

INTERIM REPORT: “DIGITAL BRITAIN”

RESPONSE BY THE DIGITAL RIGHTS GROUP

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1. Introduction

The Digital Rights Group (DRG) is a leading independent distributor of content in the UK. We work with a wide range of clients, from independent producers to international TV networks, from web developers to ISPs and social networks, and individual talent to media agencies and global brands. DRG group companies include: Channel 4 International; ClickTV; iD Distribution; iRights; Portman Film and Television; Zeal Entertainment and DRG America.

In our first full year of trading DRG will achieve between £20-30m in gross sales for third party producers, which places us in the bottom half of the UK’s “top ten” league table of television rights distributors (see page 4 below).

2. Executive summary

This response is prompted by DRG’s concern about the threat to the future of investment in UK creative content, and especially to original TV programme content, in the context of sharply declining revenues in the commercial television sector. Against a background of cyclical and structural disruption in the relevant media investment markets we are concerned about the degree of market power exercised by BBC Worldwide (BBCW). Unlike its competitors, BBCW is insulated from the attritional impact of collapsing advertising revenues in the commercial marketplace because of its unique and privileged relationship with the BBC Corporation. We submit that BBCW’s status as a privileged participant in TV rights distribution markets is incompatible with the principles of fair competition, and that the effect of the downturn on commercial businesses is likely to have an *intensifyingly* anti-competitive effect on these markets.

Our comments relate especially to Actions 14, 15 and 16 of the interim report *Digital Britain*, though our interests extend broadly to any matter of policy that could have a bearing on the ability of broadcasters to commission new TV programming. We therefore have a direct or indirect interest in all of the matters discussed in Section 3 of *Digital Britain* on “Digital Content”.

In brief, our response:

- emphasises the importance of sustaining the market position of small producers, and of existing Terms of Trade, in sustaining a vibrant, competitive UK rights distribution market, and cautions against the rewriting of Terms of Trade;
- draws attention to the market power of BBC Worldwide in UK and international rights distribution markets, and to its privileged position in these markets;
- objects to the market distorting behaviour of BBC Worldwide in this market;
- strongly endorses the principle stated in *Digital Britain* of the need to secure the future existence of a “long-term and sustainable second public service organisation” to compete against the BBC; and
- proposes the introduction of a distribution quota, or equivalent mechanism, designed to prevent BBC Worldwide from increasing its market power in relevant markets.

3. Background and industry context

The fortunes of fully commercial businesses like DRG are impacted both by long term structural changes in media markets associated with the impact of digitalisation and resulting audience fragmentation, and a pronounced cyclical downturn in advertising revenues currently forecast to run for the rest of 2009 at 12-14% lower per month in the commercial UK TV market than in the equivalent period in 2008¹. Other relevant factors include: a shift in advertising spend from analogue TV to the internet; the non-revenue generating nature of most digital media business models to date; a lower than expected BBC licence fee settlement; the lack of investment in content by key internet players, like Google; and the growing expectation that content will be provided free to the customer at the point of consumption. These factors are acknowledged in the interim report.

The successes of the UK television content sector are also acknowledged:

“Overseas sales of UK programmes and formats grew by 23% in 2007, with overseas revenues of UK distributors and producers totalling £663m, producing a net contribution to content creation, after distribution costs and commissions, of around £380m.”

As the interim report goes on to say, however, “this overall growth trend stalled in 2008” and the sector “has begun to face significant revenue pressures. This is an understatement. What has emerged is a large “funding gap” for TV content. On the basis of figures provided by OFCOM, and using 2004 as a base, this gap in UK originated content commissioning is now calculated on a worst case scenario at around £500 million per annum. What was an annual market of £3 billion worth of new commissioned content is now rapidly moving to £2.5 billion.

The speed at which a “funding gap” is opening up is alarming. It is therefore essential that no opportunities are missed to fill this “gap”.

¹ This figure was quoted by Steve Morrison, CEO of All3Media, at the January 2009 board meeting of the British Screen Advisory Council (BSAC).

