1 The BBC makes a valuable contribution to the UK – serving all audiences with high quality and distinctive programmes and services which inform, educate and entertain. Over the course of the next 11 year Charter period, the BBC will need to constantly adapt its UK public service activities,<sup>1</sup> in response to changing audience preferences and new technologies. In line with market norms, the BBC will often follow a ‘test, learn, adapt’ approach to service development. This process of service evolution will be essential if the BBC is to effectively fulfil its Charter-defined mission and public purposes.
- I.2 The BBC welcomes the opportunity to respond to Ofcom’s consultation documents – Assessing the impact of proposed changes to the BBC’s public service activities and Assessing the impact of the BBC’s public service activities.
- I.3 The Charter and Framework Agreement give the BBC Board responsibility, in the first instance, for considering the impact of planned changes to the BBC’s public service activities. This reflects the Board’s responsibility for setting the strategic direction of the BBC and its duty to act in the public interest, taking account of the costs and benefits of the BBC’s activities.
- I.4 It is important that Ofcom’s regulatory approach to the BBC’s public service activities is clear, proportionate, consistent and targeted only at cases in which action is needed. It should balance the need for the BBC, under the supervision of the Board, to continuously innovate and evolve its public service activities, with the requirement to take account of the impact on fair and effective competition.

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<sup>1</sup> The UK Public Service activities comprise the BBC’s Public Services – i.e. the BBC’s TV, radio and online services – and ‘non service activities’. Non-service activities are activities which are not UK Public Services but which directly or indirectly fulfil the BBC’s mission and promote one or more of the BBC’s Public Services. Examples of these include the BBC’s participation in TV platform joint ventures such as Freeview.

## Overarching observations

- 1.5 The BBC has four overarching observations about Ofcom's proposed approach to ex ante assessments of the impact of material changes to the BBC's public service activities ('Competition Assessments'), and its ex post approach to significant competition issues which may emerge over the course of the Charter period ('Competition Reviews').

### *Consideration of the BBC's positive effects on competition*

- 1.6 Ofcom's is required<sup>2</sup> to consider the potential adverse effects of the BBC's public service activities on competition. However, Ofcom's framework should also reflect the positive impacts that the BBC can have on competition in systematic way. While the BBC recognises that there are risks that it may crowd out commercial activity and may harm competition elsewhere in the supply chain, equally, it is also possible that:

- The BBC 'crowds in' commercial activity by stimulating demand for competitor services – for example, BBC iPlayer has facilitated the development of the market for Video on Demand (VoD) services by helping to create an audience for catch up TV services.
- The BBC can promote competition elsewhere in the supply chain – for example, the development of the BBC's HD channel generated an increased demand for digital TV platforms.

- 1.7 Although the two consultation documents mention the BBC's positive impacts on several occasions, it is not clear how these benefits will be considered within Ofcom's analytical framework. As a result, Ofcom's approach risks focusing exclusively on gathering evidence relating to potential negative effects, rather than considering the adverse impact on competition net of any positive impacts.

### *Recognition of the BBC's relative scale in a changing market context*

- 1.8 The BBC, like other broadcasters, is facing a rapidly changing market context characterised by new consumption habits, commercial consolidation at different points in the media value chain, and the blurring of conventional

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<sup>2</sup> See Clauses 3 (c), 12 (3), 19 3(c) and 21 (3) of the Framework Agreement

market definitions. The BBC's relative scale and market share in the UK is for the most part diminishing. There is little evidence to suggest that the BBC's publically funded services are having a significant impact on the level of competition, choice and market entry or expansion in the UK media sector.

*Certainty of regulatory intervention*

- I.9 An important feature of any regulatory framework is that it provides clarity on when intervention is likely to be required. Without this clarity, it will be harder for the BBC to plan and evolve its services, creating risk aversion and hampering innovation. There are several areas where Ofcom could provide further clarity on its approach – for example, the regulatory framework for assessing changes to public service activities hinges on ‘materiality’<sup>3</sup> which, in turn, is linked to the rather elastic concept of ‘significant adverse impact on fair and effective competition’.
- I.10 Although Ofcom provides some indication of the type of factors it will take into account when considering whether a proposed change is material, it does not state what fair and effective competition means. We broadly agree with the factors identified by Ofcom; it will be relevant to look at the BBC's market share and the scale of the BBC's proposal relative to the overall size of the market, alongside a high-level and forward-looking assessment of the competitive conditions at play and the extent to which the BBC activity will be a substitute for commercial activity. The market context in which the BBC operates will have a direct bearing on judgements about whether a proposal is likely to have a significant impact on fair and effective competition.

