

Response to Ofcom
PSB Review: Phase 2

pact.

December 2008

Executive summary

- 1) The UK independent content creation and exploitation sector is well placed to make the transition into the digital era. The Codes of Practice introduced in the 2003 Communications Act have underpinned this, creating a flexible model for programme pricing that is able to respond to developments in technology and emerging markets.¹ Commissioning broadcasters no longer routinely provide 100%, or near 100%, of production costs in exchange for a primary broadcast licence. Independents are now often required as a matter of course to use their secondary rights under the Terms of Trade to raise investment to meet the costs of programme production.
- 2) As part of this transition to a flexible pricing model, the Codes of Practice/Terms of Trade have fostered competition in the exploitation of content across different platforms, enabling the independent production and distribution sector to compete alongside the distribution arms of broadcasters to develop new and existing markets for UK content. In addition to maximising competition and the efficiency in the exploitation of rights, this has provided benefits to consumers in innovation and choice in how they access UK content.

Competition, efficiency and choice in rights exploitation

- 3) The disaggregation of IP rights under the Codes of Practice has stimulated competition and efficiency in the exploitation of rights to UK television content. The licensing of rights was previously restricted largely to the distribution arms of broadcasters, with mixed results. In 2003, the last year before the new Codes of Practice came into effect, Channel 4's 4Rights division reported a profit of just £11.7m, for example.² The Codes of Practice have encouraged the growth of a number of independent distributors with growing global presence. A Mediatique

¹ The 2003 Communications Act called for Codes of Practice between independent suppliers and PSB broadcasters. These led to the negotiation of Terms of Trade between PSB broadcasters and Pact (on behalf of independent producers). Broadly speaking, the Terms of Trade require that certain rights to a programme, such as secondary UK television, new media and international, will reside with the producer, while the commissioning broadcaster will receive primary broadcast rights (which includes a package of various repeat transmission rights) and a share of revenues earned from the exploitation of the rights controlled by the producer.

² Channel 4 statement for 4Ventures 2003.

report on the independent sector this August stated that: “While it is early days for these operations, the UK production industry is clearly beginning to create long-term value on an international level.”³

- 4) In our view this heightened competition is not a zero-sum game. By having greater flexibility in how their secondary rights are exploited, companies are now better placed to ensure that the value of their intellectual property is maximised. As the Mediatique report noted: “Until very recently, there were few options for distribution of rights beyond the integrated broadcaster operations (BBC Worldwide, ITV, C4i), where independents long felt their product was not being exploited efficiently, if at all. There are now some significant distribution players outside the mainstream broadcasters.”⁴
- 5) Most importantly, though, this competition has increased choice for the consumer. The greater availability of secondary rights to the wider market has enabled other services to offer UK originated content to UK consumers in different ways. And as independent production entities have developed their business models, they have started to become involved in innovative forms of delivery themselves, such as launching online on-demand portals ,creating online gaming services as spin-offs to television quiz shows and new interactive factual programmes on social networking sites.

Flexible pricing model

- 6) As fragmenting audiences and advertising revenues have put pressure on the value of the primary broadcast window, the PSB broadcasters have reduced the price they pay for programmes in exchange for the primary licence. Ofcom’s most recent market report showed that the cost-per-hour of first-run originations for PSB broadcasters has fallen in recent years. This does not mean that the actual production costs of programming fell, merely the amount invested by the broadcaster. Across the five main PSB channels (i.e. excluding the BBC digital channels), hours of first-run originated output (network and regions/nations) rose by 2% last year, but spend fell by 5.3%.⁵ Over the last three years, the average (all-day) cost per hour for first-run originations for all PSBs (including the BBC

³ All Grown Up: Cash, Creativity and the Independent Production Sector, Mediatique, August 2008, page 5.

⁴ Ibid, page 22.

⁵ Ofcom Communications Market Report 2008, page 161.

digital channels) fell in real terms from £78,900 in 2005, to £74,600 in 2006, to £70,900 in 2007, the most recent available year.⁶

- 7) Therefore, since the Terms of Trade were fully implemented in 2005, the amount spent per hour on new UK commissions by all PSB has fallen by more than 10%.
- 8) Some of this drop may be due to moves to lower cost genres or efficiency savings in the production process, but it is widely accepted, and increasingly the open policy of commissioning broadcasters, that the proportion of production costs covered by the primary licence from broadcasters is falling – and that independent producers are expected to raise financing themselves to bridge the resulting gap. The BBC recently publicly briefed suppliers that it was seeking proposals for children’s commissions with co-financing attached so that it could pay a lower proportion of production costs in exchange for a primary licence.
- 9) To do this, producers are increasingly raising investment from the private sector by leveraging their secondary rights under the Codes of Practice/Terms of Trade. They do this, for example, by securing distribution advances from distributors financing against projected sales to secondary markets.
- 10) To be clear, producers are not simply cash-flowing a production – they are providing genuine risk investment towards the production costs of a programme to cover the increasing difference between the value of the licence fee and the actual costs of producing a programme. Independents who raise deficit finance to invest in programmes for the UK PSB broadcasters are taking a high level of risk. If the programme is a success, then they stand to re-coup their investment and make a commercial return; if the programme fails, then they will have lost their investment. Over the past four years, independents have spread this risk across their catalogue of programmes and rights to maintain margins and generate profits.
- 11) By contrast, commissioning broadcasters will generally re-coup the cost of their licence fee from the advertising revenues around the first transmission and the primary rights and uses that they have. In addition to this, all of the PSB broadcasters are now net participants in all of the revenues that are received (in perpetuity) from the exploitation of the independents’ programme.

⁶ Annual Communications Market Report 2008, Ofcom, page 177, figure 3.25.

Funding UK content in the digital era

- 12) The net effect of the 2003 Communications Act on the programme supply sector has been to create a more mature, entrepreneurial and flexible market in the funding of UK content. This ability to secure funds from various and developing markets also means that the UK independent sector has the necessary skillsets to thrive in a more fragmented digital world. Indeed many independently-produced programmes are available on many platforms where the only income that can be expected is a share of net advertising revenue.
- 13) At a time of economic recession and significant decline in advertising revenues, Pact would argue that the UK PSB system is better placed to find ways to maintain high levels of investment into UK content precisely because of the Codes of Practice/Terms of Trade, which have enabled the development of a market characterised by many agents seeking financing that contributes to the creation of UK content. This is efficient as it uses the considerable commercial and creative networks of all players in the UK market to maximise investment. Any actions that seek to undermine these arrangements could have the effect of diminishing these multi-source revenues, and thereby contributing to a further decline of UK original content.
- 14) Ofcom predicts a funding shortfall of up to £235m per annum by 2012 just to maintain current levels of UK-made, public service programming.⁷ Independents, and the flexible pricing model underpinned by the Codes of Practice, can be part of the solution for the funding of UK content. Analysis by Oliver & Ohlbaum Associates for Pact found that the primary commission from the main broadcasters currently provides over 85% of the lifetime income for an average new programme but, with the growth in secondary and ancillary markets, is likely to be closer to 75% in ten years' time.⁸ A flexible model will allow such trends to be reflected in how content is funded, with a greater proportion of investment over time coming from secondary and new markets.
- 15) Yet the ability of the independent content sector to play this role must not be taken for granted, and the sector faces both structural and cyclical challenges. As noted above, the value of the primary commission may be falling, but it still represents 85% of income over the lifespan of a programme, and the majority of

⁷ Second Public Service Broadcasting Review, Phase 2: preparing for the Digital Future, Ofcom, September 2008, page 5.

