Digital Britain

Response to Interim Report submitted by FremantleMedia

March 2009

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SUMMARY

Economics of digital content

- FremantleMedia would like to see the Digital Britain report set out a clear implementation plan for tangible measures which will have a meaningful impact on the longer term, structural issues the production sector now faces, in particular the long term decline of advertising as the commercial sector's predominant source of revenue.

Suggested actions:

1. **Reduce the barriers to product placement on British TV screens and allow viewers to make their own choices about the editorial impact of placement activity.**
2. **Use the launch of Project Canvas set top box and TV hardware to position on demand viewing as a low cost pay per view (PPV) service based on micropayments of a few pence/programme.**
3. **In order to make this possible, move rapidly to establish a national billing agency under the auspices of the proposed Rights Agency which will provide a mechanism through which all rights owners can monetise on demand viewing and explore micropayment pricing strategies which can overcome price barriers to PPV services.**
4. **Examine the potential impact on the wider market of the BBC keeping iPlayer as a free service once Project Canvas delivers iPlayer programming direct to the TV screen.**
5. **Persuade the BBC to consider adopting a PPV model for on demand programming to avoid undermining the commercial sector's access to PPV revenue streams.**

Piracy

- Success in the fight against piracy is an essential prerequisite to any attempt to rebuild the business model for digital content and fill the growing gap left by the projected decline in advertiser funding.
- We will only succeed in combating piracy if the industry can develop a graduated response to illegal activity which allows rights holders to focus legal action against a small minority of persistent offenders. This will only be possible with the active collaboration of ISPs.

Suggested actions:

1. **Establish the proposed Rights Agency as the central body to guide and coordinate the industry's response to illegal file sharing.**
2. **Support the Rights Agency's co-regulatory approach with appropriate fallback provisions to ensure the development of an enforcement regime which will prove practically effective.**
3. **Ensure the industry's Code of Practice on illegal file sharing establishes effective intermediate sanctions after notification and before court action so that legal action is reserved only for persistent offenders.**

Terms of trade

- The existing terms of trade have enabled the production sector to build a world-leading position in the TV formats business.
- Central to this success is the principle of producer control of exploitation.

Suggested actions:

1. **Ensure the review of terms of trade maintains the principle of producer control.**
2. **Focus the review on creating a rights framework which will be well-suited to a multi-platform digital future by ensuring its objective is the maximisation of the value of each programme and satisfaction of consumer demand, rather than the protection of individual windows through warehousing and holdback provisions.**

FREMANTLEMEDIA RESPONSE TO DIGITAL BRITAIN INTERIM REPORT

Action 10 – Economics of digital content

ACTION 10
In the final report we will examine measures needed to address the challenges for digital content in more detail, including opportunities for providing further support to foster UK creative ambition and alternative funding mechanisms to advertising revenues.

Continuing creative success

1. Despite intense and rapidly growing competition for the audience's attention (from video games, internet services like Facebook and mobile entertainment) the UK TV industry is doing remarkably well in retaining the loyalty of its audience. As Figure 1 shows, the amount of TV watched is stable and even showing signs of growth. Even for the 16-34 age group most susceptible to alternative pursuits, total viewing has decreased by less than 5% over 8 years (Figure 2).