*Focus on competition rather than individual competitors*

- I.11 Ofcom's discussion of the potential competition concerns posed by the BBC's public service activities considers both the short-run or static impacts (e.g. on commercial revenues and profitability) and the longer-run or ‘dynamic impacts’ of the BBC public service activities (e.g. the consequences of reductions in commercial revenues and profitability on incentives to

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<sup>3</sup> Clause 7 (7) of the Framework Agreement defines a material change as (a) the carrying out of any new activity as a new UK Public Service; and (b) any change to a UK Public Service which may have a significant adverse impact on fair and effective competition.

innovate or exit from a market). These longer term effects are critical in understanding the potential impacts of a BBC public service activity on fair and effective competition. While Ofcom recognises this in principle, its proposed analytical approach to Competition Assessments and Competition Reviews appears to place more of an emphasis on static impacts. Highlighting a focus on longer-term, dynamic impacts would provide greater clarity on what is meant by the concept of ‘fair and effective competition’

## **Specific points on Ofcom’s proposed approach**

1.12 The BBC’s response also considers a number of specific points concerning the two consultation documents. In terms of Ofcom’s proposed approach to Competition Assessments, the BBC has the following key observations:

- Ofcom and the BBC should adopt, as far as possible, a consistent analytical approach to identifying materiality, even though the conclusions of each party may differ.
- While the BBC will engage with stakeholders during the development of material change proposals, Ofcom should have realistic expectations about the extent to which third parties might be willing (and able) to provide information which helps the BBC to design its proposals in a way that mitigates competition concerns.
- Ofcom stresses the importance of having sufficient information from the BBC to undertake a materiality assessment of a service change. To address this concern, Ofcom should include a ‘pre-notification’ stage, before the BBC undertakes a Public Interest Test (PIT). During this stage, the BBC and Ofcom could agree, for example, a common approach to the counterfactual<sup>4</sup> and research programme. This will minimise the risk that the BBC would have to repeat elements of its analysis because Ofcom had subsequent concerns about the approach.

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<sup>4</sup> Development of the counterfactual is an important element of both the Public Interest Test and Competition Assessment as it identifies what might happen in the absence of the proposal going ahead. It is required to understand the additional public value and competition impacts that can be attributed to a material change in a BBC public service activity.

I.13 With respect to Ofcom's proposed approach to BCRs, the BBC would make the following key observations:

- It would not be appropriate for Ofcom to re-consider incremental service changes which have already been subject to ex ante scrutiny by the BBC Trust, as this creates the risk of 'double jeopardy'. The BBC also considers it would be inappropriate for Ofcom to instigate a Competition Review in response to changes in market conditions which are external to the BBC.
- Ofcom should fully align its analytical approach to Competition Reviews with the provisions of the Framework Agreement. The Agreement makes clear that Ofcom can instigate a BCR if there are reasonable grounds to believe that the carrying out of a UK public service activity is having a significant adverse impact on fair and effective competition. Ofcom must then establish during the review that there is actual evidence of a significant adverse impact on fair and effective competition. Only then should it consider whether the public value of a service, or parts of it, justifies the adverse impact on fair and effective competition. The current wording in Ofcom's consultation paper does not imply this sequential approach.
- Ofcom should seek considerable input from the BBC to identify appropriate 'alternative scenarios' or service modifications, in the event that it identifies competition concerns that are not outweighed by public value. This is necessary to ensure any modifications are consistent with the BBC's strategic objectives.

## 2 Introduction

- 2.1 The BBC makes a valuable contribution to the UK – serving all audiences with high quality and distinctive programmes and services which inform, educate and entertain them. Over the course of the next 11 year Charter period, the BBC will need to constantly adapt its UK public service activities<sup>5</sup> in response to changing audience preferences and new technologies. In line with market norms, the BBC will often follow a ‘test, learn, adapt’ approach to digital service development. This process of service evolution will be essential if the BBC is to effectively fulfil its Charter-defined mission and public purposes.
- 2.2 Ofcom’s two consultation documents - *Assessing the impact of proposed changes to the BBC’s public service activities* and *Assessing the impact of the BBC’s public service activities* – set out the tools, procedures and guidelines that Ofcom plans to use when regulating material changes in, and the impact of, the BBC’s public service activities on fair and effective competition.
- 2.3 The BBC welcomes the opportunity to respond to these two consultation documents. The Charter and Agreement give the BBC Board responsibility, in the first instance, for considering the impact of planned changes to the BBC’s public service activities. This reflects the Board’s responsibility for setting the strategic direction of the BBC and its duty to act in the public interest, taking account of the costs and benefits of the BBC’s activities.
- 2.4 It is important that regulatory oversight by Ofcom in these areas is clear, proportionate, consistent and targeted only at cases in which action is needed. The new regulatory framework should balance the need for the BBC, under the supervision of the Board, to continuously innovate and

