

BY EMAIL AND POST

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Date 14 April 2004

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Dear Kate

BBC Charter Review

I am writing in response to your letter of 17 December 2003, inviting the OFT's comments on the DCMS document *Review of the BBC's Royal Charter* (the 'Consultation Paper'). I would like to thank the DCMS for agreeing to provide additional time for our response.

Summary

This letter provides an outline of the OFT's public position, as an independent competition enforcement body, on those issues raised by the Consultation Paper that fall within its remit.¹ Please note, however, that the letter sets out the views of OFT officials, rather than that of the OFT Board.

After summarising the manner in which the current UK competition regime applies to the BBC,² and the OFT's understanding of the specific competition controls that apply to the BBC only, the letter sets out some suggested changes to the current regulatory regime.

General Principles

It is generally acknowledged that the BBC distorts competition by its very existence. This simply reflects the economic reality that intervention on a market by a state owned entity, providing a service which is free at the point of delivery and is funded by a general licence fee, is likely to lead to other suppliers and consumers on that market behaving differently from how they would otherwise behave, were such intervention not to occur.

We note that the degree to which the BBC is permitted to intervene in the marketplace is a policy decision, based on a value judgment as to the type and range of broadcasting that should be accessible by consumers. As a competition authority, we are concerned to ensure

- ¹ These issues are touched on by the following "key questions" in the Consultation Paper: 2 and 3 on page 17 and question 1 on page 25.
- ² The application of the EC's state aid rules to the BBC is therefore excluded from this letter.



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that such a decision, presupposing as it does that no other body could provide an equivalent service, is: (i) based on objective evidence; and (ii) effectively enforced, to ensure that the adverse effect on competition does not go beyond what was originally foreseen when the policy decision was made.

General Competition Law

Competition Act 1998

The Competition Act 1998 ('CA98') prohibits the following conduct by undertakings where it has an effect on UK markets:

- agreements which have the object or effect of preventing, restricting or distorting competition (the Chapter I prohibition); and
- the abuse of a dominant market position (the Chapter II prohibition).³

The activities of undertakings entrusted with providing services of general economic interest are excluded from the CA98 prohibitions if their application would obstruct provision of those services and provided that there is no less restrictive way of providing the same service.

From this it may be seen that, in order for the BBC's conduct to be subject to the CA98, it must:

- (i) be acting as an undertaking; and
- (ii) (a) have entered into an anticompetitive agreement; or
(b) be abusing a dominant market position; and
- (iii) not be providing a service of general economic interest or, if it is, it must be providing it in a way that is more restrictive of competition than any alternative way of delivering the same service.

Although these tests ensure that certain conduct of the BBC is subject to general competition law, the following points should be noted:

- (i) There is no problem in principle in applying the Chapter I prohibition to agreements entered into by the BBC and a third party. However, much of the concern over the BBC's actions arises from its unilateral conduct, which falls outside the scope of the Chapter I prohibition. Agreements between different entities under the BBC's sole control will generally be viewed as being between parts of the same undertaking. As a result, these will also fall outside the Chapter I prohibitions.
- (ii) Where the Chapter I prohibition does not apply, the BBC's conduct will only be caught by the CA98 if the Chapter II prohibition is engaged, which requires there to be market dominance, coupled with an abuse. Dominance is generally defined as the ability to prevent effective competition by having "the power to behave to an appreciable extent independently of ... competitors, customers and ultimately ... consumers".⁴ In "normal" economic markets, this power will tend to exist only where an undertaking's market share exceeds 40%. The BBC's share of UK markets is often just below this level. Any finding of dominance where the BBC's

³ These prohibitions mirror Articles 81 and 82 EC Treaty, respectively, which the OFT will be able to enforce from 1 May 2004 where conduct affects trade between EC Member States. As a result, references in this letter to the Chapter I and/or Chapter II prohibitions should be read as potentially including Articles 81 and/or 82 EC Treaty, respectively, from 1 May.

⁴ *United Brands v. Commission*, Case 27/76 [1978] ECR 207.

market share is less than 40% would have to be based on arguments that the nature of the market concerned and the BBC's unique position, in terms of its funding (i.e. its guaranteed licence fee income) and possibly its regulatory status, enable it to behave independently of normal competitive constraints and that it is therefore dominant, notwithstanding its market share.