⁸ UK TV Content in the Digital Age – Opportunities and Challenges, Oliver & Ohlbaum Associates, January 2006, page 3.

turnover for independents still derives from that primary commission – circa £1.35 billion out of a total sector turnover of £2.2 billion.⁹ This makes independents especially vulnerable to the recent, widely-reported cuts in broadcasters’ programme budgets. Independents are already seeing the impact of these cuts on their margins, and this is expected to hit home more fully over the next 12 months as commissions agreed before the recent cuts in programme budgets dry up.

- 16) While there has been corporate consolidation in the production sector, this, and City investment, has already slowed dramatically. According to one report, the second half of 2007 saw 8 sales of production companies, while the first half of 2008 recorded just two.¹⁰
- 17) Nor does the level of consolidation to date mean that the relationship between buyers and suppliers has substantively changed. The UK programme supply market is likely to remain a buyers’ market for the foreseeable, with investment concentrated in the hands of a few broadcasters. Oliver & Ohlbaum Associates’ modelling for Ofcom predicts that, as the business model for non-PSB broadcasters will continue to make it difficult for them to invest in the creation of UK content, the four PSB broadcasters will continue to account for 90% of investment from UK broadcasters in UK content through to 2020.¹¹
- 18) In O&O’s 2006 research for Pact, the largest independent supplier accounted for less than 15% of total supply within a genre, and less than 10% of total UK supply. No single large independent accounted for more than 10% of the new programming supply of any specific broadcaster.¹²
- 19) These factors mean that the rationale behind the independent quota and the Codes of Practice – i.e. the imbalance in negotiating power between buyers and suppliers, and the risks inherent in broadcasters’ in-house production departments of unduly restricting access to market for external suppliers – is still relevant. We do not see either of the independent quota or Terms of Trade as representing a significant cost to PSB broadcasters. We therefore welcome Ofcom’s recent statement in regard to ITV that: “We [Ofcom] believe commissions from independent producers add diversity to ITV’s schedule and do not agree that this represents a significant opportunity cost to ITV plc.”¹³

⁹ Independent Production Census, Digital-i for Pact.

¹⁰ All Grown Up: Cash, Creativity and the Independent Production Sector, Mediatique, August 2008.

¹¹ PSB Review Phase 1: The Digital Opportunity, Ofcom, page 66.

¹² Ibid.

¹³ Ofcom’s Second Public Service Broadcasting Review – Phase 2: preparing for the Digital Future, Section 7.7, page 114.

- 20) This supported PKF's research for the Department for Culture, Media and Sport as part of the BBC Charter review process. PKF concluded that there remained a potential for a reduction in costs for the BBC as a result of increased commissioning from independents (due to the increase in competition), and that the Terms of Trade would have little, if any, impact on the vast majority of shows due to the number of repeats granted to the BBC under the primary licence.¹⁴
- 21) More importantly, though, removing the Codes of Practice will risk damaging investment UK content in the digital era, reversing the evolution to a flexible model and forcing UK content creation to revert to its previous, more rigid structure, whereby broadcasters funded 100%, or near 100%, of production costs, and the independent production sector effectively worked for hire. If this occurred, it is in our view unlikely in the current climate that broadcasters would increase their level of spend on UK content to replace lost investment by independents. Rather, they would seek to lower production values of UK origination, put a greater focus on UK content from genres with a lower cost per hour, or simply acquire more imports. For the consumer, this will mean:
- a. a restricted range of UK content; and/or
 - b. lower quality UK content; and/or
 - c. a reduced level of UK content; and/or
 - d. less choice and innovation in UK content delivery due to reduced competition in secondary markets.
- 22) In Pact's view, the fact that 90% of UK broadcaster investment is forecast to come from the current PSB broadcasters means that they all have a potentially important potential role to play in PSB going forward. This role is important not just in providing investment for content creation, but also in ensuring that that investment funds content from a diverse and competitive supply base, i.e. one that enables external suppliers to compete on a level playing field. As Ofcom states, in terms of PSB, this is not for reasons of industrial policy, but because a strong and competitive production sector delivers UK programming that is high quality, innovative, and representative of the broadest possible range of viewpoints.

¹⁴ Review of the BBC Value for Money and Efficiency Programmes, PKF for DCMS, April 2006, page 20.

23) We therefore support the revised Model 1, as this retains roles for all the existing PSB broadcasters. Under this model, though, we have certain concerns or additional proposals, including:

- a. Urgent additional funding to maintain a healthy Channel 4
- b. We see no reason why this model might not also include contestable funding for “at risk” genres, such as children’s, providing of course sufficient funding is available.
- c. Clarity over future children’s provision – either via an enhanced children’s service from Five, contestable funding or an English-language remit for S4C, or possibly a combination of these.
- d. A strong Channel 4 presence in terms of (non-news) nations and regions commissioning, with a focus on developing sustainable companies outside London via increased access to larger scale commissions.
- e. A continuing strong role for Channel 4 in funding UK film.
- f. We agree with Skillset that PSB status should be attached to a clear commitment and obligation towards developing human resources and expertise that will deliver PSB content across different platforms.
- g. We agree with Ofcom’s suggestion that PSB licencees be permitted to fulfil appropriate PSB requirements on different platforms, providing that other appropriate PSB requirements, notably Terms of Trade, are also transferred across platforms. We note that the BBC has recently acknowledged this principle in introducing an independent quota and Terms of Trade for bbc.co.uk.

24) Most importantly, though, we ask that it be made clear that the independent quota and Codes of Practice/Terms of Trade should be retained for all PSBs both in the short-term and in the long term after 2014. The quota remains important in guaranteeing a diverse production ecology, while removing the Codes of Practice will reverse the evolution to a flexible model. Should this occur, we risk ushering in an era where, although the public may have access to a greater range of distribution services, those services will be populated with imported content, or a reduced range of lower quality UK content. This would mark a fundamental failure in PSB provision: one of the central points in our submission in Phase 1 was that UK content is crucial to PSB, and we welcome

the consensus that emerged that UK-originated content is “fundamental to the delivery of public service broadcasting purposes.”¹⁵

¹⁵ Ofcom’s Second Public Service Broadcasting Review – Phase 2: preparing for the Digital Future, page 31.

Introduction

- 1) Pact is the trade association that represents the commercial interests of the independent production sector. We have more than 600 member companies across the entire UK, involved in creating and distributing television, film and interactive content.
- 2) Independent production sector creates around half of all new UK television programmes each year; turnover more than £2 billion per year. The sector employs 20,950 people – more than the terrestrial broadcasting and the cable and satellite sectors respectively.¹⁶
- 3) For further information, please contact Adam Minns at adam@pact.co.uk (020 7380 8232).

¹⁶ Employment Census 2006, Skillset.