For this reason, we are dismayed by the Culture Secretary's decision to maintain the ban on product placement in UK originated TV content. Although the potential to raise revenues through TV product placement is limited in the overall scheme of things – not more than £25-30 million per year on most estimates – all income sources should be allowed as regards programme-making in drama and entertainment genres, clearly defined². The Secretary of State's decision not to review this matter further until 2010-11 is wrong-headed and unhelpful.

The UK needs a thriving, independent and competitive production sector. This is now under threat from a combination of factors, one of which is the existence and market behaviour of BBC Worldwide.

4. BBC Worldwide and the structure of the rights distribution market

The UK rights distribution market is dominated by BBCW with a distribution turnover of £212.1m in the year to April 2008. The UK's top distributors defined by turnover in millions are as follows³:

1.	BBCW	£212.1
2.	IMG Media	£200.7
3.	ITV Worldwide	£125
4.	Fremantle Media	£114.4
5.	Entertainment Rights	£58.9
6.	Hit Entertainment	£41.5
7.	Southern Star Intl	£29.2
8.	Digital Rights Group	£25.1
9.	RDF Rights	£21.3
10.	2Waytraffic UK	£18.8

IMG Media trade primarily in sports rights, so do not signify. Fremantle are owned by the German media group RTL. With the exception of DRG, all the other UK based companies in the top 10 are producers as well as distributors. Most are likely to experience falling turnover in the coming year, leaving BBCW in an increasingly dominant position at the top of the table.

5. The behaviour of BBC Worldwide in the rights distribution market

Although it is widely acknowledged that the success of BBCW has had a positive impact on the Corporation by enhancing license fee contributions, BBCW's distribution activities needlessly crowd out services provided by independent commercial businesses in the marketplace resulting, we believe, in a significant distortion of the market. In a strict sense,

² On product placement, we agree that certain genres of programming – specifically news programming and the making of programmes for children – should be subject, *by way of exception*, to an absolute prohibition. In relation to all other genres, including “light entertainment” but crucially also drama programming, producers should be left to determine for themselves whether to use product placement or not, and if so to what extent. Viewers should be treated like adults. Any programme which is clumsily and excessively stuffed with product placements is likely to be disdained by the average intelligent viewer. This should be the relevant test, and is the test that has long been successfully applied in the film industry.

³ Source: www.broadcastnow.co.uk

there is no need for BBCW to exist at all. If BBCW did not exist the BBC would still be able to achieve global distribution by deploying the services of other well established distributors, arguably increasing revenue by placing the “right” programme with the “right” distributor based on experience and niche expertise⁴.

Under current arrangements there will always be a suspicion that BBCW does not pay full value for the rights that it acquires from the BBC because of its privileged position. It will be argued that the BBCW’s “first look” agreement still gives other distributors an opportunity to distribute BBC programmes. Through its subsidiary Portman, DRG has successfully distributed a number of BBC dramas. However our experience is that BBCW makes a decision to make a title available to other distributors only after hawking it around key international broadcasters. In our view this is an unsurprising, but intrinsically anti-competitive way of exploiting its relationship to the parent company.

In recent years BBCW has become increasingly aggressive in the quest for third party rights to the extent that it is now outbidding its smaller commercial rivals on stand-alone projects and “first look” deals, and even acquiring equity stakes in production companies in order to secure their international distribution rights. BBCW owns significant minority stakes in Left Bank Pictures, Baby Cow, Big Talk Productions and Stephen Fry’s Sprout, (programmes previously distributed by DRG), and have “first look” deals with Fever and Outline.

We contend that the effect of a state-owned broadcaster, largely insulated from the commercial pressures being suffered by all of its competitors, competing against its smaller rivals on uneven terms, can only have a negative impact on the market, acting as a limitation on growth, tending to reduce innovation and rendering the industry unattractive to new entrants.

6. Terms of Trade

The Terms of Trade introduced by the 2003 Act are rightly regarded as one of the most successful public interventions of recent times. They have been directly responsible for the growth of one of the UK’s most impressive export industries. As *Digital Britain* acknowledges

“...an important part of the UK’s international success in content to date has been driven by a successful and entrepreneurial independent production sector. A new breed of independent production house of some scale has developed in recent years. The Terms of Trade have played a contributory role, and nearly six years on from the Communications Act 2003, both the independent sector and wider media industries have been through significant change”.

