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March 5, 2001

Paul Heron Esq, OBE
Head of Public Service Broadcasting Branch
Department for Culture, Media and Sport
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Dear Paul

CONSULTATION ON NEW BBC SERVICES

Further to my email, I enclose our response to the consultation exercise on new BBC services.

We are concerned about the possible impact of the BBC's proposals on competition. In particular we are concerned that the BBC is refusing to recognise that programmes commissioned from independent producers have a secondary value in the UK market, and that their current terms of trade undermine that secondary value. PACT complained to the OFT last year about the terms of trade for the BBC's digital side channels, but the OFT has yet to progress the case.

We believe that competition concerns about the BBC's new services are so widespread that the Secretary of State should refer the matter to the OFT before giving his approval.

Please let me know if you need any further clarification of PACT's position.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Kris Jones', written over a vertical line.

KRIS JONES
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Producers Alliance for Cinema and Television

Response to consultation on new BBC services

March 2001

NEW BBC SERVICES

INTRODUCTION

1. PACT appreciates the opportunity to comment on the BBC's proposals to launch new digital services. Our comments are confined to the television proposals, as we have no locus in respect of radio. We have not previously made any representations regarding these services and did not respond to the BBC's consultation as this exercise seemed to be specifically designed to obtain the approval of viewers and listeners rather than those of others in the broadcasting industry. The separate DCMS consultation for the broadcasting industry is therefore most welcome.
2. We are glad that the BBC intends to boost programme investment for its traditional channels (BBC1 and BBC2) and its proposed new digital television services. This, coupled with the BBC's obligation to obtain a minimum of 25% of its qualifying programmes from independent producers, represents further opportunities to make programmes for PACT members. Nevertheless, we are concerned that the BBC's proposals could have an adverse effect on competition in the broadcasting industry, both for other television channels and independent producers. Clearly we would not want the BBC's investment in new channels to curtail investment by the commercial sector in programming. However, at the heart of our concern is the current BBC practice of not paying producers commissioned under its so-called "fully-funded commission" model, for the right to re-transmit their programmes on its digital services. This means that the BBC's digital side channels can obtain programmes at minimal cost, giving them a competitive advantage over other channels. It also means that producers are largely deprived of the opportunity of earning additional revenues from sales in the UK secondary market. We consider these arrangements to be anti-competitive and an abuse of the BBC's dominant position in the market. PACT lodged a formal complaint with the Office of Fair Trading (OFT) concerning the terms of trade for digital side channels early in March 2000. Unfortunately the OFT has yet to progress its investigation beyond making some further enquiries of PACT in September last year.
3. It would appear from an examination of the BBC's proposed budgets for its new channels, coupled with its ambitions, that it intends to continue operating its current iniquitous terms of trade, to the detriment of our members. For example, it is hard to imagine that the BBC would be able to manage to provide 70% of UK-produced content, with 70% of it new content, for its proposed new BBC 4 on a budget of £31 million in its first full year of operation. Even allowing for the number of broadcast hours, high levels of repeats and sharing programmes between channels, this suggests independent producers will not receive any revenue for repeat transmissions. This undermines their ability to invest in the development of new programme ideas, to the detriment of the British content sector as a whole.

4. DCMS will be aware of the concerns of other channel operators about the potential impact of the BBC's new services on competition. We too, have significant concerns and would therefore urge that the potential impact of the BBC's new services on competition is properly assessed. We therefore consider that the Secretary of State should refer the matter to the OFT for full investigation before giving his approval.

THE PROPOSALS

5. In our submission to the ITC on public service broadcasting last year, PACT argued that "market failure" had not been a defining characteristic of public service broadcasting thus far. However, we felt that addressing market failure should be role of any new public services. The BBC have tried hard to shape their proposals so that it appears they will be distinctive and offer an alternative to other services in the market. Nevertheless, we question whether they will in fact add to the richness of programmes available to viewers. For example, BBC 3 is aimed at 16 to 34 year olds. This is the demographic that advertisers target most avidly and hence many commercial broadcasters commission programmes specifically aimed at this age group. The proposal does not therefore appear to meet an under-provision in the market. We are aware that the BBC has been concerned about the lower degree of viewer loyalty among young people who are more accustomed to multi-channel television and whose choices of channels are rather more 'promiscuous'. It therefore appears that the real intention of BBC3 is to broaden the appeal of the BBC among 16-34 year olds, rather than to address market failure.
6. There are also now many children's channels operating in the UK and most homes with children have multi-channel television. The BBC is right to observe that few of these services have a rich mix of UK-produced programmes. However, many of them could carry a higher degree of UK-produced content if they could access programmes on the secondary market. Some would be only too willing to buy programmes like *The Teletubbies* if they could get their hands on them. However, the BBC has decided not to sell such programmes where it controls the rights to other children's channels. The BBC is therefore contributing directly to the market failure of other children's channels and forcing them to source programmes from abroad. Commercial channels might also be prepared to co-produce or co-fund UK children's programmes in conjunction with the BBC. That would provide better value to the licence payer by reducing the BBC's share of production costs, and also ensure a higher proportion of UK-produced children's programmes in the market.
7. The BBC further argues that its proposed children's channels will meet a consumer demand because they will be free from advertising. However, BBC research on this issue was not thoroughgoing enough to suggest to consumers how they would be paying for such services. If consumers had been asked whether they would prefer advertising if the licence fee was cheaper, it might have obtained a different result. If there were a genuine demand for children's