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<sup>5</sup> The UK Public Service activities comprise the BBC’s Public Services – i.e. the BBC’s TV, radio and online services – and ‘non service activities’. Non-service activities are activities which are not UK Public Services but which directly or indirectly fulfil the BBC’s mission and promote one or more of the BBC’s Public Services. Examples of these include the BBC’s participation in TV platform joint ventures such as Freeview.



evolve its services, with the requirement to take account of the impact on fair and effective competition.

2.5 Ideally, the new framework would meet a number of conditions:

- Provide confidence that regulatory decisions are rooted in the public interest, taking account of the objective of the BBC to fulfil its Charter-defined mission and purposes;
- Take account of the desirability of protecting fair and effective competition, while also recognising the positive role that the BBC plays in stimulating the market;
- Enable the BBC to develop its public service activities in a timely fashion, in response to fast-moving audience and technology developments; and
- Provide clarity on when regulatory intervention is required, thus minimising the risk of uncertainty for the BBC, audiences and the wider market.

2.6 The remainder of this response is structured as follows:

- The first section sets out overarching points which apply across the two consultations;
- The second section considers specific points raised by Ofcom's consultation on assessing the impact of proposed changes to the BBC's public service activities through BBC Competition Assessments (BCAs); and
- The third section comments on Ofcom's proposed approach to assessing the impact of the BBC's public service activities through BBC Competition Reviews (BCRs).

### **3 Overarching comments on Ofcom's approach**

- 3.1 This section of the response makes general observations that apply across Ofcom's two consultation papers: *Assessing the impact of proposed changes to the BBC's public service activities*, and *Assessing the impact of the BBC's public service activities*.
- 3.2 The BBC welcomes the opportunity to comment on how Ofcom intends to consider the impacts of the BBC's public service activities on competition. Ofcom has made substantial progress in developing an approach which sets out clearly the different stages of its assessment procedures, and the respective roles of the regulator and the BBC.
- 3.3 The BBC has four overarching observations about Ofcom's proposed approach:
- (i) The treatment of the potential positive impacts (alongside the adverse ones) of BBC public service activities on fair and effective competition, in BCAs and BCRs.
  - (ii) While we accept the potential risks identified in Ofcom's 'theory of harm' about the BBC's activities, we observe little evidence of actual harm and the changing market context will have a direct bearing on the level of any future risk.
  - (iii) The need for greater clarity in parts of Ofcom's guidance on the circumstances under which the BBC might be subject to regulatory intervention.
  - (iv) The emphasis in Ofcom's analytical approach on the impact on individual competitors rather than on competition. While the short-run or 'static' negative impacts on commercial rivals are relevant, what is more important is whether there are long-run or 'dynamic' impacts on the development of competition, choice and investment in affected markets.

## **The BBC's positive effects in promoting fair and effective competition**

- 3.4 While it is Ofcom's role is to consider the potential adverse effects of the BBC's public service activities on competition, it is also important that Ofcom's overarching approach to Competition Assessments and Competition Reviews reflects the positive impacts that the BBC can have on competition in a more explicit and systematic way.
- 3.5 Without this explicit acknowledgement, there is a risk that Ofcom's approach focusses exclusively on gathering evidence on the potential negative effects, rather than considering the adverse impact on competition net of any positive impacts.
- 3.6 Although Ofcom's two consultations at several points mention that the BBC can have a positive effect in stimulating demand or encouraging innovation, the potential positive effects are not discussed in any detail. This contrasts with Ofcom's more systematic and detailed discussion of the potential competition concerns that could occur if the BBC crowds out commercial activity and/or if the BBC harms competition elsewhere in the supply chain.
- 3.7 In particular, Ofcom's discussion of the risk of harm gives little recognition to the possibility that the BBC could invest in distinctive content which is a complement to, rather than a substitute for, commercial provision. It also fails to mention that the BBC can have positive supply chain effects<sup>6</sup>.
- 3.8 It is not clear how and where Ofcom will incorporate these positive effects within their proposed analytical framework. In paragraph 5.27 of *Assessing the impact of the BBC's public service activities*, Ofcom discusses a range of additional factors which may be relevant to their assessment, including 'the possibility that a BBC public service activity can increase people's interest in and familiarity with new technology'. Elsewhere in the two consultation documents Ofcom notes other potential positive impacts – such as the BBC's

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<sup>6</sup> The BBC's investment in TV content is an example of a positive supply chain effect. In 2015 the BBC spent £1.2 billion on first run UK originations in nominal terms, to the benefit of upstream programme contributors and external suppliers of programming.

ability to stimulate demand or encourage sector wide innovation. However, Ofcom provides little detail of how such factors will feature in its analysis, e.g. whether Ofcom will consider such factors in its review of public value or whether they will be explicitly incorporated into its competition review.