Models

Do you agree that public service provision and funding beyond the BBC is an important part of any future system?

- 1) Pact strongly agrees with this view. Pact has consistently argued that plurality in public service provision is important on a number of levels, including both plurality in content delivery to the viewer and in terms of diversity within the content supply sector.
- 2) In terms of delivery, having a range of service providers offers various benefits, stimulating competition and innovation. But perhaps most importantly in terms of the PSB framework, genuine plurality in services helps offer viewers a range of perspectives and voices. This is essential in fulfilling a fundamental principle of the UK's PSB framework: representing a range of viewpoints that reflects and engages our entire society. Such inclusiveness is rightly reflected in Ofcom's definition of public purposes involving the representation of UK cultural identity, diversity and alternative viewpoints.¹⁷
- 3) One set of programme commissioners, working within one organisation, and informed by one set of public purpose goals, will not best deliver public service plurality. We note that Ofcom concluded in its previous PSB review that: "The risk of leaving PSB provision to the BBC alone is great: the lack of competition in broadcasting PSB programming risks leading to complacency, inefficient production, lack of innovation, lower quality programming, a narrowing of perspectives and the loss of PSB programming for certain groups."¹⁸
- 4) This view was supported by the Government's BBC Charter Review White Paper, which stated: "The Government believes that sustaining a plurality of PSB providers who both complement and compete with each other has been important in ensuring that this quality and diversity are maintained."¹⁹

¹⁷ Ofcom's Second Public Service Broadcasting Review – Phase 2: preparing for the Digital Future, page 13.

¹⁸ Ibid, Phase 2, Ofcom, 5.13.

¹⁹ Charter Review White Paper, A public service for all: the BBC in the digital age, March 2006.

- 5) For the purposes of Ofcom’s current review, plurality has a role, not just in news, but also across a range of genres. In children’s, Ofcom’s consumer research for this review clearly indicates that parents want a public service alternative to the BBC – plurality in children’s was second only to plurality in news.²⁰ This supported Ofcom’s findings in last year’s children’s television review, when parents said that having a genuine range of channels meant not just having the BBC compete with imported shows on commercial channels, but having real choice in public service content across more than one outlet. Parents, Ofcom found, “felt that the BBC had a distinct tone of voice and that children would benefit from a variety of voices.”²¹

Which of the three refined models do you think is most appropriate?

- 1) We agree with Ofcom’s rejection of the “BBC only” model outlined in Phase 1, as this would have failed to provide public service plurality. The other three refined models as presented in Phase 2 all meet this fundamental requirement to some degree, although they leave open whether this plurality is provided by incumbent PSB broadcasters or new entrants.
- 2) All of the refined models proposed in Phase 2 have strengths and weaknesses:
 - Model 1 maximises PSB providers by retaining PSB roles for ITV and Five as well as a healthy Channel 4 (providing additional funding is available), but is least successful in fostering innovation in new forms of delivery. It is also unclear where enhanced provision for children will be offered – possibly through a strengthened service from Five, but Ofcom does not elaborate on the extent of this service. As with all the models, we are also concerned that there is no clear provision for (non-news) network commissioning from the nations and regions.
 - Model 2 creates a strong Channel 4, with competitive funding offering possible additional funding for children’s and a way of encouraging innovation in the form of new services and entrants, but loses the guaranteed public service contributions of ITV and Five. Again, we have concerns over (non-news) network commissioning from the nations and regions.

²⁰ PSB Review Phase 1: The Digital Opportunity, Ofcom, page 35.

²¹ Ibid.

- Model 3 maximises the potential for innovation through contestable funding, offers a possible solution for children's via contestable funding, but offers only a weak Channel 4 and loses ITV and Five as PSB broadcasters. As noted above, we are concerned about (non-news) network commissioning from the nations and regions.
- 3) On balance, we see Model 1, the enhanced evolution model, as potentially the strongest. In principle, by retaining all of the PSB broadcasters, even in a reduced capacity, this model offers benefits in terms of maintaining plurality and maximising investment in UK public service content. Under this model, we see the following issues as important:
- a. As proposed by Ofcom, we agree that there is an urgent need for additional funding for Channel 4.
 - b. We also welcome the potential for an enhanced children's service from Five (though this would need to be substantially enhanced to address the current shortfall in provision, and we also ask Ofcom to consider whether S4C's remit for children's content should be extended into English-language provision).
 - c. Additionally, providing sufficient funding is available, we see no reason why contestable funding could not be introduced under this model, in addition to the services Ofcom has proposed. This might offer an alternative, backstop way of funding certain "at risk" public service genres that were not provided by the market or other PSB services – potentially children's.
 - d. We agree with Skillset that PSB status should include a clear commitment and obligation to the development of human resources and technical expertise that will deliver PSB programming on whatever platform in could be available.
 - e. Channel 4 should have a strong nations and regions presence and maintain a significant role in funding UK film.
- 4) Pact agrees that PSB duties placed on licencees should be proportionate to the benefits that they will enjoy from public assets, such as privileged access to

spectrum space. This appears to have been addressed by significantly scaling back the PSB duties of ITV in particular under the proposed Model 1.

- 5) We do, however, ask Ofcom for a greater level of detail regarding the roles of each PSB broadcaster under Model 1, and are particularly concerned that the independent quota and Terms of Trade are retained for all PSB broadcasters. We do not see either of these duties as representing a significant cost to PSB broadcasters. We note Ofcom's recent conclusion in relation to ITV in Phase 2 of the PSB review that: "We [Ofcom] believe commissions from independent producers add diversity to ITV's schedule and do not agree that this represents a significant opportunity cost to ITV plc."²²
- 6) This supported PKF's research for the Department for Culture, Media and Sport as part of the BBC Charter review process. PKF concluded that there remained a potential for a reduction in costs for the BBC as a result of increased commissioning from independents (due to the increase in competition), and that the Terms of Trade would have little, if any, impact on the vast majority of shows due to the number of repeats granted to the BBC under the primary licence.²³
- 7) In our view, the reasons that made intervention through the independent quota and Terms of Trade are still relevant – and the role of Terms of Trade in creating a flexible pricing model makes them crucial in the digital era. Below we outline our thinking on the market conditions that make the quota and the Terms of Trade continue to be important, followed by our views on how the Terms of Trade have enabled producers to raise investment for the production of PSB programming as part of a move to flexible pricing.

Rationale for independent quota

- 8) The quota was introduced to foster diversity in UK programming and ensure that a range of voices are heard, as well as driving creative excellence through competition and encouraging fresh ideas and approaches. With hundreds of production companies vying with each other and with broadcasters' in-house

²² Ofcom's Second Public Service Broadcasting Review – Phase 2: preparing for the Digital Future, Section 7.7, page 114.

²³ Review of the BBC Value for Money and Efficiency Programmes, PKF for DCMS, April 2006, page 20.

production departments, the independent sector helps keep UK content at the top of its creative game, challenging and complementing broadcasters' in-house production departments, driving innovation and offering a diversity of viewpoints.