Figure 1

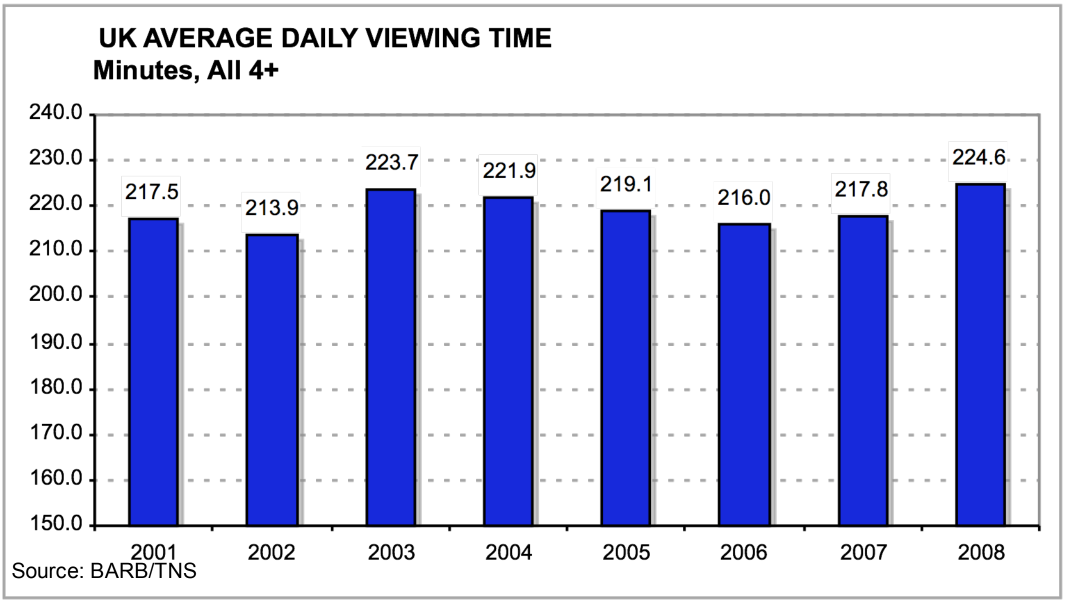
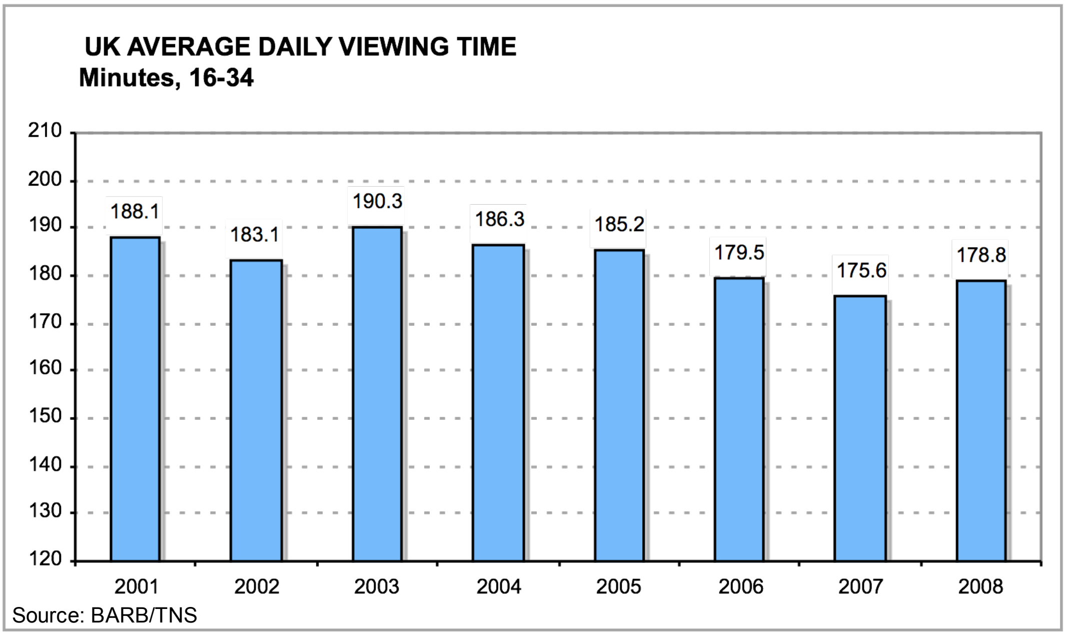
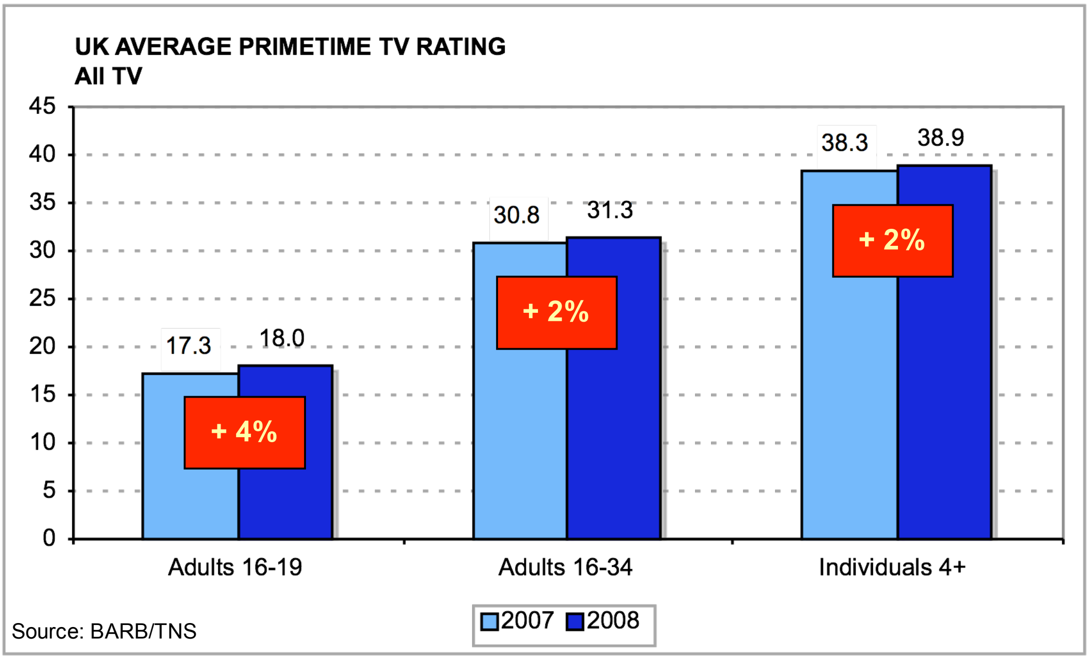


Figure 2



2. Primetime TV is attracting larger audiences (Figure 3)

Figure 3

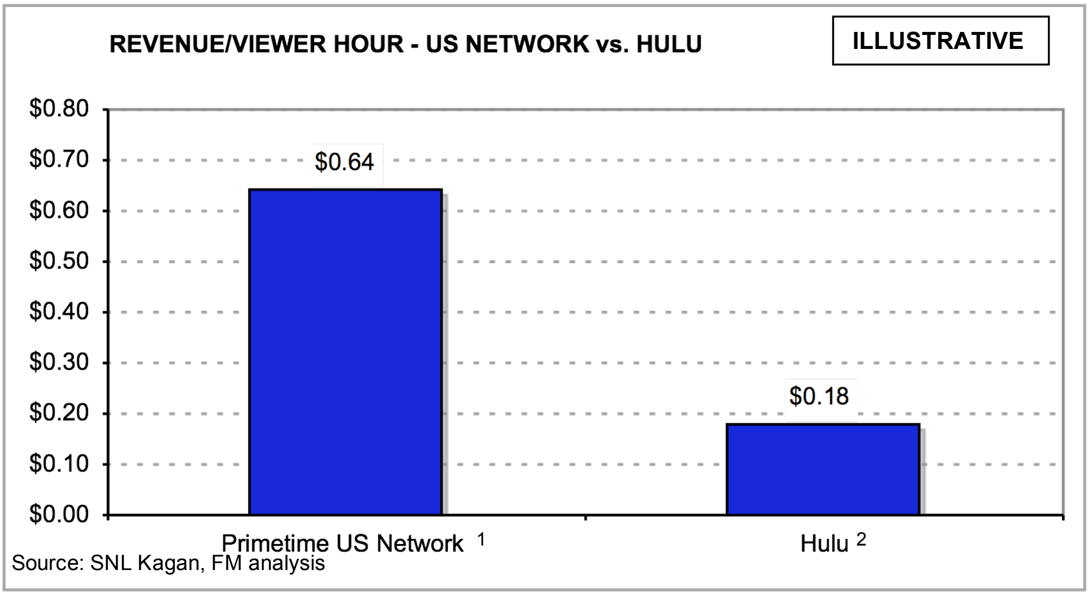


Long-term structural challenges

3. However, the production industry faces the structural challenge of finding new sources of revenue to supplement traditional advertising, which, as the Interim Report points out, is "dwindling … in its historic role as underpinning finance for much content creation".