### **The BBC's relative scale in a changing market context**

- 3.9 Ofcom sets out a 'theory of the BBC's potential harm', covering crowding-out and the risk that the BBC harms competition elsewhere in the supply chain. While the potential risks Ofcom identifies are real, we observe little evidence to suggest that the BBC's publicly-funded services are currently having a significant adverse impact on the level of competition, choice and market entry or expansion in the UK media sector.
- 3.10 It is necessary to consider the market context in which the BBC operates as this will have a direct bearing on the level of future risk. This is characterised by rapidly changing consumption habits, commercial consolidation at different points in the value chain, and the blurring of conventional market definitions.
- 3.11 For example, the market dynamics of TV content supply are changing with the growth of SVOD providers such as Netflix and Amazon. These players are increasingly investing in original content in key genres such as drama, and competing upstream for talent and ideas with established players, and competing downstream for audiences.
- 3.12 Ofcom acknowledged that the BBC's market context is changing in its 2015 *Review of Public Service Broadcasting*: 'The UK's creative sector, and the PSB system, are operating in an increasingly international context. The full effect of the acquisition of UK broadcasters and production companies by international companies, the increasing opportunities for the global exploitation of content and, in particular, the impact of new online players, is not at this stage clear.'
- 3.13 The BBC has a declining market share in many of the areas in which it operates, as those markets are becoming more competitive. Ofcom data shows that the BBC's share of total industry broadcast TV revenues has fallen from 22% in 2010 to 19% in 2015. BBC TV's share of viewing hours has

fallen from 36% in 2004/05 to 32% in 2015/16, with the growth of multi-channel competition. The BBC also operates in many rapidly growing market areas such as VoD, often characterised by strong and disruptive new entrants. BBC iPlayer is now the third largest VoD service in terms of average time spent each week<sup>7</sup>. BBC Online accounts for around 5% of the total time spent online by UK audiences<sup>8</sup>.

### **Certainty of regulatory intervention**

- 3.14 Our third general observation links to the importance of having a regulatory regime which provides clear signals about whether a particular BBC public service activity is likely to be subject to regulatory intervention. Without this clarity, it is harder for the BBC to plan and evolve its services, creating risk aversion and hampering innovation.
- 3.15 There are several areas where the BBC would value further clarity on Ofcom's proposed approach. This would ensure that the BBC is better placed from an operational perspective to understand the regulatory risks it faces. These are discussed in more detail in sections 4 and 5 but two areas, by way of example, are highlighted below.
- 3.16 For instance, the regulatory framework for assessing changes to public service activities hinges on materiality which is, in turn, linked to the rather elastic concept of 'significant impact on fair and effective competition'. (See paragraphs 4.8 to 4.13)
- 3.17 Similarly, Ofcom's proposed framework for assessing the impact of the BBC's public service activities provides little clarity about the circumstances under which it might initiate a BCR. (See paragraphs 5.8 to 5.10).

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<sup>7</sup> Based on average weekly time spent. GfK for the BBC, CMI (all adults 16+, January to December 2016, weekly sample n=500)

<sup>8</sup> comScore MMX Multi- Platform, UK Average Total Minutes, [P] BBC Sites, Jan-May 2015.

## **Focus on competition rather than impact on individual competitors**

- 3.18 Ofcom's discussion of the potential competition concerns posed by the BBC's public service activities discusses both the short term 'static' impacts (e.g. impacts on commercial revenues and profitability) and the longer term 'dynamic impacts' of the BBC public service activities (e.g. the consequences of reductions in commercial revenues and profitability on incentives to innovate or exit from the market). These longer term effects are critical in understanding the potential impacts of BBC public service activity on fair and effective competition. However, this emphasis on longer term impacts is not mirrored in Ofcom's discussion of its proposed analytical approach to BCAs and BCRs.
- 3.19 While identifying and quantifying the longer term impacts of a BBC public service activity on competition is not straightforward, Ofcom's guidance should, in our view, emphasise that its analysis will focus on impacts on the process of competition as well as shorter term impacts on the revenues of individual competitors. Highlighting this will provide further detail on what is meant by the concept of 'fair and effective competition'.
- 3.20 This approach would also signal to third parties inputting to Ofcom assessments that that they will need to provide evidence to demonstrate that the BBC's public service activity has had an adverse impact on their ability and incentives to compete by, for example, driving up their costs to levels where it may cause them to scale back or exit the market.