channels free of advertising then it is likely that the BBC's commercial competitors would have established channels funded solely by subscription. The fact that nobody has launched a subscription-funded children's channel suggests demand for such a service would be limited.

8. An examination of the proposed budgets for the BBC's services gives an indication of their priorities. £95 million will be spent on BBC3 in its first full year of operation, which is more than three times the proposed £31 million budget for the more highbrow BBC4 service, while only £41 million will be invested in the proposed children's channels. This reinforces the idea that the BBC's real intention is to attract a key audience rather than address market failure.
9. The BBC argues that its proposed new services are aimed at driving digital take-up, and yet ironically the services it proposes seem aimed more at those who are already converted to, rather than addressing the interests of those who are less attracted to, multi-channel television.

COMPETITION

10. PACT continues to be strong advocate for a competitive and dynamic television market. We would be concerned if the new BBC services restricted or distorted competition in the provision of channels and in the content supply market. We share the concerns of some broadcasters that the proposed new services could harm, rather than contribute to competition, which would be against the public interest. Furthermore, the BBC's current approach to programme rights for its digital side channels could have the effect of restricting or distorting competition in the programme supply market because of the conditions it imposes on independent producers.
11. The BBC is the biggest player in the television market by a wide margin. The last figures published by the ITC indicate that its services account for 38.5% of the total television audience. The "Out of the Box" Report published by DCMS estimates that the BBC accounts for nearly 42% of all UK expenditure on programmes. It therefore has significant scale monopolies (defined as a market share of more than 25%) both as a provider of television channels to the consumer, and as a purchaser of programmes. Its policies and practices can therefore have a wide impact on the television industry at large.

Effect on other channels

12. Commercial television channels operating in the same market as the BBC are likely to face some difficulty in competing effectively. They do not have the benefit of the BBC's size and scale and its secure public funding, and so are unable to match its significant investments in high quality programme production. While some commission a limited number of their own

programmes, many have to rely on acquiring programmes in the secondary market. Because the availability of UK programmes on the secondary market is limited, many have had to resort to importing programmes. The BBC has now stated publicly that it will retain its children's programmes and not sell them to other channels, which will further limit the supply of UK-produced programmes to other secondary channels. It may also stop any opportunities for other channels to co-produce programmes with the BBC. Without access to UK-produced programmes, other channels may find it more difficult to build their audiences, which will limit their income and make it more difficult for them to compete effectively. The result may be that other channels have to resort to importing programmes to a greater degree than they do now. The BBC's new channel proposals could therefore contribute to further market failure, rather than redress it.

13. The BBC also has a substantial competitive advantage over other competing channels, in that its digital side channels can acquire programmes from BBC1 and BBC2 at marginal costs. Presently, where the BBC owns all the secondary rights to a UK-produced programme, it will only have to pay royalties for music and performers when programmes are retransmitted on its digital side channels. Other channels would have to pay to acquire the secondary rights as well. The BBC also has the advantage of being able to cross-promote its digital side channels on BBC's 1 and 2.

Effect on independent producers

14. Increased investment in programming by the BBC is, of course, most welcome, and should provide further opportunities for independent producers to make programmes for the BBC. However, the current terms of trade under the so-called "fully-funded commission" model are iniquitous and likely to deprive producers of the opportunity to earn revenue from secondary sales in the UK.
15. Before the introduction of the BBC's digital side channels, where the BBC had acquired all programme rights, it would often sell the secondary rights to other channels. Under these arrangements, the independent producer would benefit from a share of the net profits from any sale (typically, the broadcaster would deduct commission and expenses, and then allow the producer a 30% share of remaining revenues). These revenues may have been modest because of limited competition, and the fact that the BBC has interests in secondary channels operated in conjunction with Flextech. Nevertheless, it still represented additional revenue for a sector that is widely acknowledged as under-capitalised. Such revenue could be critical to the ability of a small production company to invest in developing new programme ideas.
16. Following the establishment of digital side channels, the BBC changed its terms of trade for "fully-funded commissions". This allowed it to exploit programmes in perpetuity on any of its digital side channels without any additional payment to the producer. The producer does not therefore receive any repeat fee or

share of revenue from the exploitation of programmes on the current digital side channels. Nor does the producer receive a higher fee for the original programme in recognition of its secondary value to the BBC. Furthermore, the ability of the BBC to repeat, at will, any independently produced programme on its digital side channels destroys the secondary value of any such programme in the UK market. Other UK channels, except possibly the channels in which the BBC has a commercial interest (such as UK Gold), are unlikely to want to acquire such programmes knowing that they could be repeated at any time on a BBC channel.