4. In addition, we face the long term challenge to the industry's business model posed by the shift to on demand delivery. On demand viewing will increasingly substitute for viewing on free to air linear channels, especially once Project Canvas brings on demand viewing direct to the living room TV rather than just to the computer screen. Yet the free, advertiser-supported on demand models that are emerging generate significantly less revenue/viewer than free to air. Advertising slots in on demand programming command a healthy premium (currently between 25 and 50%, although this is likely to reduce as the on demand market stabilises), but this is more than offset by a substantial reduction in the amount of advertising inventory viewers will accept on demand. Experience from US advertiser-supported on demand services like Hulu and abc.com suggests that on demand services can carry at most a quarter of the inventory available on free to air channels in peak; beyond this, take-up of the on demand service begins to suffer. If viewers continue to resist increases in the amount of advertising included in on demand programming, revenue/viewer looks set to decline sharply as we move into the on demand era (Figure 4).

Figure 4



1 16 mins advertising/hour
2 6 advertising slots

New sources of revenue

5. We have to find new sources of revenue if we are to address these profound structural challenges and avoid a decline in investment in UK programming.

6. Many ideas have been proposed to fill the growing gap in TV production investment. In this document we will to focus on two which we believe have particular potential;

    i. Relaxing rules on product placement

    ii. Generating additional income from on demand viewing by positioning it as a low cost PPV service

i. Relaxing rules on product placement

6. Our experience in the US suggests the value of product placement to the industry as a whole is likely to be very significantly more than the £25-50m figure estimated by Ofcom in 2005. Estimating benefits on the basis of the value of the placement deals alone substantially understates the value of product placement:

    i. Product placement is a powerful defensive weapon. Advertisers are increasingly concerned about the impact of ad-skipping on PVRs. Placement increases brand involvement and helps TV companies to persuade advertisers to remain loyal to TV as a medium rather than moving their spend online or to other media;

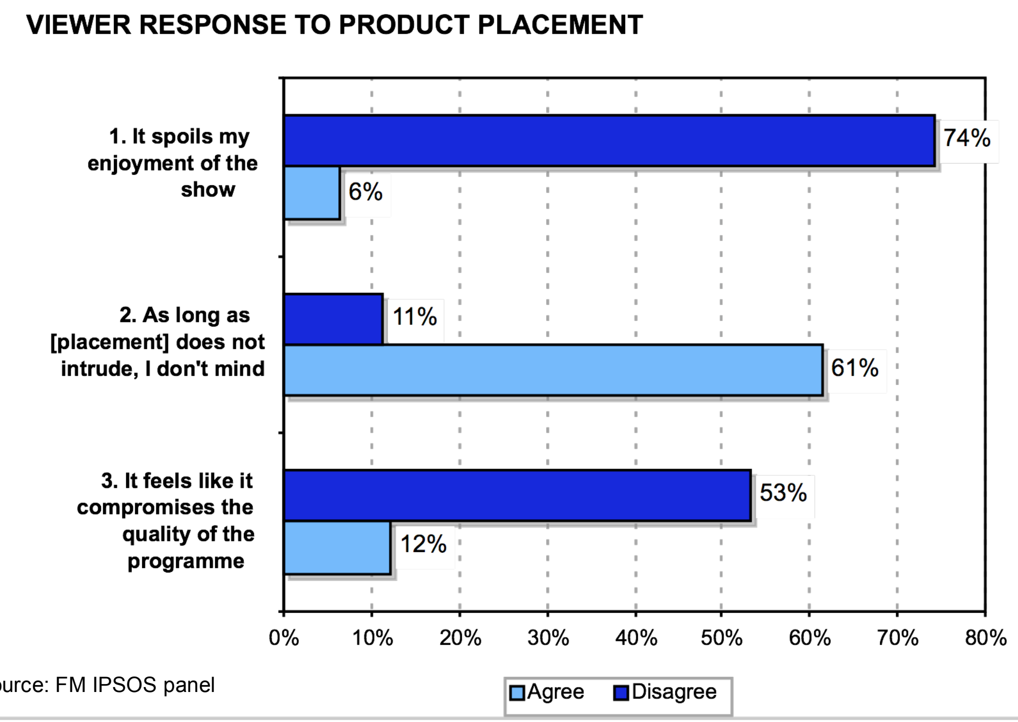
    ii. In our direct experience, the value of the placement deal is only a fraction of the total value of a major brand integration initiative. Broadcasters will use placement deals to sell ad spots alongside placement opportunities; these deals are reported to generate revenue many times the value of the placement deal itself;

    iii. The total potential value of product placement to the industry is very difficult to calculate, but could easily be over £100m/year in terms of revenue losses prevented and new advertising revenue generated in addition to the value of placement deals themselves.

7. Research into UK viewers' reaction to product placement (Figure 5) suggests they are much more comfortable with it than the current regulatory stance implies:

    i. We showed a research panel of 510 viewers a clip from the unedited version of *American Idol* in which Coke had prominent product placement, and then asked question 1 specifically referring to the Coke placement. We then asked questions 2 & 3 referring to placement in general. The results show that the proportion of viewers who find placement activity reduces their enjoyment of the programme or compromises its integrity is very small.

Figure 5



Source: FM IPSOS panel

Agree/Disagree scored on 1-10 scale; in this exhibit, 1-3 =Disagree, 8-10 = Agree

    ii. This is consistent with Ofcom's 2005 research, which found that placement activity was actually more readily accepted than traditional advertising as a programme funding mechanism, generating a strong disapproval score of only 7% compared to 10% for traditional advertising.

8. These results are also consistent with the results we obtain from research into audience response to *American Idol* in the US. Audiences are both accustomed to and comfortable with a high level of commercial involvement as long as it does not interrupt their emotional engagement with the show. What matters to them is not whether it is done, but how. Just as there are good programmes and poorly-executed programmes, so there is well-executed and poorly-executed product placement. Audiences are perfectly aware that James Bond is a mannequin for an ever-increasing range of upscale brands; this does not conflict with their enjoyment or with their willingness to pay to see Bond films as long as the products are seamlessly interwoven into the story.

9. Television audiences are exposed to extensive product placement on a daily basis when they watch movies, which highlights the absurdity of the current restrictions. It is very hard to make sense of the existing rules; the implicit justification is that placement is allowable in films because producers work so hard to make it appear seamless.

10. The reality is that producers need to work to make it seamless whatever the genre, and they have the most direct and immediate interest in doing so. If they do not succeed,

and clumsily-executed placement detracts from the audience's enjoyment of the programme, the audience will punish them immediately and painfully by taking their attention elsewhere. A producer or broadcaster who allows crude or clumsy placement activity will not survive for long. It is very strongly in the producer's interest to tailor commercial involvement to the tastes and preferences of the British audience.

ii. Generating additional income from on demand viewing by positioning it as a low cost PPV service

11. The on demand viewing experience is currently positioned as an add-on to linear viewing: it is primarily defined as 'catch-up' viewing, free to the viewer, and only available after the free to air broadcast transmission. Its role is essentially defensive: it is there to support the free to air channel brand.