## 4 Assessing the impact of proposed changes to the BBC's public service activities

- 4.1 This section considers points raised by Ofcom's proposed procedures and guidance when assessing changes to the BBC's UK public service activities. It also comments on aspects of Ofcom's proposed analytical approach to undertaking BCAs.

### Materiality assessments

- 4.2 The Framework Agreement requires that material changes to services should be subject to dual scrutiny by the BBC Board and Ofcom. It defines a material change as the carrying out of any activity as a new UK Public Service or any change to public service activities which may have a significant adverse impact on competition. The BBC Board will be required, in the first instance, to assess whether a potential change is material, in order to determine whether a Public Interest Test is required. Ofcom will also need to consider whether a change proposed by the BBC is material and, if so, determine whether the change can proceed.
- 4.3 Ofcom's statement that many of the BBC's decisions are part of its day-to-day business and, as such, are not 'material' from a regulatory perspective (i.e. as defined by the Framework Agreement), is positive (paragraph 4.10).
- 4.4 The BBC continuously makes changes to improve its public services, for editorial, creative or other reasons. This is necessary to ensure the services evolve in line with audience expectations and technology developments, and are, therefore, able to effectively fulfil the BBC's Charter-defined mission and purposes.
- 4.5 The BBC agrees with Ofcom that it would be useful for the BBC's policy<sup>9</sup> - to be published in due course - to describe the types of public service changes

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<sup>9</sup> The Framework Agreement requires the BBC to publish a policy setting out how it will consider material changes to BBC public service activities. See clauses 7(5) and 16 (6) of the Framework Agreement for detail.

which fall into this category. This will provide clarity to the BBC, audiences and the market.

*Approach to identifying material changes*

- 4.6 The BBC's policy will also include further information on how the BBC will assess whether a proposed change is material.
- 4.7 For the purposes of simplicity and efficiency, we recommend that Ofcom and the BBC should adopt, as far as possible, the same approach to assessing materiality including the factors used<sup>10</sup>. The materiality 'threshold' should be set at an appropriate and proportionate level to ensure that only those changes which may have significant adverse effects on fair and effective competition are subject to detailed and resource intensive assessments.
- 4.8 We note the factors that Ofcom suggests it will take into account in its materiality assessment (listed in paragraph 4.33) and those that it suggests the BBC should take into account (listed in paragraph 4.9 in Ofcom's consultation paper). We broadly agree with these; an important factor to consider should be the BBC's share of supply (or some other metric indicating the BBC's relative position, such as its share of revenues) and the likely impact of the proposed change on it. This should be considered alongside a high-level and forward-looking assessment of the competitive conditions at play<sup>11</sup> (for example, demand growth, ease of entry/expansion and switching costs) and the extent to which the BBC activity is a substitute for commercial activity. The market context in which the BBC operates will have a direct bearing on judgements about whether a proposal is likely to have a significant impact on fair and effective competition.
- 4.9 In addition, we would ask Ofcom to re-consider some of the elements of its proposed approach to materiality assessments, as outlined in paragraphs 4.32 to 4.34 of the consultation paper.

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<sup>10</sup> While Ofcom and the BBC might take the same analytical approach they may, of course, reach different conclusions.

<sup>11</sup> The BBC agrees with Ofcom that it would not be appropriate to undertake a formal approach to market definition. But it is nevertheless desirable to consider the scale of the BBC's proposed change, and the likely usage resulting from that change, in relative rather than in absolute terms.