- 9) There is no sign of a change in these market conditions, according to Ofcom's research. The commissioning of UK programmes will remain a buyers' market, with the four PSB networks (BBC, ITV, C4 and Five) accounting for the vast majority of investment in new UK programmes. Oliver & Ohlbaum's forecasts for Ofcom for this review indicate that the PSBs will account for 90% of broadcaster investment in originations through to 2020.
- 10) Even though independents are increasingly acting as investors in programme production, the level of production investment required from a PSB broadcaster is likely to remain high enough to ensure that financing a television programme without a PSB broadcaster is extremely hard. The primary broadcast market continues to account for the majority of revenues over the lifespan of a television programme - and is likely to continue to account for above 75% of lifetime value over the next decade.²⁴
- 11) Therefore, the fact that the BBC and ITV have in-house production capacity (and Five is permitted to produce in-house) remains an issue. Vertical integration creates incentives for the dominant PSBs to use their market power to unduly exclude external suppliers. Instead of simply acting in viewers' interests by commissioning the highest quality programmes, there is a risk that broadcasters will unduly favour in-house producers, constraining competition in the supply market and restricting the range of public service programmes on offer to the public. As Ofcom recently stated:

“Vertical integration is not normally considered a problem by competition authorities and regulators unless it is combined with market power. Without market power, broadcasters would be incentivised to serve the interests of the viewers and therefore commission programmes that offer the best value for money. However,...the current market structure may not provide this incentive – and could therefore lead to a diminution in programme quality.”²⁵

²⁴ UK TV Content in the Digital Age – Opportunities and Challenges, Oliver & Ohlbaum Associates, page

3.

²⁵ Review of the Television Production Sector, Ofcom, January 2006, page 42.

12) With the BBC, for example, there have been sustained and widespread concerns that, until recently, programme commissioning was unfairly biased towards in-house production departments. More than a decade after the introduction of the independent quota, the BBC was failing to meet its 25% minimum. Even when it did, as director general Mark Thompson told the Lords Select Committee, the quota was regarded as a ceiling, not a floor.²⁶ This was only recently addressed through the Window of Creative Competition.

13) We therefore see the independent quota as continuing to deliver substantial benefits in terms of diversity and creative competition in UK programming, with negligible cost to PSB broadcasters.

Terms of Trade

14) The rationale behind the Terms of Trade is also just as relevant. According to research commissioned by Pact from Oliver & Ohlbaum Associates, the PSB networks and their spin off channels currently account for 79% of all viewing; by 2015, this is still forecast to be as high as 70%, representing more than 70% of all TV advertising revenue.²⁷

15) This is confirmed by Oliver & Ohlbaum's forecasts for Ofcom, which show that the dominance of the PSB broadcasters in terms of spend on original commissioning is likely to continue, even if the total value of commissions declines. According to Ofcom, commissioning spend from multi-channels (PSB spin-offs and non-PSBs) is likely to fall in proportion to declines at PSBs (under both its "gradual transformation" and "stagnation" scenarios). The result is that spend from non-PSBs and PSB spin-off channels will remain at around 10% of the total spend from all broadcasters through to 2020, with the main PSB services controlling the remaining 90%.²⁸

16) There was no evidence of this dominance weakening in Digital-i's 2007/08 census of the independent production sector for Pact. The report found that independent companies' revenues from primary commissions from broadcasters have hit £1.35

²⁶ Mark Thompson oral evidence to House of Lords Select Committee on the BBC Charter Review, First Report, Section 254.

²⁷ UK TV Content in the Digital Age – Opportunities and Challenges, Oliver & Ohlbaum, page 29.

²⁸ PSB Review Phase 1: The Digital Opportunity, Ofcom, page 66.

billion, up from £1.14 billion in 2005. Of this, all but a little over £200m came from the main terrestrial-based broadcasters.²⁹

17) While there has been consolidation in the independent sector, this has not allowed producers to exert undue pressure on broadcasters (although a hit show will inevitably command a premium). In Oliver & Ohlbaum Associates' research for Pact, the largest independent supplier accounted for less than 15% of total supply within a genre, and less than 10% of total UK supply. No single large independent accounted for more than 10% of the new programming supply of any specific broadcaster.³⁰ The UK programme supply market, therefore, is likely to remain a buyers' market.

18) The fact that only around 10% of commissioning spend is predicted to come from multi-channels or PSB spin-offs through to 2020, means that little has changed since the conclusions of the Independent Television Commission's A Review of the UK Programme Supply Market. This highlighted the strength of the main terrestrial broadcasters in negotiating rights to content, stating that:

“Almost all investment in programming flows through a few main broadcasters - the BBC, ITV, Channel 4 and Five between them account for 90% of all programme commissions in the UK - which means they determine the programmes that viewers get to see, and have significant bargaining power when buying programmes from independent producers.”³¹

19) This view was reinforced more recently by Ofcom in its review of the production sector. Ofcom concluded that the growth of rival, non-PSB channels would make little difference to the importance of the primary licence as a source of programme finance, and hence have little impact on the negotiating strength of the terrestrial broadcasters. Ofcom stated:

“The sources of demand for external productions are growing – mainly from digital channels, but also some emerging demand from international markets and new distribution platforms. However, the main terrestrial broadcasters are likely to remain the main buyers of originated programming going forward – and so their negotiating strength will only be ameliorated to a limited extent.”³²

²⁹ Independent production census 2007/08, Digital-I for Pact, page 18.

³⁰ Ibid.

³¹ A Review of the UK Programme Supply Market, ITC, page 5.

³² Review of the Television Production Sector, consultation paper, Ofcom, page 8.

20)Historically, this bargaining power has allowed broadcasters to seek an array of additional rights to be bundled into the price they pay for the primary licence for no additional cost. As we have noted, the incumbent PSB broadcasters have historically used their dominant position to stifle secondary markets by warehousing IP rights and seeking excessive, exclusive holdback periods. This creates a danger that new entrants will be excluded from developing new platforms and services with UK content, resulting in a significant loss to the viewer.

Flexible pricing under the Terms of Trade

21)Rather than increasing investment in UK content, removing the Codes of Practice will undermine it. The Codes of Practice and the ensuing Terms of Trade between broadcasters and producers underpin a flexible pricing model that is key to funding the creation of UK content going forward as it is able to respond to developing forms of delivery. Gone are the days when broadcasters would routinely provide 100%, or near 100%, of production costs in exchange for a primary broadcast licence. Independents are now often required as a matter of course to use their secondary rights to raise investment to meets the costs of programme production, which they have excelled at doing.

