



Kevin Bakhurst
Group Director for Broadcasting and Online Content
Ofcom

8 November 2022

Dear Kevin,

Ofcom's Review of the interaction between BBC Studios and the BBC public service

I am writing on behalf of the BBC Board's Fair Trading Committee in response to Ofcom's Studios Review of the interaction between BBC Studios and the BBC public service.

We welcome Ofcom's finding that you were satisfied with the BBC's approach to the exchange of information, our commercial governance structure and its reporting arrangements which ensure that there is appropriate separation between the public service and BBC Studios, and our approach to charging BBC Studios for the use of the BBC brand.

However we also take very seriously that Ofcom raised concerns relating to the current approach to some of the BBC's secondary content sales and some errors in relation to the supply and pricing of goods and services.

The Fair Trading Committee, on behalf of the BBC Board, has, as you recommended, reviewed the BBC's approach. This has involved careful consideration of the issues raised in order to satisfy the Board that the BBC's processes and arrangements are in accordance with our rules.

Secondary Content sales

Ofcom's concern

In its Studio's Review statement, Ofcom noted that:

“for certain categories of content that BBC Studios distributes, where the BBC public service owns the intellectual property, co-production arrangements are in place. Under these arrangements BBC Studios is entitled to the entirety of the profit related to the distribution of the associated secondary content rights. This is a long-established practice and it does not appear to us that the BBC has fully reviewed and updated it in the light of our rules. We have not seen evidence that the public service has undertaken objective tests to ensure that its co-production arrangements with BBC Studios are at arm's length and on commercial terms, and therefore it is not clear to us how the BBC is satisfying itself that it is achieving compliance.”

“In principle, the public service entering into a co-production deal with BBC Studios for a specific programme could be compliant with our rules. However, based on the information we have seen, we are still concerned that there may not

be adequate processes in place to determine whether the value the public service receives from BBC Studios as its distributor/co-producer is in line with the value of the rights being traded. We are therefore not clear how the BBC Board is satisfying itself that these arrangements are at arm's length and on commercial terms."

The BBC's plans to address Ofcom's concerns

Ofcom's concerns relate to about 20 longstanding programmes originally produced by BBC in-house production (before the spinning out of BBC Studios) and an even smaller number of current in-house production programmes (either Nations or News and Current Affairs) in which Studios makes upfront investment. They also represent a relatively small proportion of BBC Studios total investment in BBC programmes (about 10% to 20%) and therefore a small proportion of BBC Studios' costs as a whole (about 1% to 4%).

To address Ofcom's concerns, the BBC is establishing a formal process for approval by UK public service commissioning on each of these titles at the point of re-commissioning / re-investment. This approval will include a clearly articulated and recorded rationale for the deal parameters for each transaction and in particular the basis on which the value the public service receives from BBC Studios as its co-producer is reasonably considered to be in line with the value of the rights being traded.

This analysis will include:

- Deal structure – for example, the involvement of other producers or investors, allocation of rights in and ex-UK and for different formats, etc. This can be directly assessed against projects where the BBC is commissioning from independent producers or with the involvement of third-party investment.
- Investment level – this criterion will allow quantitative comparison of Studios investment and that of other co-producers for comparable programming.
- Creative input – degree to which Studios is supplying creative input consistent with value created by another co-producer. This is a more qualitative criterion but we can compare and contrast with third-party projects.
- Qualitative value to PS slate – while inherently qualitative, this is an essential component to Public Service decision making around such transactions and indeed would typically also apply to projects involving third-party producers/distributors.

Each relevant title will be considered on a case-by-case basis, supported by transparent reporting of commercial performance by BBC Studios. While we consider that our historic approach has been consistent with Ofcom's trading and separation obligations, it is possible that the deal parameters for certain titles may be amended as a result of this process. This in turn may have implications for the level of Studios' investment in certain programmes and in turn mean Public Service Commissioning either receiving greater share of net profits directly from sales or exploring third-party investment for the rights.

We have shared with Ofcom the title-by-title schedule for reinvestment in the c.20 ongoing programmes in which BBC Studios invest. On this basis we consider that all the relevant programmes will have been considered under our new process by the end of

2023/24. The BBC team will keep Ofcom up to date on our progress and make the relevant records available for their review.

We consider that this should fully resolve Ofcom's concerns by establishing an explicit process that includes objective criteria and analysis to determine that the value the public service receives from BBC Studios as its co-producer is in line with the value of the rights being traded.

Supply and pricing of goods and services

Ofcom's concerns

In its Studios review statement, Ofcom noted that it had some concerns regarding the sufficiency of information and processes in relation to the BBC's arrangements for the supply and pricing of goods and services. Ofcom also stated that during its review it identified some issues with the BBC's regulatory reporting for 2019/20, but also noted that the BBC had already put in place new processes and training and that the 2020/21 regulatory reporting had been improved.

Ofcom said that the BBC should conduct its own assessment and detailed review of its transfer charging process and make any necessary changes to these as a result of its assessment. These changes could include strengthening both the internal controls and the internal audits with respect to transfer charges.

The Fair Trading Committee's review

The BBC has thoroughly reviewed its processes in the light of Ofcom's observations and concerns.

Having completed this review, the BBC is confident that appropriate analysis was carried out and implemented in good faith. However there have been some minor errors of presentation or interpretation, most likely as a result of human error or a misreading of a particular reporting requirement in certain circumstances. Below we set out a high-level view of the extensive procedures in place on transfer pricing and regulatory reporting. The BBC has taken the opportunity to make further improvements to project management processes, training and assurance processes to reduce the likelihood of such issues in the future, which we set out below.