- 4.10 Ofcom's suggested factors include 'the indication of a possible adverse impact on fair and effective competition' (first bullet on page 19). Given that the Framework Agreement defines a material change as one which may have a significant adverse impact on fair and effective competition, this appears to suggest a lower bar for the assessment of materiality. We suggest that Ofcom's final guidance is amended to capture 'potential *significant* adverse impact on fair and effective competition' rather than 'possible adverse impact'.
- 4.11 Ofcom states it will also consider 'how similar the BBC proposal is to commercial offerings that currently exist'. The BBC agrees that the extent to which the BBC's public service activities are a substitute for commercially provided offerings is relevant for understanding the extent to which the BBC may crowd-out commercial activity. However, the BBC can have a positive impact on competition by stimulating demand. In light of this, Ofcom should take into account, not only how similar the BBC proposed change is to commercial offerings but also whether the proposal is complementary to existing offerings<sup>12</sup>.
- 4.12 Lastly, Ofcom states it will also take into account how similar the BBC proposal is to commercial offerings that 'may emerge'. Given the difficulty in anticipating how commercial services might evolve over time, we recommend future services should be taken into account only where there is reliable evidence that these are likely to emerge.

### **Information from third parties**

- 4.13 Under the Agreement, when the BBC undertakes a Public Interest Test, it will be required to consult with interested parties where appropriate<sup>13</sup>.

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<sup>12</sup> BBC micro:bit is a good example of where the BBC has had a positive impact in both promoting wider supply chain benefits and stimulating demand for complementary products. BBC micro:bit is a small programmable device developed by the BBC in partnership with over 20 formal partners and was distributed to all year 7 pupils during the 2015/16 academic year on a one off basis. The partners were selected from across the value chain. BBC micro:bit has successfully stimulated interest in small code-able devices. While there are other products available which were similar to BBC micro:bit, the device was specifically targeted at a younger age range than other products to act as a 'taster' for more complex ones aimed at an older age bracket.

<sup>13</sup> The BBC's policy on how it will consider material changes to its public service activities requires the BBC to consult with interested persons where appropriate. See clauses 7(5) and 16 (6) of the Framework Agreement.

Consulting with stakeholders can help the BBC to identify how the proposed change could affect competition. The BBC will endeavour to provide stakeholders with sufficient information to ensure that they can comment meaningfully on proposed material changes. However, it must be recognised that stakeholders may be unwilling to share confidential information with the BBC for a variety of reasons (and indeed may feel constrained in doing so by competition law - for example, where information about future market strategy is at issue).

- 4.14 In light of this, Ofcom should have realistic expectations about the BBC's ability to develop its proposals to mitigate competition concerns in the absence of evidence from stakeholders. In that regard, recognition that 'the BBC can only address concerns that have been raised with it' (paragraph 4.17) is helpful. Ofcom may want to highlight the importance of interested third parties engaging constructively with the BBC at this stage and where possible making use of arrangements such as non-disclosure agreements.

### **Inclusion of a 'pre-notification' stage**

- 4.15 The consultation paper places considerable emphasis on Ofcom having sufficient information from the BBC to make a materiality assessment of a change proposal (see paragraph 4.24 to 4.28).
- 4.16 In recognition of this, we recommend that Ofcom includes a 'pre-notification stage' in its timetable after the BBC has announced it will be undertaking a Public Interest Test. During this pre-notification period, before the BBC starts its analysis to inform the Public Interest Test, the BBC and Ofcom could agree, for example, the baseline and counterfactual for the assessment and the research approach.
- 4.17 This would minimise the risk that the BBC would have to repeat elements of its analysis because Ofcom had concerns about the BBC's approach taken in market research or has a fundamentally different view<sup>14</sup> of what the

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<sup>14</sup> We are not advocating that every aspect of the counterfactual needs to be agreed in advance with Ofcom. However, a key objective of agreeing the counterfactual with Ofcom before starting analysis would be to eliminate the risk of any substantial diversion of views about how the world might evolve in the absence of the BBC taking forward its proposal.

appropriate counterfactual should be. Furthermore, including this stage may, in the long run, minimise the possibility of delay to Ofcom's timetable because it has insufficient information to conduct its competition assessment.

### **Assessment of non-service activities**

- 4.18 The Framework Agreement states that the BBC may carry out non-service activities and historically these have often involved the BBC working in partnership with third parties.
- 4.19 Partnership will be an important area of activity for the BBC in the light of the new duty set out in Article 13 of the Charter. However, Ofcom's discussion of how it intends to consider non-service activities is limited<sup>15</sup>. We would argue that Ofcom's regulatory role should only apply to the BBC's activity and not extend to that of the BBC's partners.
- 4.20 For example, if the BBC were to launch a new TV platform as part of a joint venture, Ofcom's competition assessment should focus on the impact of the BBC's involvement in the platform joint venture rather than the impact of the platform joint venture in the round. Further guidance on this point would be helpful in minimising uncertainty both for the BBC and its partners.