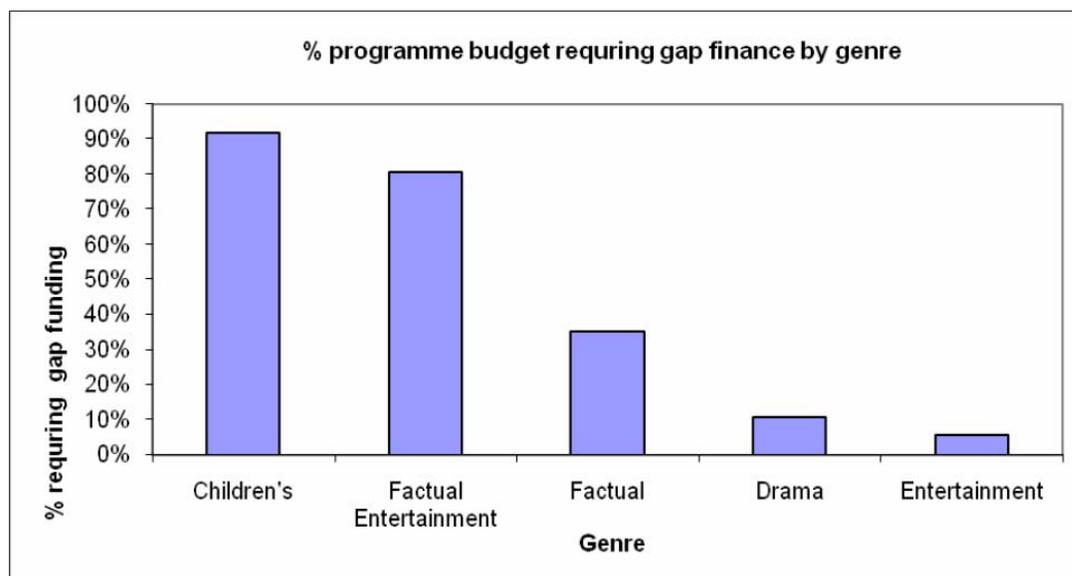
22)As fragmenting audiences and advertising revenues have put pressure on the value of the primary broadcast window, the PSB broadcasters have reduced the price they pay for programmes in exchange for the primary licence. Ofcom's most recent market report concluded that the cost per hour for PSB broadcasters of first-run originations has fallen in recent years. This does not mean that the actual production cost of the programme fell, merely the amount invested by the broadcaster. Across the five main PSB channels (i.e. excluding the BBC digital channels), hours of first-run originated output (network and regions/nations) rose by 2% last year, but spend fell by 5.3%.³³ Over the last three years, the average (all-day) cost per hour for first-run originations for all PSBs (including the BBC digital channels) fell in real terms from £78,900 in 2005, to £74,600 in 2006, to £70,900 in 2007, the most recent available year.³⁴

23)Therefore, since the Terms of Trade were fully implemented in 2005, the amount spent per hour on new UK commissions by all PSB has fallen by more than 10%.

³³ Ofcom Communications Market Report 2008, page 161.

³⁴ Annual Communications Market Report 2008, Ofcom, page 177, figure 3.25.

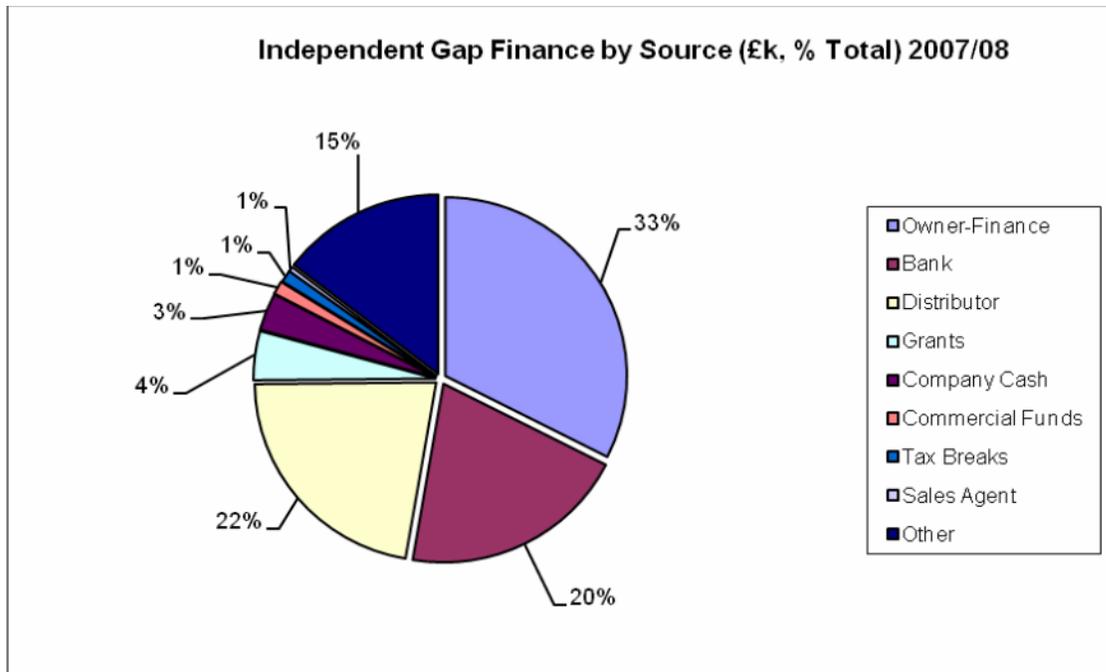
- 24) Some of this drop may be due to moves to lower cost genres or efficiency savings in the production process, but it is widely accepted, and increasingly the open policy of commissioning broadcasters, that the proportion of production costs covered by the primary licence from broadcasters is falling – and that independent producers are expected to raise financing themselves to bridge the resulting gap. The BBC recently publicly briefed suppliers that it was seeking proposals for children’s commissions with co-financing attached.
- 25) To do this, producers are increasingly raising investment from the private sector by leveraging their secondary rights under the Codes of Practice/Terms of Trade. They do this, for example, by securing distribution advances from distributors financing against projected sales to secondary markets. This is not simply cashflowing a production, this represents genuine risk investment towards the production costs of programme to cover the increasing difference the value of the licence fee and the actual costs of producing a programme.
- 26) The amount of investment required varies by genre, but a snapshot of 20 independent companies suggests that it can be up to 90% of the programme budget for children’s; 37% for factual; and 15% for drama, as shown below.³⁵



Source: Pact census, Digital-i for Pact

³⁵ Independent production census 2007, Digital-i for Pact, page 40.

27) To bridge this gap, producers are raising investment from the private sector, not public subsidies. In our sample, the largest source of gap financing in was the company directors/owners (33% of total), followed by distributors (23%) and banks (20%). Public support represents just 1%, as the table below illustrates.³⁶



Source: Pact census, Digital-i for Pact

28) Independents who raise deficit finance to invest in programmes for the UK PSB broadcasters are taking a high level of risk. If the programme is a success, then they stand to re-coup their investment and make a commercial return; if the programme fails, then they will have lost their investment. Over the past four years, independents have spread this risk across their catalogue of programmes and rights to maintain margins and generate profits.

29) By contrast, commissioning broadcasters will generally re-coup the cost of their licence fee from the advertising revenues around the first transmission and the primary rights and uses that they have. In addition to this, all of the PSB

³⁶ Independent Production Census 2007/2008, page 29, Digital-i for Pact.

broadcasters are now net participants in all of the revenues that are received (in perpetuity) from the exploitation of the independents' programme.