17. Under these arrangements, the BBC acquires UK-produced programmes at marginal cost and the producer loses out on the potential to enjoy revenues from secondary UK sales. PACT believes that these arrangements are anti-competitive and an abuse of the BBC's dominant position. PACT therefore made a formal complaint to the OFT in February 2000. The essence of our case is that the arrangements infringe the provisions of Section 18(2)(a) and (b) of the Competition Act 1998. These provisions prohibit conduct that, inter alia includes:
 - directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions; and
 - limiting production, markets or technical developments to the prejudice of consumers.
18. Our view is that the BBC arrangements do indeed impose unfair purchase prices and unfair trading conditions, and that they limit the development of the independent production market, and competition in multi-channel television market. Regrettably the OFT has yet to progress this case beyond seeking points of clarification from PACT in August last year, to which PACT responded in September.
19. It appears from the proposed budgets and the ambitions outlined by the BBC that it intends to keep to its current terms of trade for independent producers. Of course, the BBC argues that it offers independent producers a choice of using either the "fully funded commission" or "licensed commission" route. However, as we have pointed out to the OFT, the BBC rarely enters into licensing deals. It actively discourages such deals by offering terms where the producer would have to make up to 60% of the production costs from secondary sales, which is rarely feasible.
20. Independent producers cannot sustain their businesses where they earn an average margin of 7% on original productions, and receive little or no revenues from secondary sales. The BBC's policy of acquiring all programme rights, and exploiting them at will on its digital side channels, therefore undermines the longer term health of the independent production sector, with consequences for competition in the content supply market overall and for the wider UK economy.

21. No other channel operator is able to exploit programmes on secondary digital channels in the way that the BBC does. Perhaps the closest comparison would be with ITV and ITV2. ITV is prevented by the Networking Arrangements, which are regulated by the ITC and the OFT, from acquiring any programme rights beyond the primary rights. It therefore has to agree a separate licence and pay an additional licence fee for the right to transmit programmes on ITV2. If ITV2 sought to match the BBC's ambitions for BBC3, it would need considerably more resources than the £95 million available to the BBC to secure 80% of new content and 90% UK production.
22. Independent producers are also concerned about the ability of the BBC to determine how it will balance in-house and independent productions across its public service channels. Current regulations give the BBC considerable freedom to decide how it will comply with independent production quotas. Unlike other broadcasters who must ensure that each channel complies with quota requirements, the BBC is allowed to apply the quota globally to all its public service channels. That means the BBC could decide to reserve production for BBC's 1 and 2 for its in-house producers provided its digital side channels carried a sufficiently high proportion of independent productions to comply with the quota. Any such move would have a detrimental effect on competition between in-house and independent producers and would prevent independents from making some of the more substantial BBC programme projects. The BBC has already determined that News 24 is reserved for its own productions.

CONCLUSION

23. We are not directly opposed to the BBC launching new public service channels on its digital platforms. However, we are concerned about the potential effects of such services on competition, both for other television channels and for independent producers. A number of other players in the television market have also voiced concerns about the potential effect of the BBC's proposals on competition.
24. Independent producers are losing out on revenue potential because of the BBC's refusal to recognise the secondary market potential of independent productions and pay for secondary exploitation of such programmes on its digital side channels. PACT has actively pursued its concern about the BBC's terms of trade for digital side channels through a formal complaint to the OFT. Regrettably the OFT has not been able to progress this complaint.
25. We consider that concern about competition is so widespread that it would be wrong for the Government to give its approval to the BBC's proposals without a proper investigation of the likely impact on competition. We would therefore urge that the Secretary of State refers the proposals to the OFT for a full investigation.

26. We believe that it is in the interests of the British television market to maintain the BBC as a publicly funded public service broadcaster. However, if the BBC is able to continue to exploit its dominant position in the market and behave in ways that adversely affect competition, then in the longer term we fear that the only way of dealing with it will be through breaking-up the BBC and privatisation.