### **Information on timescales for launch**

- 4.21 The BBC understands the importance of not making changes to a proposal once Ofcom has started its competition assessment. It also understands that it is helpful for Ofcom to have information on when the BBC is proposing to implement any changes to its public service activities (see para 4.25), given that many of the markets that the BBC operates in are undergoing rapid change.
- 4.22 However, it is not always possible for the BBC to predict when it will launch its proposals – particularly where launch dates are dependent upon, for example, technical or other issues which are not entirely within the BBC's

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<sup>15</sup> Ofcom, *Assessing the impact of proposed changes to the BBC's public service activities*, December 2016, footnote 42

control. For example, the timing of the closure of BBC Three as a broadcast channel was dependent on a range of factors including contractual obligations to provide sufficient notice to TV platform providers, lead times required to develop a marketing campaign to inform audiences of the channel closure and commissioning lead times to develop online content for the replacement BBC Three Online service

- 4.23 Ofcom's guidance should recognise these uncertainties when requiring the BBC to provide information on the broad timescales for implementation.

### **Timescales for completing Ofcom's assessment**

- 4.24 A key criticism of the previous regulatory framework for assessing changes to the BBC's public services was the length of time it took to complete them and the uncertainty this created.<sup>16</sup>

- 4.25 The fact that Ofcom may suggest modifications to the BBC's proposal to address concerns about impacts on fair and effective competition, which may, in turn, require the BBC to revisit its analysis of public value (see paragraph 4.65) could prolong the timescale for the new regulatory assessments well beyond the expected six month timeframe. In this instance, we recommend that Ofcom commits to fast-track its subsequent assessment.

### **Ofcom's proposed analytical approach**

- 4.26 Section 5 of Ofcom's consultation paper provides guidance on Ofcom's proposed analytical approach to competition assessments. The BBC has a number of observations on Ofcom's proposed approach.

#### *Forecast period for the Public Interest Test*

- 4.27 As the Public Interest Test is a forward looking assessment, the BBC will predict usage of its services and will consider how affected markets might

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<sup>16</sup> DCMS, *A BBC for the future: a broadcaster of distinction*, May 2016, p57

change over time<sup>17</sup>. Our preference would be to undertake forecasts on a three yearly basis. This would align with the BBC's timelines for budgeting and planning. It also reflects the inherent difficulties in making forecasts in markets that are undergoing rapid change. However, the BBC may under certain circumstances forecast beyond a three year period, for example, where there is some uncertainty in launch timing or where it may take some time for usage of the service to reach a steady-state point.

#### *Identifying static and dynamic impacts*

4.28 Ofcom states that in its BCAs it will consider, among other things, impacts on take up of third party services, commercial revenues and profitability. We note that while it may be relatively straight forward to estimate the likely impact of a BBC proposal on third party take up, calculating how changes in usage of commercial services translate into changes in commercial revenues and profitability is less straightforward. For example, changes in viewing of competitor TV services will require Ofcom to make assumptions about the relationship between TV viewing and TV advertising and subscription revenues. Understanding the impact on profitability may require Ofcom to also gather information on, or make some assumptions about, competitors' costs and how these might change over time and in response to changes in output.

4.29 In addition, as argued above, the focus of Ofcom's analysis should be on competition rather than individual competitors. If theoretically a BBC proposal has an adverse impact on the revenues and profitability of the BBC's closest rival but ultimately the change does not impact on their ability to compete<sup>18</sup>, then this should not pose a cause for concern.

#### *Ofcom's review of public value*

4.30 We note that Ofcom intends to review the BBC's assessment of public value and is unlikely to conduct its own original research (paragraph 5.22). This

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<sup>17</sup> Given the inherent difficulties in forecasting take-up and competitor impacts, it is likely that our forecasts will be assumption-driven for analytical purposes rather than precise estimates. We will, of course, explain our choice of assumptions and consider modelling different scenarios if appropriate.

<sup>18</sup> By driving up their costs (because of a reduction in scale) thus diminishing its incentives to innovate or causing it to exit the market entirely

approach is consistent with the requirements in the Framework Agreement where the BBC Board is tasked with taking the lead role on assessing the public value of the proposals<sup>19</sup>. The BBC's assessment will focus on the additional, or change in, public value associated with the proposal net of the costs to licence fee payers of providing the service. Its measurement of public value will take into account: the contribution of the proposal to the fulfilment of the BBC's mission and public purposes, estimates of usage, audience benefits, and wider cultural and social benefits.

- 4.31 The BBC's policy on material changes will set out further detail on how it intends to measure the public value of proposals.