Competition, efficiency and choice in rights exploitation

30)The disaggregation of IP rights under the Codes of Practice has stimulated competition and efficiency in the exploitation of rights to UK television content. The licensing of rights was previously restricted largely to the distribution arms of broadcasters, with mixed results. In 2003, the last year before the new Codes of Practice came into effect, Channel 4's 4Rights division reported a profit of just £11.7m, for example.³⁷ The Codes of Practice have encouraged the growth of a number of independent distributors with growing global presence. A Mediatique report on the independent sector this August stated that: "While it is early days for these operations, the UK production industry is clearly beginning to create long-term value on an international level."³⁸

31)In our view this heightened competition is not a zero-sum game. By having greater flexibility in how their secondary rights are exploited, companies are now better placed to ensure that the value of their intellectual property is maximised. As the Mediatique report noted: "Until very recently, there were few options for distribution of rights beyond the integrated broadcaster operations (BBC Worldwide, ITV, C4i), where independents long felt their product was not being exploited efficiently, if at all. There are now some significant distribution players outside the mainstream broadcasters."³⁹

32)Most importantly, though, this competition has increased choice for the consumer. The greater availability of secondary rights to the wider market has enabled other services to offer UK originated content to UK consumers in different ways. And as independent production entities have developed their business models, they have started to become involved in innovative forms of delivery themselves, such as launching online on-demand portals ,creating online gaming services as spin-offs to television quiz shows and new interactive factual programmes on social networking sites.

³⁷ Channel 4 statement for 4Ventures 2003.

³⁸ All Grown Up: Cash, Creativity and the Independent Production Sector, Mediatique, August 2008, page

5.

³⁹ Ibid, page 22.

- 33) This flexibility in pricing is vital as the UK makes the transition to the digital era and a greater number of forms of delivery open up. Ofcom predicts a funding shortfall of up to £235m per annum by 2012 just to maintain current levels of UK-made, public service programming.⁴⁰ Independents, and the flexible pricing model underpinned by the Codes of Practice, can be part of the solution. Analysis by Oliver & Ohlbaum Associates for Pact found that the primary commission from the main broadcasters currently provides over 85% of the lifetime income for an average new programme but, with the growth in secondary and ancillary markets, is likely to be closer to 75% in ten years' time.⁴¹ A flexible model will allow such trends to be reflected in how content is funded, with a greater proportion of investment over time coming from secondary and new markets.
- 34) Yet the ability of the independent content sector to play this role must not be taken for granted. As we have detailed in the preceding sections about the independent quota and the Terms of Trade, the rationale behind both interventions remains relevant today as fundamental structural issues remain in place. Nor is independent sector immune to current cyclical pressures. The primary commission still represents 85% of income over the lifespan of a programme, and the majority of turnover for independents still derives from that primary commission – circa £1.35 billion out of a total sector turnover of £2.2 billion.⁴² This makes independents especially vulnerable to the recent, widely-reported cuts in broadcasters' programme budgets. Independents are already seeing the impact of these cuts on their margins, and this is expected to hit home more fully over the next 12 months as commissions agreed before the recent cuts in programme budgets dry up.
- 35) While there has been corporate consolidation in the production sector, this, and City investment, has already slowed dramatically. According to Mediatique, the second half of 2007 saw 8 sales of production companies, while the first half of 2008 recorded just two.⁴³
- 36) In Pact's view, the fact that 90% of UK broadcaster investment is forecast to come from the current PSB broadcasters means that they all have a potentially important potential role to play in PSB going forward. This role is important not just

⁴⁰ Second Public Service Broadcasting Review, Phase 2: preparing for the Digital Future, Ofcom, September 2008, page 5.

⁴¹ UK TV Content in the Digital Age – Opportunities and Challenges, Oliver & Ohlbaum Associates, January 2006, page 3.

⁴² Independent Production Census, Digital-i for Pact.

⁴³ All Grown Up: Cash, Creativity and the Independent Production Sector, Mediatique, August 2008.

in providing investment for content creation, but also in ensuring that that investment funds content from a diverse and competitive supply base, i.e one that enables external suppliers to compete on a level playing field. As Ofcom states, in terms of PSB, this is not for reasons of industrial policy, but because a strong and competitive production sector delivers UK programming that is high quality, innovative, and representative of the broadest possible range of viewpoints.

- 37) We therefore ask that it be made clear that the independent quota and Codes of Practice/Terms of Trade should be retained for all PSBs both in the short-term and in the long term after 2014. The quota remains important in guaranteeing a diverse production ecology, while removing the Codes of Practice will reverse the evolution to a flexible model, forcing UK content creation to revert to its previous more rigid structure, whereby broadcasters funded 100%, or near 100%, of production costs, and the independent production sector effectively worked for hire.
- 38) If this occurred, it is in our view unlikely in the current climate that broadcasters would increase their level of spend on UK content to replace lost investment by independents. Rather, they would seek to lower production values of UK origination, put a greater focus on UK content from genres with a lower cost per hour, or simply acquire more imports. For the consumer, this will mean:
- a. a restricted range of UK content; and/or
 - b. lower quality UK content; and/or
 - c. a reduced level of UK content; and/or
 - d. less choice and innovation in UK content delivery due to reduced competition in secondary markets.
- 39) We agree with Ofcom's suggestion that PSB licencees be permitted to fulfil appropriate PSB requirements on different platforms. However, were this to happen, the Terms of Trade and independent quota should be applied to any services, regardless of platform, operated by PSB broadcasters that contribute towards the fulfilment of their PSB remits.
- 40) We also propose that, as well as retaining the quota for all PSB services, it is time to liberalise the IP regime further. We broadly agree with Ofcom's approach that core public service content should remain widely available and free at point of use for the public in what might be termed a "public service window". As Ofcom

suggested in Phase 1 of its PSB review, however, around that public service window there should be opportunities to develop new forms of delivery that may have an additional payment.

- 41) In particular, there should be opportunities for making content available as soon as possible outside the public service window on a non-exclusive basis. Even under the current Codes of Practice, PSB broadcasters have a significant and exclusive “holdback” period. This is the period after their primary transmission use or uses, but before they are required to make content available to the wider market. During this holdback period broadcasters are able to control that content exclusively (and even when this content is released after the holdback period they retain non-exclusive rights). In some cases, such as on-demand rights for returning series, one of the most popular forms of on-demand television content with the UK public, this exclusive control can last for up to three years after the initial broadcast transmission.
- 42) We see little public value in this holdback period granting exclusive control to the broadcaster. The public wants choice in how it access content. As the example of the music industry shows, people will use alternative, illegal means if denied prompt access to content at a reasonable price.
- 43) The Codes of Practice have already introduced a limited degree of non-exclusivity, i.e. when the holdback period has expired, and both Ofcom and PKF have reported no significant opportunity cost to ITV and the BBC respectively. Content should in our view therefore be made available to the market more quickly on a non-exclusive basis. The commissioning broadcaster will of course retain non-exclusive rights, and benefit from a share of the revenues generated by third-party exploitation – which may well be generated in ways they would be unable to offer themselves.

Do you agree that in any future model Channel 4 should have an extended remit to innovate and provide distinctive UK content across platforms? If so, should it receive additional funding directly, or should it have to compete for funding?

- 1) Pact argued in its submission to Phase 1 of this review that Channel 4 has played an important role in delivering public service content that greatly enriches the PSB landscape. Channel 4 should urgently receive additional, guaranteed funding so that it can develop its business model with some degree of confidence.