PACT
March 2001



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June 28, 2001

Andrew Ramsay Esq
Head of Creative Industries and Broadcasting Group
Department for Culture, Media and Sport
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View

Dear Andrew,

PROPOSED NEW BBC DIGITAL SERVICES

Thank you for your letter of 7 June inviting comments on the latest submission from the BBC on its proposed new digital services.

As we made clear in our earlier submission on new BBC digital services, we are not directly opposed to the launching of new public service channels on its digital platforms. However, we are concerned about the potential effects of such services on competition, both for other television channels (who also commission independent productions) and for independent producers. A number of other players in the television market have also voiced concerns about the potential effect of the BBC's proposals on competition.

In PACT's view much of the 'distinctiveness' and 'value for money' about which the BBC speaks is largely possible because of the operation of a business model for commissioning and distributing independently produced programmes that is anti-competitive.

Independent producers are losing out on revenue potential because of the BBC's refusal to recognise the secondary market potential of independent productions and pay for secondary exploitation of such programmes on its digital side channels. PACT has actively pursued its concern about the BBC's terms of trade for digital side channels through a formal complaint to the OFT. I attach a copy of our latest complaint, which I should be grateful if you could treat as confidential. You may want to consider whether Ministers need to be briefed on our complaint.

Indeed we consider that concern about competition is so widespread that it would be wrong for the Government to give its approval to the BBC's proposals without a proper investigation of the likely impact on competition.

I can confirm that PACT has no objection to its earlier submission on the BBC's new services being made public.

I am copying this letter to Vanessa Brand.

Yours sincerely

A handwritten signature in black ink, appearing to be 'Kris Jones', written over a vertical line.

KRIS JONES

Head of Public Affairs

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The Rt Hon Tessa Jowell, MP
Secretary of State
Department for Culture, Media and Sport
2-4 Cockspur Street
LONDON
SW1Y 5DH

23rd July 2001

Dear Minister

We understand that you are presently considering the BBC proposals for the launch of their new digital channels, and will be carefully considering also the various opinions expressed by other individuals or companies who could be affected by the establishment of such new channels.

As you are aware, the Independent Production sector has made a valuable and significant contribution to BBC programming in all genres, and indeed in the BBC's recent annual report, a number of independent programmes were specifically mentioned as BBC highlights, both creatively and economically.

The BBC have now approached Beryl Vertue as Chair of PACT, and herself an important Independent BBC supplier, and several companies individually, stressing the importance of the digital channels to the BBC, and also stressing the importance of PACT's support for them. Increasingly, as the pressure for ratings becomes more acute, it is becoming very difficult, particularly on BBC1, to allow new talent and ideas to be exposed and given time to grow. The BBC's willingness and ability to launch and nurture new programmes and talent in the past has proven to be of great value to the industry, and most particularly the viewers. We therefore agree with the BBC that the existence of the proposed new channels could be an exciting opportunity for them and the Independent sector, to establish new talent and new programme ideas without the pressure for immediate success which currently exists.

We have expressed to the BBC that PACT has no objection to new digital channels, but that we do have some serious concerns which we feel must be addressed.

It is of course important that the funding of the new channels would not be at the expense of the funding needed by BBC1 and BBC2 to maintain a high standard and range of programming. We are concerned to ensure that the new channels do not become a method of obtaining cheap programmes, or indeed become a dumping ground for special interest programming.

Equally, a very important concern to PACT is that a competitive and fair price is paid for original programming. For your guidance, at the moment the situation exists whereby an Independent Producer can be commissioned to produce a programme or series for a digital channel for a low budget, with consequent much reduced fees, whilst still having to maintain a standard of production the BBC and the producer would want. The concern is that the BBC have the right to further exploit such programmes on their other terrestrial channels, with no further payment to the Independent Producer. Therefore, whilst of course PACT agrees that the opportunities to nurture new talent and create a diversity of new programmes are exciting and valuable, we believe it is fair that it is proportionately valuable in terms of revenue if the programmes are considered successful enough to be exploited further on other channels. Whilst the BBC has been proactive in initiating negotiations with the talent unions (writers and actors) in order to ensure that their contributions and positions are rewarded and protected, no such discussions have yet taken place as regards producers.

We are pleased to say that in view of these concerns, the BBC have now agreed to an early meeting in a desire to reach an understanding on use related additional payments for Independent Producers.

If the Government decides to approve the proposed BBC digital channels the Independent production sector will give its support subject to the BBC's unconditional agreement to the principle of additional fees for additional use on other BBC channels, whatever they may be. This chimes with the arguments we made to the Government in the Courage to Compete submission when we made a clear case for the unbundling of rights and the need for transparent pricing.

Yours sincerely

A handwritten signature in black ink, appearing to read 'John McVay', with a large, stylized flourish extending from the end of the signature.

JOHN McVAY
Chief Executive, PACT