

10 February 2017

Consultations on preparing for regulation of the BBC

Thank you for our recent meeting and the constructive discussion on Ofcom's preparations for regulation of the BBC, including the consultations published to date. We appreciated your confirmation that the matters raised would be given consideration.

Subsequent comments from members have re-iterated the issues discussed. They have stressed the problems posed by the BBC's public service and commercial activities. They have emphasised the importance of setting, monitoring and enforcing restrictions upon the BBC's activities and operations. They have underlined the importance of Ofcom's powers and willingness to act upon its own initiative, to investigate approaches and complaints raising valid concerns, despite the difficulties of providing the supporting evidence specified at the time of the approach, and to take effective action.

I thought that you might find helpful a selection of the comments received since our meeting. I am happy for you to pass these on to those dealing with the relevant sections of the consultations.

In relation to BBC competition assessments and reviews, there was concern that Ofcom should not set too high a bar on its initiation of BBC competition assessments and reviews. Ofcom ought not allow more minor complaints handling and public interest analysis to be conducted under the supervision of the new BBC Board, without effective oversight and intervention.

In respect of the BBC's commercial activities, the consultative draft at 1.22 asks complainants to demonstrate how the BBC's arrangements are outside of market norms and in particular how they are likely to impact UK competition. This gives rise to concerns as to the degree to which information is actually available in the market, so as to enable complainants to demonstrate that the arrangements are outside the norm, as the draft requests. Members welcome Ofcom's intention to compel the BBC to publish the methodology by which transfer prices are calculated. However, they point out that the prices themselves will not be published.

Members noted Ofcom's intention, as set out in 1.25 *'to undertake work early in the new Charter period to develop its understanding of the processes and practices around the operation of the BBC's commercial subsidiaries and their relationship with the Public Service. For example, we expect to look in detail at the BBC's transfer pricing arrangements and the specific nature of the range of different commercial activities that sit with in the BBC's commercial subsidiaries including the BBC's identification of individual lines of business for the purpose of setting a commercial rate of return'*.

They welcome Ofcom's prioritisation of this work.

Members were highly critical of the BBC Trust's report on transfer pricing, published in October 2016. They felt it illustrated the problems inherent in the past governance system, where it was left to the BBC Trust and BBC Executive to address the concerns raised by the independent review

conducted by Ernst & Young. They hope that Ofcom will not simply endorse the response of the BBC Trust and the BBC Executive to that report, but consider the issues of concern identified by the review, its recommendations and issues outside its remit, including examination of the BBC's arrangements' compliance with State Aid and competition law. These include transfer pricing and compliance with the law on State Aid and competition, regular review of contractual and pricing arrangements between the BBC and its commercial subsidiaries, for example the GNL brand agreement, transfer pricing in relation to GNL programming. They also welcome Ofcom's intention to require the BBC to publish the methodologies it uses to establish transfer prices and for valuing the BBC brands. They consider that consistent monitoring of the BBC's performance against targets is an important step, helping to ensure compliance with rules on state aid.

Members note Ofcom's view at 3.29 that the BBC Public Service should make goods and services supplied to its commercial subsidiaries available to the wider market on equivalent terms and prices. They stress that this should apply to the BBC archive and that its video archive should no longer be exclusively supplied to the BBC's commercial subsidiaries on terms unavailable to its commercial rivals.

In assessing commercial rate of return (3.42), members note that Ofcom would allow the BBC 'to demonstrate the business plan for how low returns on one activity supported higher returns elsewhere.' Members are concerned that this could give rise to a very wide interpretation in practice. The BBC's funding structure enables it to sustain losses that would not be acceptable in a genuine commercial enterprise. The BBC might seek to argue that losses made by news services are counterbalanced by the BBC's general contribution to the UK's reputation abroad, or its enhancement of the broader consumer view of the BBC itself. Members ask whether Ofcom would counter the prospect of the BBC using news as the trusted entry point to sell the same users other BBC services; or whether Ofcom might consider this a suitable justification for the BBC's continued investment in a commercial news service.

Members hope that the BBC will be open to and respond to partnership approaches from third parties, rather than confine itself to partners identified by its own Fair Trading unit or otherwise.

In assessing the impact of the BBC'S Public service activities, members have particularly welcomed Ofcom's recognition at 3.12 that the BBC's presence may also mean that people are less willing to pay for media services and have a reduced tolerance for advertisements, further reducing potential revenue. The NMA has highlighted the need for internal and external restraints upon the BBC and proper appreciation of its adverse impact upon the commercial news media, local, regional, national and international. Members describe how it can affect substantial strategic decisions for commercial organisations, on anything from entry and development of nascent markets, to their approach to ad blocking, or to their relationship with large dominant platforms.

I hope that this is helpful.

Yours sincerely,

News Media Association