- (iii) In addition, infringement of the Chapter II prohibition requires that the BBC's conduct be abusive. There is no generally applicable definition for what constitutes an abuse and the boundary between legitimate and abusive conduct may be narrow in individual cases. In general, however, it may be said that conduct by a dominant company is abusive where it seriously *and unjustifiably* distorts competition, or leads to a weakening of competition, on a relevant market.⁵ Whilst, as noted above, the conduct of the BBC will often necessarily distort competition on a market, the question of whether this is justified is inextricably linked to the regime within which the BBC is authorised to act in a certain way. Thus, for example, the OFT took the view that provision of the BBC's Digital Curriculum service, free at the point of use, was unlikely in itself to be abusive within the meaning of the Chapter II prohibition, given that it had been duly authorised by the Secretary of State, under the BBC's Charter.⁶

Enterprise Act 2002

The OFT has powers under the Enterprise Act 2002 ('EA02') to refer a UK market to the Competition Commission for a market investigation where it suspects that a feature of the market prevents, restricts or distorts competition. A 'feature' is defined as the structure of a market (including any aspect of the structure), or conduct by one or more supplier, acquirer or consumer. Ofcom has a similar power to make a reference in so far as the feature concerned relates to commercial activities connected with communications matters.⁷ Following such a reference, the Competition Commission has extensive powers to order remedial action to address the adverse effect on competition.

As a matter of policy, the OFT would probably need evidence that structural features of a relevant market, which can include government regulation, conferred market power on the BBC before taking action against it under the EA02, rather than the CA98.⁸

BBC-Specific Controls

Other than general competition law (whether UK or EC) and EC state aid rules, the only express constraints on the BBC's competitive conduct are contained in its Royal Charter and related documents. Under Article 7(1)(b) of the Royal Charter, the BBC's Governors must "satisfy themselves that all activities of the Corporation are carried out ... in accordance with the Corporation's fair trading commitments". We understand from the public documents produced by the BBC that it interprets this provision as placing obligations on how it operates its commercial services only.

⁵ See Bellamy & Child, *European Community Law of Competition*, para. 9-066.

⁶ See OFT publication: *Competition case closure summaries, April to June 2003*, p.6, published with the OFT Weekly Bulletin for the week beginning 28 June 2003, available at <http://www.of.gov.uk/News/Weekly+Gazette/2003/28+June+-+4+July+2003.htm>.

⁷ See section 370(2) Communications Act 2003.

⁸ See OFT Guideline 511 *Market Investigation References*, at paragraph 6.19.

Commercial Services

In accordance with its Charter, the BBC has published a document entitled *The BBC's Fair Trading Commitment*. This document explains that the BBC's fair trading commitment has three main features, namely:

- clear criteria for all *commercial activities*, including compliance with legal and regulatory requirements;
- fair competition (by the BBC's commercial activities) in all markets; and
- no risk to licence payers.

The document also cross-refers to the BBC's separate *Commercial Policy Guidelines* which, it states, "are designed to ensure that [the BBC's] *commercial activities* are consistent with [its] overall programming purpose, conducted in a transparent manner and do not involve cross-subsidies from public funds" (emphasis added). The *Commercial Policy Guidelines* provide more detail by setting out six "key Fair Trading principles which govern BBC commercial activities" (essentially, these comprise the actual Fair Trading Commitment), namely:

- commercial activities should comply with clear criteria of what is appropriate for the BBC as a public service broadcaster;
- there should be clear separation between publicly-funded and commercial activities in terms of their operation and accounting;
- commercial subsidiaries or operations must pay fair charges for any goods or services received from the BBC;
- prices charged by commercial activities to their customers should be a fair reflection of both costs incurred and market practice;
- no public funds must be used, or put at risk, by commercial activities; and
- the BBC's publicly-funded services may not be used unfairly to promote BBC commercial goods and services.

The above framework, highlights two key issues:

- the rules only apply to the operation of the BBC's *commercial services* – public services are excluded; and
- they are quite narrow in scope, being aimed at regulating the relationship between commercial and public services to ensure that the BBC complies with general competition law, state aid rules and Article 7(g) of the BBC's Charter, rather than placing wider constraints on the BBC's behaviour.