- 2) As with all PSB broadcasters, we welcome Channel 4 being allowed to fulfil its PSB remit via its portfolio channels and other platforms providing that other appropriate PSB requirements are also transferred to these services, such as Terms of Trade and the Out of London quota. Permitting Channel 4 a degree of flexibility in how it delivers public service content is welcome, but this would be counterproductive if the broadcaster were allowed to dilute its overall public service offering by cherry picking which duties it carries over onto new platforms.
- 3) In our response to Phase 1, we raised concerns in this regard over Channel 4 moving its schools content online. We understand the strategy behind this shift and welcome the current £6m spend online. However, as Ofcom is aware, the Terms of Trade with independent producers do not apply to schools television programming to the same extent as other genres. We are concerned that this should not set a precedent when commissioning other genres online. The schools exception should rightly be transferred across to the online world as long as the content being commissioned is specifically targeted at school children and their teachers. If it is serving a different or more general audience for other purposes not associated with formal education then the normal Terms of Trade should apply. Either way, the migration from television to online should not prejudice future public policy regarding online content and the Terms of Trade or other PSB duties.
- 4) However, we do not agree that Channel 4 should be given additional funding simply in order to meet the overhead or distribution costs of making content available on other platforms. This risks putting the institution before the content it provides, using scarce public resources to underwrite moves into other media while failing to address the shortfall in investment in public service content that is at the heart of this debate.

Do you think ITV1, Five and Teletext should continue to have public service obligations after 2014? Where ITV1 has an ongoing role, do you agree that the Channel 3 licensing structure should be simplified, if so what form of licensing would be most appropriate?

- 1) We support a continuing role for ITV and Five as PSB broadcasters, and we accept that their PSB requirements must be proportionate to their benefits. However, we have also asked for the independent quota and Terms of Trade to be retained, both in the short and long term. We have outlined our argument on this, both in terms of the substantial public benefits that the two interventions

provide and the negligible opportunity cost to ITV and Five, in response to question 2.

- 2) We also ask for clarification on Five's proposal that it might have an enhanced children's role. This would have to entail a meaningful rise both in terms of the level of content that it offers and the age-range it serves in order to address the short-fall in provision, particularly for older children, that Ofcom has identified. We understand that the annual value of Five's PSB licence has risen considerably this year, and suggest that this might be used to balance an increase in children's provision from Five.
- 3) One of our key concerns with an enhanced service from Five is that its current business model may not transfer successfully to making programming for older children, as it provides a relatively low proportion of programme production costs. Five's current service offers pre-school programming for young children, and independent producers are able to raise a high level of financing to cover the shortfall in production costs as there are more possibilities for commercial licensing. This is not the case in drama and factual for older children, the key areas Ofcom has identified as experiencing a shortfall, and Five may have to be willing to provide a substantially greater share of the production costs.
- 4) With this in mind, we suggest that Ofcom also consider the long term potential of S4C extending its remit to cover English-language children's content. S4C's current investment of £10 million per year in children's programming represents a proven commitment to the genre. As we outline in the section on short term measures, opportunities to use this investment for the production of English-language programming have to date been limited. Long term, however, we would welcome consideration of S4C's remit being expanded to cover English-language programming, though recognise that this should not undermine its core, Welsh-language mandate. If this remit were to include English-language content, S4C, or producers commissioned by S4C, should be considered for any contestable funding that is available for children's programming.

What role should competition for funding play in future? In which areas of content? What comments do you have on our description of how this might work in practice?

- 1) Contestable funding for UK content might take the form of longer term, ongoing contracts as suggested by Ofcom, or content a programme-by-programme model. Both systems in our view merit consideration, although we will focus on the programme-by-programme model as Ofcom has already presented an ongoing system as part of its current PSB review.
- 2) In either case, a condition of funding should be that the programme has guaranteed UK distribution. We would also welcome, where appropriate of funding being award to non-television content.
- 3) Pact understands the arguments about trying to avoid the bureaucracy associated with the worst of programme-by-programme funding models, but equally there are successful initiatives in the UK and around the world that are proven and relatively straightforward. We have proposed a children's tax credit modelled on the UK film tax credit, and such a model might be extended to other public service genres where there is a proven failure in the market to provide an appropriate level and range of content. The current film tax credit has been in operation for nearly two years and has been free of the abuse associated with the previous, very different, tax relief regime under the Section 42 and 48 sale and leaseback systems.
- 4) Alternatively, the model of NZ on Air in New Zealand might be considered as a programme-by-programme funding scheme that has operated successfully. Established by the Broadcasting Act of 1989, NZ on Air was launched at the time of the deregulation of the broadcasting market, with the aim of safeguarding the provision of PSB programmes. The non-profit making Crown entity employs a modest staff of around 14 people to administer a direct government grant worth circa \$100m per annum.
- 5) In making a funding grant the NZ on Air board requires proof from the producer that a broadcast partner is in place. It expects to see evidence of the size of the potential audience for the project and that the project fulfils NZ on Air's overarching remit to stimulate the creation of New Zealand radio and television programmes about New Zealand and New Zealand interests.

Targeting “at risk” genres

- 6) We welcome Oliver & Ohlbaum Associates' conclusion as part of its research for Ofcom that children's content is particularly suitable for its proposed form of

contestable funding, but in our view children's content is equally suited to a programme-by-programme model. The important, common factors are that there is proven failure in the market to deliver an appropriate range and level of content (as Ofcom has demonstrated); that children's is readily definable as a genre; and that there are likely to be multiple bidders for funding, with numerous producers and broadcasters specialising in this genre, thereby ensuring creative competition.

- 7) Regardless of whether it is envisaged to operate on programme-by-programme or ongoing basis, we urge that funding be ring-fenced only for genres where there is a proven market failure. This is important in order to avoid negative competition and State Aid impacts, as well as to ensure that funding is directed at the most appropriate areas. The basis for a robust process for determining where there is a market failure is already in place in the form of Ofcom's annual market reports. The particular genres judged to be subject to market failure, and therefore eligible for contestable funding, could be subject to review every few years. We would argue that children's should be instated as eligible from the inception of such a fund, subject to later reviews as appropriate.
- 8) We also support these deficits in public service television programming being addressed where appropriate through delivery on new platforms. Therefore, where suitable, contestable funding should be available to wider forms of audiovisual or interactive content that target the same audience groups.
- 9) In children's, parents concerns over the safety of online provision would have to be considered, and may limit the scope for new media provision in this genre. However, we note BBC children's services have pursued a "360 degree" commissioning strategy for multi-platform content, and we ask Ofcom to consider the findings of the BBC Trust's current review of BBC children's services in its thinking on this issue.

Long-term: nations and regions

Do you agree with our findings that nations and regions news continues to have an important role and that additional funding should be provided to sustain it?

- 1) We agree that nations and regions news has an important role, but are concerned that this will overshadow other important areas of PSB, such as funding solutions for Channel 4, children's programming, current affairs, specialist factual and (non-news) commissioning from the nations and regions.
- 2) In Ofcom's consumer research, current affairs, specialist factual and children's are valued as highly as nations and regions news, and in some aspects are seen as greater priorities. All are ranked as high in importance in terms of being on the PSB channels and in delivering PSB purposes, but the public had a high desire for more specialist factual and children's, compared to only a medium desire for more nations and regions news.⁴⁴

Which of the three refined models do you think is most appropriate in the devolved nations?