12. One reason for this is that with the exception of cable households, on demand viewing is limited to the computer screen. However, Project Canvas is due to change this, and to clear the path from the broadband connection to the TV screen in the living room. Project Canvas's goal is to make on demand viewing a seamless element of regular viewing – just another option on the EPG.

13. Once this happens, it makes little sense for on demand viewing to continue to be seen just as 'catch-up TV'. On demand offers viewers real benefits in comparison with scheduled free to air TV:

    i. It offers greater convenience and flexibility for the viewer: they can watch whenever they like, and can pause and fast forward as they wish;

    ii. It offers the opportunity for programmes to be viewed in advance of as well as following broadcast transmission;

    iii. It offers the opportunity for interactivity and added value services

14. The introduction of the Canvas technical standard will provide a unique opportunity to reposition on demand viewing in the viewer's mind. When a household purchases a Canvas set top box or TV set, it will have access to a new product: on demand viewing which is just like regular linear viewing – but better. This gives us the opportunity to find a way of monetising on demand viewing and bringing in the additional revenue streams the content industry so desperately needs to find.

15. If we miss the opportunity Canvas presents us with, it will be difficult if not impossible to change the audience's perception of on demand once it is established as a free service.

16. If we do not find a way of monetising on demand viewing to a greater level than appears possible through advertiser funding, then we face the prospect of the steady and continuous erosion in commercial sector revenues, and we are potentially condemning the commercial side of the production sector to inexorable decline unless we can find another, additional revenue stream.

17. If we fail to find a way to change the economics of on demand viewing, the industry will face conflicting incentives which will hold back adoption of digital technology, since it will be financially disadvantageous to shift from a linear to an on demand business model.

18. Some form of pay per view (PPV) is the most logical and equitable means of monetising on demand viewing. It relates payment directly to usage, and it returns additional funds directly to the producers and broadcasters of programmes which succeed in finding an audience, avoiding the need for an intermediary body to recycle funds within the industry.

19. There are three major obstacles to the development of PPV:

    i. Establishing a widely used and trusted payment mechanism

    ii. The attitude of the BBC

    iii. Piracy (dealt with under action 11 below)

i. Establishing a widely used and trusted payment mechanism

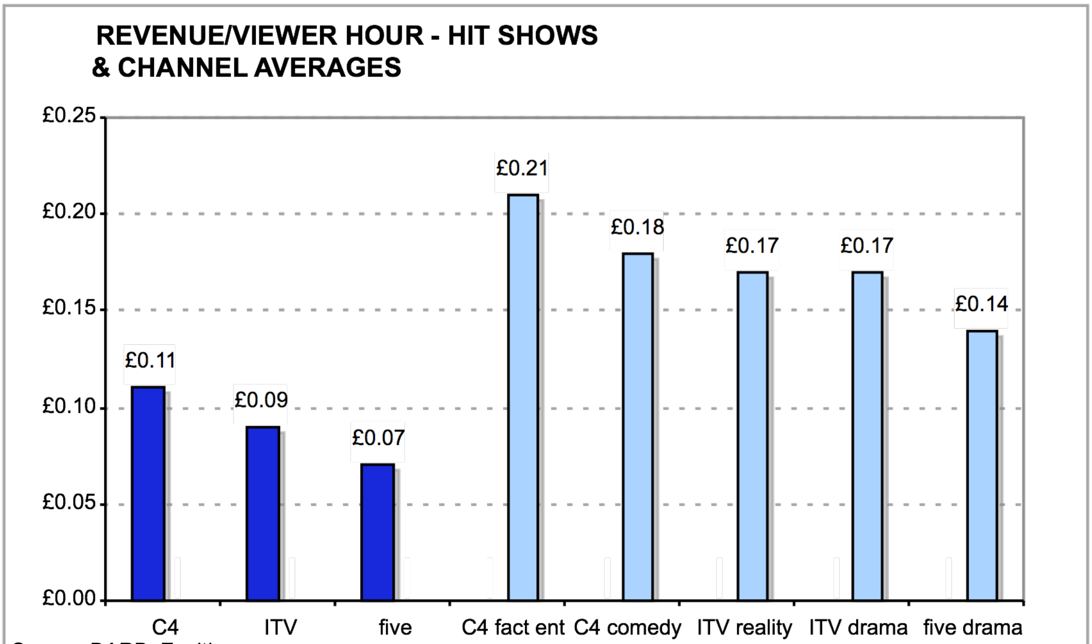
20. The prices we will be able to charge for on demand PPV for the great majority of TV programmes are likely to be much lower than the level at which PPV has been tried in the past. Traditionally, PPV has been used mostly for premium events at relatively high price points. This pricing strategy is unlikely to be successful for the vast majority of on demand programming:

    i. The take-up rates for non-event PPV at price levels of £1.00 or above are small;

    ii. In the broadband environment we will be competing in an international marketplace against material provided free to view, so price barriers must be low.

21. However, prices do not have to be more than a few pence/programme to make a significant contribution to programme economics. As Figure 6 shows, average revenue/viewer hour for the commercial terrestrial channels is only around 10p. Even programmes with the audiences most attractive to advertisers generate only a maximum of around 20p.

Figure 6



Source: BARB, Zenith Optimedia, Attentional

22. The figures above suggest that in a mixed advertiser-supported and PPV model (a pre-roll advertisement plus payment), prices as low as 5p/programme could offset the likely medium term reductions in advertising revenue caused by declining CPTs and reductions in the amount of advertising inventory.

23. The indicative research we have carried out on viewers' willingness to pay suggests a remarkably high level of acceptance of the concept of payment for on demand viewing, with over 40% of respondents indicating a willingness to pay at least 5p, and over 20%

indicating a willingness to pay £1.00 (Figures 7 & 8). These figures are both surprising and encouraging, given that on demand viewing is currently available at no charge.