Project management processes

Each year the SLA process involves various Finance teams, Commercial Legal, Policy/Regulation, and each division that provides services to the commercial subsidiaries.

This process has designated Finance and Legal leads in the BBC and BBC Studios (and other commercial subsidiaries) who are responsible for liaising, drafting, checking numbers, and tracking progress of the SLAs for which they are responsible. The process is co-ordinated by BBC Finance and BBC Policy, who maintain a master-list tracking all SLAs and version control against previous years.

The Controller, Regulatory Policy and Assistant General Counsel are briefed on progress and escalate issues that cannot be resolved at the operational level. The Fair Trading Committee is regularly updated by management on the status of SLAs.

The BBC has improved its relevant training

In response to Ofcom's observations, we established an in-depth training programme for Ofcom reporting. This is a mandatory annual requirement for all finance teams involved in the transfer pricing and Ofcom reporting activities. These sessions cover our regulatory reporting requirements, recent presentational errors, the process (including any changes), reporting schedule, impacts on SLA process and Group Trading Manual, along with examples of reporting.

Additionally the BBC currently requires about 6,000 staff regularly to complete mandatory Fair Trading training – about 4,600 take a high-level Fair Trading Awareness course and about 1,400 take a more detailed Advanced Fair Trading course. Training need is determined by job role. We are currently in the process of amalgamating the Fair Trading awareness content into a comprehensive BBC Code of Conduct training course which will be mandatory for all c.17,900 BBC public service staff.

The BBC has extensive and ongoing internal and external assurance processes

The Fair Trading Committee receives regular management reports on progress with the transfer-pricing process, reviews any significant changes to transfer pricing methodology, and reviews and approves the Group Trading Manual annually. The FTC also receives a six-monthly risk and compliance report from the BBC's Risk team.

The BBC's Audit and Risk Committee (also a NED-led sub-committee of the BBC Board) is responsible for monitoring, reviewing and mitigating risks related to the BBC's regulatory compliance.¹ The Policy Team reports quarterly to the BBC's Audit and Risk Committee on regulatory compliance and risk, including the transfer pricing process.

Each year the Fair Trading Committee commissions external Fair Trading assurance (currently performed by Deloitte), which includes examination of transfer pricing, separation arrangements and use of and payment for the BBC brand. For 2021/22, Deloitte concluded: "In our opinion the BBC has established and applied a system of internal controls that provide reasonable assurance that it has complied with the requirements of the Fair Trading Arrangements."²

In addition to these activities and the ongoing advice and monitoring undertaken by BBC Finance, Policy and Legal teams throughout the year, the Fair Trading Committee intensified our internal assurance processes. In 2021, the Fair Trading Committee commissioned the BBC's Internal Audit team to review the SLAs and transfer pricing processes. We have implemented a number of recommendations based on this review. The Fair Trading Committee has also decided that Internal Audit should continue to carry out and report on regular spot checks of the transfer pricing regime.

Furthermore, the BBC has a number of obligations to maintain and report accounting records, including statutory, contractual as well as Ofcom requirements. The NAO audit our financial results each year, including intra-group transactions, and have not found issues in our maintenance of accounting records. The NAO have not raised any points on maintaining adequate financial records or concerns on intra-group reporting in either

¹ See Audit and Risk Committee report (p.105-109) and Our principal risks report (p.110-126) in [BBC Annual Report and Accounts 2021/22](#).

² [BBC Annual Report and Accounts 2021/22](#), p.135.

their formal audit opinion or their management letter (which covers lower grade suggestions for improvements).³

Transfer pricing

In one case, we believe that Ofcom erroneously categorised a concern; that we had set a transfer price below market prices. This transfer price was based on benchmarking available at the time the price was set and was therefore set in good faith and in line with Ofcom's trading and separation regulations. Subsequently we obtained more comprehensive and recent benchmarking data, reviewed the transfer price and proactively amended it to maintain compliance with the Trading and Separation Rules. At all times we set prices for this service on the basis of our best knowledge of market prices.

Proportionality of the regulatory requirements

For the year ended 31 March 2022, the SLAs relating to PSB services to Studios accounted for £111m, representing 8.8% of Studios reported operating costs of £1,253m. Given the limited issues identified to date within those SLAs, we consider it highly unlikely that Studios could have achieved any meaningful advantage over its commercial rivals. As such, there was little if any risk of market distortion or unfair competitive advantage.

Therefore, we renew our request that Ofcom amends its requirements to target more closely areas where there is a demonstrable risk of harm. Alternatively, Ofcom should at this point provide guidance on what it considers to be a level of cross-subsidy at which a material risk of such harm is likely to occur i.e. a form of de minimis threshold for the raising of concerns or investigation. As well as introducing greater targeting of risk areas, this would also bring greater consistency with the BBC's other significant financial accounting, monitoring and reporting requirements and represent a reasonable and proportionate approach to the supervision of transfer pricing arrangements between the BBC and its commercial subsidiaries.

By way of comparison, the NAO applies an overall Group threshold for materiality of £50 million (1% of Group revenue), a performance materiality of £37.5 million (75% of overall materiality) and a reporting threshold of £300,000.

Finally, on behalf of the BBC Board I would like to assure you that the Fair Trading Committee continues to examine these matters assiduously, taking internal and external audit advice to seek continuous improvement. I hope this reply satisfies you that the BBC has undertaken a detailed review and further improved our systems in light of Ofcom's concerns.

Yours sincerely,

Ian Hargreaves

Non-Executive member of the BBC Board and Chair of the Fair Trading Committee

³ Comptroller and Auditor General's Certificate and Report on the Group Financial Statements, [BBC Annual Report and Accounts 2021/22](#), p.204-213.