The “significant change” referred to here is presumably the fact that a small number of large producers (principally All3Media, Shed Media, RDF and Fremantle) have established themselves through a series of acquisitions and consolidations. These consolidated businesses are taking a larger share of the market; their revenues rose by 15% in 2007 whereas the combined turnover of smaller companies fell by 18%⁵. Nevertheless the importance of these consolidations should not be over-stated: of the top 150 UK producers 115 or more generate sales of under £10m per year. These businesses are the lifeblood of the rights market, and continue to rely on the Terms of Trade for survival.

⁴ For example, it could be argued that Fremantle would have done a better job than BBCW selling the rights to *Strictly Come Dancing*.

⁵ Annual Survey of UK Independent TV Producers, *Broad cast*, March 2008.

There have been some unintended consequences from the 2003 Terms of Trade in the form of reduced commissioning budgets and reduced licence fees paid by UK broadcasters for original homegrown productions. Until recently this downside has not signified much because it has been possible to cover deficits through international sales. However, the value of foreign sales is also now being squeezed as a consequence of structural and cyclical challenges being experienced in global media markets.

As a distributor of television rights, DRG's ability to maximise producer revenues is completely dependent on the production companies' capacity to retain these rights in secondary markets. If such rights were to be restored to broadcasters it would have an enormous impact on the revenue generating power of the independent sector as a whole.

We therefore strongly support the view that it would be detrimental to the independent production sector as a whole for the government to reverse the changes made in the Communications Act 2003.

We also strongly oppose the lesser option of formally increasing the share of back end revenues (net receipts) retained by commissioning broadcasters - currently between 15% and 50%. This revision would significantly diminish the earning capacity of many producers.

Maintaining the Terms of Trade is not enough however. We see a vital need in the market for alternative, broadcaster independent, sources of investment for content production. In this sense DRG occupies an important position in the financing model, seeking to fill the "gap" between broadcaster finance and producer budgets. However, to achieve this, DRG must have the ability to scale its presence and enjoy a level playing field vis-à-vis BBCW, which can access finance on preferential times.

The key point here is that the existing Terms of Trade can only continue to be successful if alternative sources of content finance are developed.

7. Conclusions

The prospects of UK distribution companies like DRG are threatened by a combination of structural and cyclical factors in the media economy, of which the most serious is the looming "funding gap" for investment in TV content. The second most important factor is unfair competition in UK markets, with BBCW acting in an unwarranted and predatory manner from a position of privileged access to content.

Policy-makers to date have generally failed in their various reviews to ask whether the public service element of broadcasting should be rooted in competition and plurality, or whether it should be concentrated in the BBC. The way that BBCW behaves in rights distribution markets constitutes a small sub-set of this bigger set of issues.

Independent distributors have been a critical factor in the overall success of UK television content in recent years. Many small producers do not have the resources to exploit their opportunities internally and depend on such distributors. A question arises therefore: how can these distributors be protected from unfair competition from BBCW?

8. Proposed remedies

8.1 First, we strongly endorse the principle stated in *Digital Britain* of the need to secure the future existence of a "long-term and sustainable **second public service**

organisation” to compete against the BBC, with the proviso that any such organisation should carry forward Channel 4’s remit to invest in independent production.

- 8.2 Secondly we propose that a **distribution quota** be established. Policed by OFCOM such a quota would go a long way to correcting current ills. BBCW should be limited to distributing only content produced by the Corporation, with third party content left entirely for the commercial sector. Additionally, we propose that the BBC should be obliged to put 25% of in-house programming with qualifying independent distributors. This quota would be based on annual spend and be evenly spread across all genres. It would at the same time reduce the dominance of BBCW in distribution markets and positively enhance competition by enabling the BBC to help grow the independent distribution sector.

To be clear, under our proposal a more focused BBCW would retain a “first look” on BBC produced programmes required for its portfolio of global channels, on the condition that such programmes are priced transparently and competitively.

- 8.3 Finally, and less critically, we urge that HMG reconsider its position on **product placement**, subject to a continuing prohibition on placement in the most sensitive genres of programme making. In the current environment none of the players in the commercial TV production and distribution market can afford to forego any income, however modest.