Figure 7

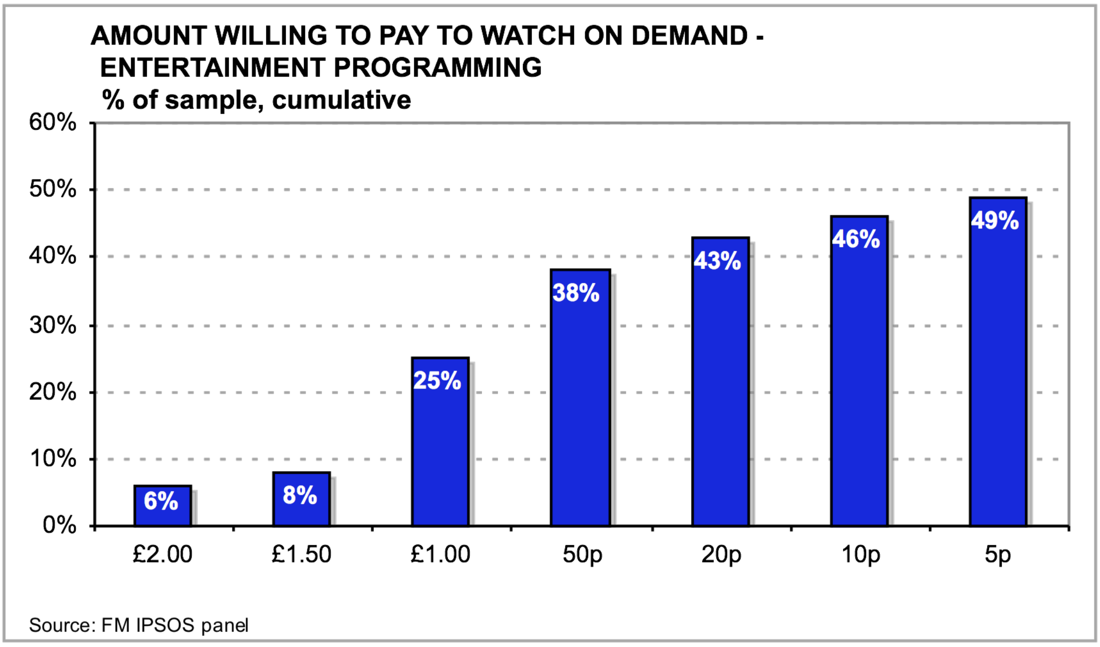
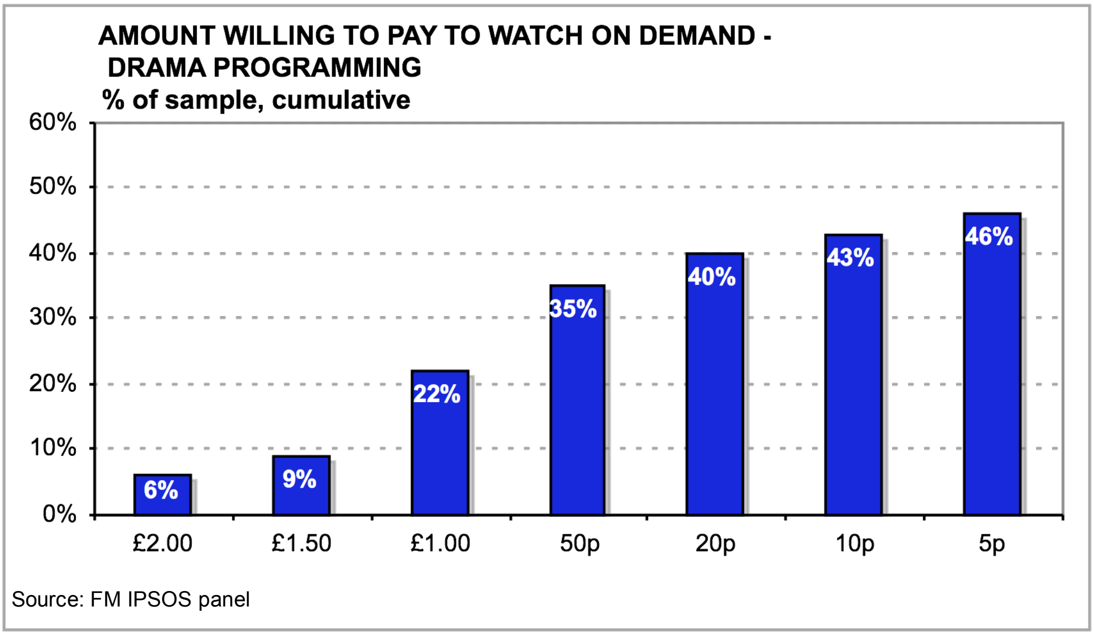


Figure 8



24. Market research can give us only limited insight into consumers' likely buying behaviour. It will take time for tariff strategies and price points to emerge in a developing market. Sky's experience over the last 20 years provides a useful reference point: when Sky began to implement its subscription model in the early 1990's, it would have taken a brave forecaster to predict that average revenue per household for a service which does not include any mainstream terrestrial channels would reach £450/year by 2008. Prices will need to start low to establish the market and build over time.

25. We will only be able to tap into this new revenue source if we can establish mechanisms which make it both practical and economic for consumers to make large numbers of micropayments of this size. Consumers will not establish billing relationships with a large number of suppliers, especially if payments are for very small sums. This creates a

natural tendency towards market concentration and anti-competitive behaviour. Project Kangaroo has already fallen foul of the competitive implications of consolidation in the on demand market. In order to make micropayments possible, we must find ways of aggregating payments which are not anti-competitive.

26. The implementation of a de facto, non-commercial UK technology standard for on demand viewing through Project Canvas gives us the opportunity to establish a national billing agency which would develop low-cost billing relationships with UK consumers for on demand content. This agency could offer billing services to any provider of on demand content on a cost-plus basis. The agency:

    i. Would operate as a pure service provider, overseen and regulated by the new Rights Agency (in much the same way as the Oyster consortium works for TfL);

    ii. Would enable small payments of a few pence to be aggregated on an economic basis;

    iii. Would provide a seamless, 'One Click' ordering process for on demand PPV material;

    iv. Would support a wide range of pricing strategies, from subscription, to individual programme PPV, to mixed advertising and PPV models;

    v. Is technically feasible at relatively modest levels of investment using existing technology (in particular, the technology used in mobile telephony billing systems);

27. If the service is successful, it could extend its scope to include payments for other forms of digital content on the internet. The potential impact on the UK's creative industries could be profound: giving digital businesses access to new micropayment revenue streams could bring down barriers to entry and galvanise the content sector.

ii. The attitude of the BBC

28. The BBC has led the technical development of on demand viewing through iPlayer and Project Canvas. The BBC's technical leadership has been of immense benefit to the industry in driving innovation and establishing de facto technical standards.