To the extent that the fair trading commitment expresses a desire by the BBC to comply with general competition law, this may be viewed as reflecting a laudable goal, shared by most large companies, to be a good corporate citizen by complying with the laws of the land. As such, it is an internal commitment and does not in itself impose any obligation on the BBC that goes beyond general competition law.⁹ It is also arguable that Article 7(g) of the Charter, although it imposes an additional, strict requirement on the BBC to fund commercial and public

⁹ Paragraph 4.12 of the Whish Report (see note 10 below) notes that it is misleading for the Guidelines to suggest that the BBC is subject to competition law because of the fair trading commitment. Rather, the fair trading commitment sets out principles to help ensure that the BBC does not breach that law.

services separately, simply buttresses the requirements of general competition and state aid rules, rather than imposing an additional, more stringent, requirement on the BBC.

The fair trading commitment sets out a workable framework for avoiding the anticompetitive effects that could arise from the BBC entering into commercial activities. This conclusion was reached by Professor Richard Whish, who reported to the DCMS on the BBC's fair trading commitment in 2001.¹⁰ Professor Whish concluded that "*the Fair Trading Commitment and the Guidelines are appropriate to ensure that the BBC does not distort competition in commercial markets*" and "*adequately address the fair trading issues that are relevant to the BBC*".¹¹ It is important to note, however, that, as Professor Whish put it, "*the crucial issue is whether the BBC has implemented and will continue to implement an adequate compliance policy to ensure that infringements of the competition rules do not take place*".¹² This issue was outside the remit of Professor Whish's review.

Public services

As far as the BBC's public services are concerned, the only scope for competition regulation, over and above general competition and state aid law, arises from the process by which the Secretary of State gives her consent to the creation or alteration of such services. For example, the conditions on which consent for the BBC's Digital Curriculum service was granted appear to reflect a desire by the Secretary of State to limit the service's adverse impact on competition. There is currently no formal, public role for competition authorities (whether the OFT or Ofcom) in the approval process for new services.

Although the position is not entirely clear, it appears from the Charter that the need for such prior consent only arises for Commercial Services and so-called Ancillary Services (e.g. BBC Online). Home Services and the World Service are permitted by the Charter itself, without further consent requirements being imposed. Presumably, therefore, the question of control over those services only arises on Charter renewal.

Conclusions and Suggestions for Reform

From the above it may be seen that:

- although general competition law applies to the BBC's activities, it may not enable competition authorities to examine some conduct that may harm competition;
- the BBC's own fair trading rules are concerned with operation of its commercial services only; and
- the BBC's public services are either provided outside any direct economic oversight (Home Services, World Service) or are subject to a consent regime in which the impact of the service on competition may be taken into account yet competition authorities have no formal, public role.

Scope for Additional Regulation

In this context, the Secretary of State may wish to consider ways in which Ofcom, as the competent independent competition authority for the communications sector, could be given powers to impose specific competition controls on the BBC, to reflect the BBC's unique

¹⁰ *Review of the BBC's Fair Trading Commitment and Commercial Policy Guidelines*, April 2001. Please note that, although Professor Whish is now a member of the OFT Board, he has not been involved in the preparation of this letter.

¹¹ *Ibid.*, paragraph 2.1.

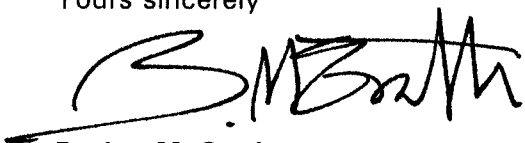
¹² *Ibid.*, paragraph 2.2; see also paragraph 3.2.

position in the UK broadcasting sector. Whilst it is beyond the scope of this letter to set out how far such controls would extend, we would suggest that they should at least aim at providing truly independent monitoring of the impact of the BBC's activities on competition, backed by appropriate information gathering powers, and *ex ante* enforcement powers, should the BBC act outside the scope of applicable rules (for example, on due separation between the BBC's publicly funded and commercial activities or cross promotion of services).

Ofcom could also be given a formal, public role on advising the Secretary of State on the merit of applications by the BBC for new service consents and the likely economic impact of such services, within a recognised analytical framework, combined with *ex post* powers to enable it to ensure compliance with consents, once granted. Taken together, this should help ensure that the interests of consumers in fair, competitive markets, in which the scope of the BBC's activities were clearly defined, were explicitly recognised in the approvals process and protected once a new service is operational.

I trust that the above comments are helpful for the purposes of your review.

Yours sincerely

A handwritten signature in black ink, appearing to read 'B. McGrath', written over a horizontal line.

Becket McGrath
Director, CE4
Media, Sport and Information Industries