## **5 Assessing the impact of the BBC's public service activities**

- 5.1 This section of the response raises points concerning the guidelines and procedures Ofcom is proposing to adopt when undertaking BCRs. This section also makes observations about Ofcom's proposed analytical approach.

### **Baseline for BBC Competition Reviews**

- 5.2 Ofcom's BCRs will provide a vehicle for Ofcom to examine existing BBC public service activities where incremental changes over time raise competition concerns.
- 5.3 The BBC welcomes Ofcom's confirmation (para 3.4) that it is not intending to look at the day-to-day business decisions made by the BBC or to revisit specific issues settled in the Charter process, or that it will look to question the remit of the BBC as settled in the Charter and Agreement.
- 5.4 Nevertheless, that leaves a range of issues which potentially remain within scope of BCRs. This has two potential consequences. First, it creates regulatory uncertainty, making it difficult for the BBC to plan and encourages

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<sup>19</sup> See article 20 (4) of the BBC Charter

risk-aversion. Second, Ofcom may find that this encourages third parties to 'game the system' by trying to instigate a BCR despite the fact that Ofcom has put in place a number of requirements (set out in para 4.4) to discourage them from doing so.

- 5.5 While the BBC accepts that there may sometimes be a need for Ofcom to consider the cumulative impact of incremental changes, Ofcom should not reconsider changes which have already been subject to ex ante regulatory scrutiny by the Trust as this raises the risk of 'double jeopardy'. Ofcom rightly highlights that when deciding whether to carry out a BCR, it will want to consider whether its resources could be better deployed elsewhere (paragraph 4.11). This might be an example of where that consideration would be relevant given the resource that would already have been expended by both the BBC and the Trust in the original assessment process.
- 5.6 Secondly, the BBC believes that it would be inappropriate for Ofcom to instigate a BCR in response to changing market conditions where there have been no incremental changes to the BBC's provision. The BBC should not be penalised for external factors beyond its control. If the source of competition concerns in a particular market is external to the BBC, then it is very hard to see how modifications to BBC services would mitigate those concerns.

### **Proposed timetable for conducting a review**

- 5.7 While we appreciate that BCRs are intended to be more flexible tools than BCAs, the BBC is nevertheless concerned that Ofcom has not provided any definitive guidance on how long these reviews might last. This creates uncertainty for the BBC, its partners and audiences.

### **Ofcom's proposed analytical approach**

#### *Threshold for BCRs*

- 5.8 It is important that the proposed analytical approach for BCRs fully reflects the position reached in the Agreement (clause 12), and also the respective roles of Ofcom and the BBC Board in relation to governing and regulating the BBC.

- 5.9 The Agreement is clear that Ofcom may undertake a competition review of a UK public service where there are reasonable grounds to believe it is having a significant adverse impact on fair and effective competition. If Ofcom then, during the initial stage of the review, finds actual evidence that there is significant adverse impact on fair and effective competition, then it must assess whether the public value of the service, or parts of it, justifies the adverse impact on fair and effective competition<sup>20</sup>. In other words, the Agreement suggests that Ofcom's assessment of whether a BBC public service is having an adverse impact on competition and whether that impact is justified by public value of the service are sequential steps.
- 5.10 To ensure consistency with the Agreement, we recommend that Ofcom amends the wording of paragraph 4.27 to make clearer that this is the sequence that will be followed in a BCR.

*Use of alternative scenarios*

- 5.11 The identification by Ofcom of 'alternative scenarios' or service modifications, as described in paragraph 5.3 (for example, the removal or reduction of a particular activity), should follow the above sequential steps, i.e. where Ofcom has established that a service, or parts of a service, are having an adverse competitive impact that is not justified by the public value. There is then a question about the nature of the 'alternative scenarios' or modifications to the service. Under clause 12 (5), Ofcom can require a modification to the service – or impose conditions - to address the competition concern. However, the modifications would require considerable input from the BBC to establish their likely public value and financial implications, and to ensure, as far as possible, that they would be consistent with the BBC's strategic and creative objectives. For example, if Ofcom wanted to examine the impact of reducing the volume of a particular genre of content on a service, it would also need to understand the options for the replacement content and the implications.

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<sup>20</sup> See clause 12 of the Framework Agreement



*Treatment of costs*

- 5.12 The BBC agrees that a BCR might have to take into account the costs of an activity if these are regarded as the source of a competitive impact (para 5.27). However, references to lowering the licence fee are not appropriate. In the event that the BBC was required to scale back a service as a result of a BCR, the BBC Board would retain discretion about how to reallocate the money saved.