29. However, the BBC's commitment to providing on demand viewing as a free, licence fee funded service is likely to inhibit the re-positioning of on demand as a paid-for, premium product and make it much harder for commercial players to generate PPV income from on demand services.

30. The BBC's position is consistent with its role as a non-commercial, licence-fee funded service. However, it may not be consistent with the future health of the production sector as a whole, which must be able to access new PPV revenue streams if it is to combat the projected decline in advertising revenue and continue to grow.

31. The BBC will need to reconsider the positioning of iPlayer as a free service if on demand is to have the potential to generate significant new revenue streams for the industry as a whole.

32. We propose that the market impact assessment for Project Canvas should include an assessment of the potential impact on commercial players' ability to launch paid-for on demand services if iPlayer remains a free service.

Action 11 – Rights and distribution

ACTION 11
By the time the final Digital Britain Report is published the Government will have explored with interested parties the potential for a Rights Agency to bring industry together to agree how to provide incentives for legal use of copyright material; work together to prevent unlawful use by consumers which infringes civil copyright law; and enable technical copyright-support solutions that work for both consumers and content creators. The Government also welcomes other suggestions on how these objectives should be achieved.

1. Any attempt to develop on demand viewing as a premium, paid-for service will fail if consumers have a readily accessible and free illegal alternative. The suppression of piracy is essential to the success of the strategy outlined above.
2. Experience elsewhere suggests that significant reductions in the level of illegal downloading can only be achieved through cooperation between government, ISPs and rights holders. In particular, it has shown that it is essential to have a graduated response to file sharing which takes users through a number of sanctions before persistent abusers are taken to court.
3. The threat of court action is a vital weapon in our armoury in the fight against file sharing. It will always be the final sanction against persistent offenders, and we cannot be afraid to use it. However, court action is a blunt instrument: expensive, time-consuming and potentially politically unpopular (e.g. where the target of the action turns out to be under age). It is very important that it is not the first significant action we take against offenders once they have been notified that their potentially unlawful file sharing activity has been identified.
4. We need to agree a legal framework which includes proper intermediate sanctions which have a real prospect of reducing the number of offenders we target before we turn to legal enforcement. The most logical sanctions involve the offender's access to broadband capacity: either reducing bandwidth or the suspension of internet access. We understand from the MPAA's work that ISPs have access to these tools and already use them to combat other forms of illegal activity (e.g. child pornography). It is essential we obtain the ISPs' active cooperation to use them in the fight against copyright theft.
5. The government's proposed position set out in BERR's response to the July 2008 consultation only addresses the notification issue; it does not provide for effective intermediate sanctions, and implies that the next step after notification would be legal action.
6. This approach will fail to deliver an effective enforcement regime for digital rights. It will not be possible to pursue court action against the number of alleged abusers (on BERR's own estimates, after notification the industry would still be pursuing 30% of 6.5 million file sharers – nearly 2 million infringers). Given the difficulty of collecting information about illegal activity, mistakes will inevitably be made which will threaten the credibility of the enforcement process and create political pressure for its suspension.
7. If the government is serious about protecting and nurturing the UK content industry, we need an effective enforcement regime which will provide a real disincentive to illegal file sharing. The regime must include intermediate sanctions that discourage all but the hard core of determined offenders.
8. The strong action being taken by the French government against piracy shows that given the political will, it is possible to legislate to protect the foundations of the content industry. The French government's proposed regime includes suspension of internet access as an effective intermediate sanction before court action.

9. We welcome the government's proposal to establish a Rights Agency to coordinate the response of all parts of the industry to the problem and to help develop the technical, legal and commercial elements of the solution. We support the government's co-regulatory approach which seeks to develop solutions to the file sharing problem through negotiation between the ISP and rights holder communities. However, this approach must be supported by a willingness to intervene if agreement proves difficult to achieve, as it has thus far in the MOU discussions between ISPs and rights holders. If the Rights Agency does not itself have backstop powers, or cannot call upon them in the event of a failure to reach agreement, it will be merely a talking shop and will have little impact on the problem of copyright theft.

10. The Rights Agency can also have an important role in specifying and overseeing the creation of a national billing agency to enable rights holders to collect micropayments and open up a potentially vital new PPV revenue stream.

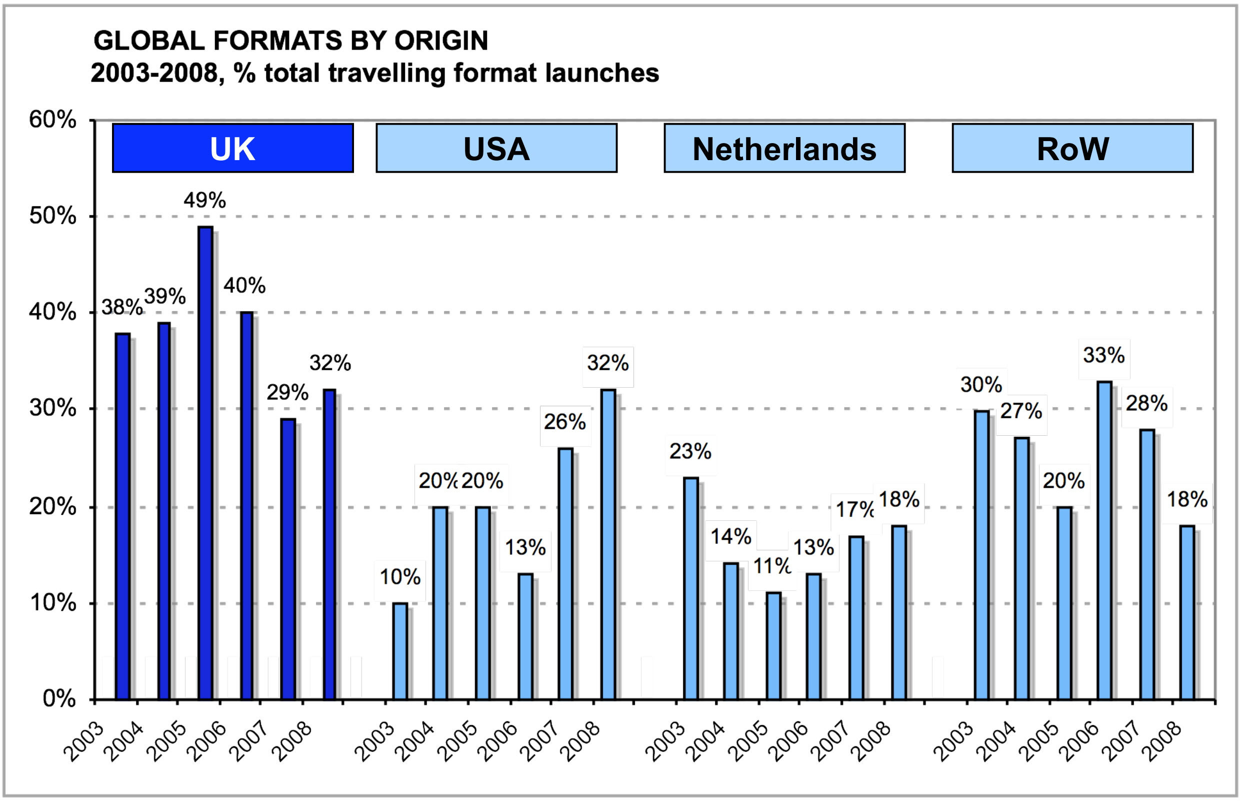
11. Success in the battle against copyright theft will have at least as much to do with the availability of legal alternatives to illicit file sharing as it will to the imposition of an effective copyright enforcement regime. We are committed to the development of legal and affordable alternatives to illicit file sharing; we believe low cost PPV can potentially provide one key element of the legal alternative services we need to put in place.

Action 15 – Original UK content (terms of trade)

ACTION 15
The existing Terms of Trade between the independent producers and broadcasters have worked well. In light of new entrants to the market, new business models and new distribution channels, it makes sense to have a forward look at how the relationship between independent producers and those who commission their ideas could evolve. This review will focus on the appropriate rights holding agreements and definitions required for a multi-platform digital future, on the overall health of the sector and on continuing to ensure that viewers, listeners and users get the best and most innovative content and programming.

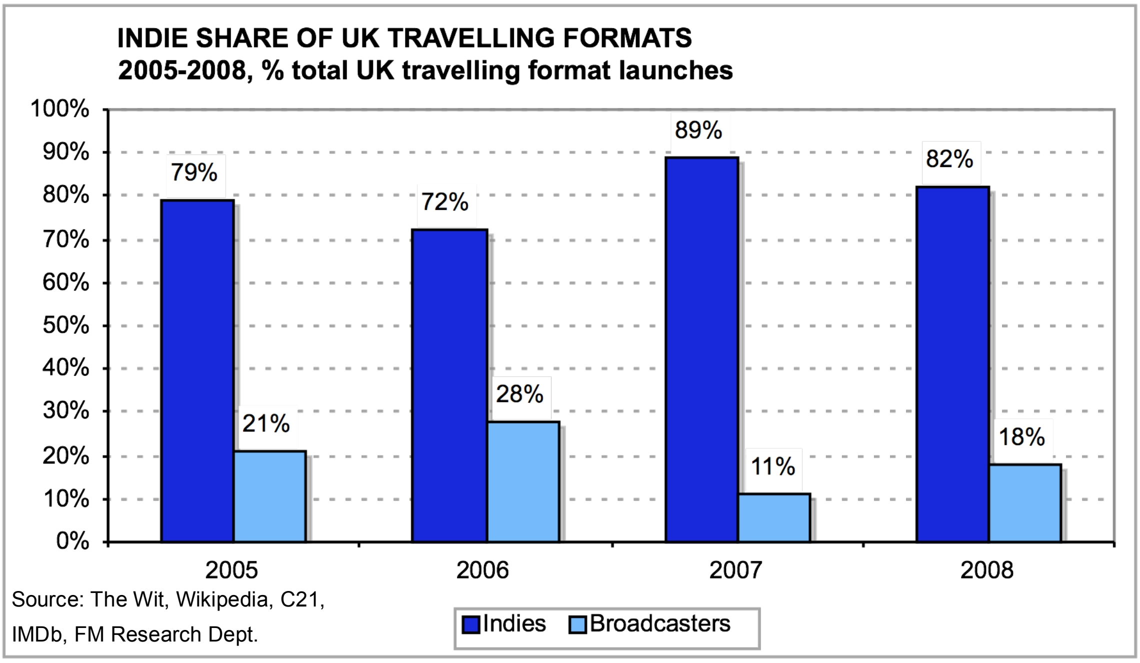
1. The confluence of cyclical and structural change has led to calls for changes to terms of trade to redistribute income between producers and broadcasters.
2. We need to respond to these calls in a way which addresses the structural problems the industry faces.
3. As we do so, we should bear in mind that the existing model has proved commercially very successful:
    i. The UK has been the world's most successful exporter of TV formats, and independent producers have produced the great majority of UK's format exports (Figures 9 & 10).

Figure 9



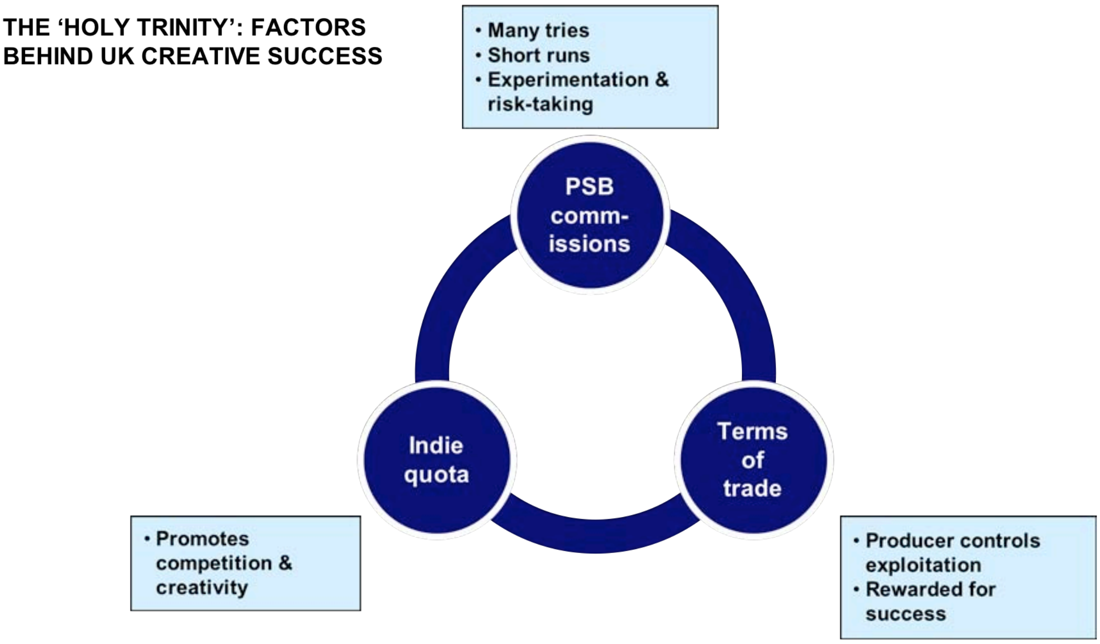
Source: The Wit, Wikipedia, C21, IMDb, FM Research Dept.

Figure 10



ii. The existing terms of trade have played a very important role in that success, by giving producers the ability to control the exploitation of their formats and the incentive to ensure they are commercially successful (see Figure 11, which sets out the 'Holy Trinity' of factors behind the UK's remarkable creative success over the past 5 years):

Figure 11



4. If this success is to continue, it is essential that the terms of trade retain the principle of producer control of rights. Producers have the time, the focus, the knowledge, the track record and the incentive to make the most of their intellectual property. Although broadcasters have successful and competent exploitation businesses, if they control exploitation rights to all their commissioned programming they end up with far more

material than they can focus on effectively. Past experience shows clearly that exploitation activity is stifled if the initiative is left in broadcasters' hands.

5. As long as this principle is maintained and its objectives are strategic, we see potential benefits from a review of terms of trade. We suggest the core objective should be to ensure that the rights framework enables the value of each programme to be maximised. At present the rights framework is more focused on the protection of individual windows (including the broadcast window) through holdbacks.

6. This approach will create consumer benefits, since one of the consequences of the current regime is that programmes are withheld from viewers, rather than being made more readily available whenever consumers are ready to watch.

7. It will also reduce incentives for illegal file sharing. Viewers will turn to illegal means to find their favourite programmes when legal alternatives are unavailable. By focusing on the maximisation of programme value, the rights framework will avoid creating artificial obstacles to the legal availability of programming.

8. Examples of unnecessary holdbacks and warehousing in the current rights framework:

    i. On demand rights: under current terms of trade, even if a broadcaster does not wish to extend its initial 30 day on demand window, the programme is subject to a further 5 month holdback during which time it cannot legally be made available to viewers;

    ii. Returning series: returning series comprise the great majority of popular TV shows (returning series accounted for 58% of the primetime schedule on the PSB channels during 2008). If a series is recommissioned, it can be subject to holdback for a period of up to three years under the current terms of trade.

ANNEX A

NATIONAL BILLING SYSTEM – FIRST DRAFT CONCEPT

This Annex sets out ideas for how a national billing system might work. The likely cost and feasibility of the concepts set out here has been tested in outline with a major supplier of billing systems for the mobile telephony sector. Based on models established in the mobile sector, initial investment required is relatively small given the potential significance of the project – in the single digit millions – and variable costs low enough to make the charging of micropayments of a few pence per transaction economic.

Further work is needed to establish a more detailed specification for system capabilities and delivery:

- Technical feasibility and integration with Canvas technology;
- Process for specifying, financing and creating the system;
- Likely timescale and costs.

Setting up an account

- Every Canvas-specified set top box (STB) or TV set comes with account set-up pre-loaded, so entering basic account information forms part of the sequence of setting up the STB.
- Data entry via a remote is time-consuming and clumsy, so the account holder will have the option to enter account information online or via the telephone.
- Accounts will be pre-paid to ensure that actual payment transactions are sufficiently large to be cost-effective.
- Accounts can be linked to a wide variety of payment mechanisms:
    - Credit and debit cards;
    - Bank accounts (via direct debit);
    - Cash options via retail outlets (using mobile phone top-up or National Lottery retail infrastructure plus a magnetic strip card)
- Accounts will have an automatic top-up option with a specified top-up amount.
- Account holders will be able to log in to check account balance and account activity both onscreen and online.
- Single STBs could host multiple accounts through the use of other billing methods, e.g. premium rate phone calls or premium rate SMS

Options

- *The account holder could have the option to enter more detailed demographic data (to provide the rights holder with better information on audience composition and improve CPTs) in return for price discounts.*
- *To encourage viewers to use the system and try out PPV programming, each new account could come with an initial credit balance, so viewers would only be asked to enter billing details once they have used up their initial allocation and are accustomed to using the system.*

Ordering a programme

- The Canvas-specified EPG shows programming available both off-air and on demand. It clearly differentiates between free and paid-for programming.
- The viewer highlights a paid-for on demand programme, selects with one click.

- A small dialogue box appears as an overlay, telling the viewer the price of the programme and asking if s/he wishes to purchase and watch. The dialogue box warns the viewer if their account is close to zero or if it will shortly be topped up.
- The viewer clicks to confirm.
- The dialogue box disappears and the programme begins.

Pricing options

- The system will be as flexible as possible to allow rights owners to experiment with different pricing strategies:
    - Subscription;
    - Individual programme PPV;
    - Mixed advertising supported and PPV (i.e. the viewer can choose to watch a limited amount of advertising in return for a reduction in programme or subscription price)

Authorisation

- Each transaction will be authorised via an exchange between the STB and central system servers. Authorisation processes of this type can be carried out without noticeable delay to the user.
- The system will need a call centre to handle account enquiries and disputes – but the approach to dispute management can be permissive when individual transaction amounts are likely to be very low.

Hardware requirements

- There would be no additional hardware requirements for the Canvas STB.

Rights owners

- The system will be open to all rights owners offering paid-for programming via the Canvas EPG.
- In cases where rights ownership is shared between multiple parties, the system will be able to apportion revenues between owners according to preset rules .
- Rights owners will be provided with retrospective audience demographic data.

System management & financing

- The Rights Agency will specify and regulate the system.
- The system will be privately financed and managed under fixed term contract to the Rights Agency (cf. Oyster).
- Given widespread experience of comparable systems in other sectors, all significant aspects of the system's performance can be benchmarked and regulated. The contract will specify performance targets against which the operators will have to deliver.
- In the event of failure to meet performance targets, the operator's contract can be terminated.