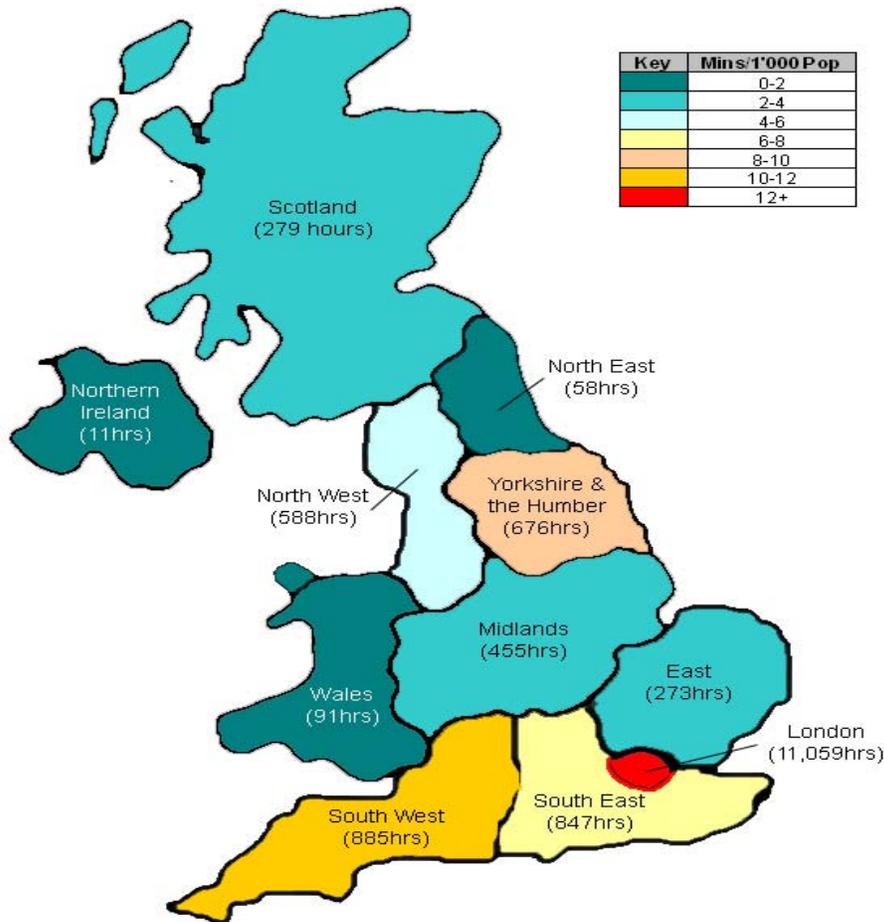
- 1) Representing the nations and regions at network level is in Pact's view fundamental to one of the prime public purposes of PSB as defined by Ofcom - reflecting UK cultural identity. It is also important to another public purpose, representing diversity and alternative viewpoints.
- 2) In Phase 1, Ofcom asserted that out of London production and portrayal at network level are "major issues," and the intention that Phase 2 of the review would be to examine this area more fully.⁴⁵ We are concerned that there is a lack of focus in Phase 2 on (non-news) network commissions from the nations and regions.
- 3) As we outlined in our response to Phase 1, research commissioned by Pact demonstrates the lack of representation of the devolved nations and English

⁴⁴ Ofcom's Second Public Service Broadcasting Review – Phase 2: preparing for the Digital Future, figure 4, page 33.

⁴⁵ PSB Review Phase 1: The Digital Opportunity, Ofcom, section 9.12, page 113.

regions at network level. Pact's latest Production Trend Report for Out of London, conducted by Attentional, confirmed our previous report and showed that London provides a disproportionately high level of hours per capita than the rest of the country, as illustrated below.

Nations and regions representation per capita



Source: Attentional for Pact

- 4) In terms of (non-news) network commissions from the devolved nations and English regions, we see the BBC and Channel 4 as the most important services. If ITV is allowed to reduce its requirements, this is likely to lead to a substantial

decline in investment, even with the BBC's increased quota of 50%. Therefore, to partially offset this, Channel 4 should strengthen its out of London presence, with a quota of 35%, as it has pledged, and, just as importantly, a focus on enabling suppliers in the nations and regions to compete for large scale commissions with which they can develop their businesses.

- 5) As a publisher broadcaster sourcing its programming from external suppliers, Channel 4 has a particularly important role in terms of fostering plurality in supply (and thereby offering the public genuine range in content).
- 6) Therefore, we would welcome clarification of Channel 4's future out of London commitment, which is not detailed in Ofcom's descriptions of its proposed models. This commitment should focus not just on achieving a high out of London quota, but also on enabling companies in the nations and regions to compete for larger scale commissions around which they can develop their businesses on a sustainable basis. The ability to secure such larger scale commissions gives companies the confidence to make capital investments in business development and infrastructure on a strategic basis, and thus drives sustainability.

Do you agree with our analysis of the future potential for local content services?

- 1) Pact supports the creation of local services as a public service that fosters local communities. We see online provision as particularly suitable for such services, given that Ofcom's research for this review indicated that the public values the internet particularly highly as a source of information about local communities and other communities of interest.
- 2) Independent content creation companies should play an important role in creating content for such services, as they often have strong ties to local communities and represent a way of engaging those communities, as well as offering a plurality of voices.

Funding

Do you agree with our assessment of each possible funding source, in terms of its scale, advantages and disadvantages?

- 1) Yes, except that, as noted, the increasing role of independent producers as providers of financing for the production of PSB has been overlooked in this debate. Broadcasters argue that the value of the primary licence has fallen, but so has the proportion of the production costs that they provide in exchange for that licence. Independents are routinely expected to act as co-producers or bring co-financing into the production. They are able to do so by exploiting their IP ownership under the Terms of Trade, as we have detailed in section 1 of this submission.

What source or sources of funding do you think are most appropriate for the future provision of public service content beyond the BBC?

Direct public funding

- 1) Pact maintains that it may fall within the remit of certain Government departments to fund aspects of PSB – for example, the Department for Children, Schools and Families and Department for Innovation, Universities and Skills could have a role in formal and informal learning and schools content. This would, however, raise questions of editorial integrity.

Licence fee

- 2) Pact has been reassured by statements by Ofcom and the Secretary of State for Culture, Media & Sport that any re-allocation of the licence fee (from, for example, from funds allocated for digital switchover) should not damage the BBC's programme budgets. We therefore support the principle of re-allocating licence fee income that is set aside for digital switchover costs. Although this funding does not represent an increase to the overall funding available for all public service activities, it would represent additional funding for the production of UK content, which Ofcom has identified as crucial to PSB, if it were re-allocated to investing in programmes.

- 3) As a secondary option to re-allocating the digital switchover fund, we see merit in reinvesting profits generated by BBC Worldwide, as we originally proposed. BBC Worldwide is performing well above inflation: in 2006/07, pre-tax profits hit £111m, up 24% year-on-year and triple profits from three years ago.⁴⁶ Redistributing profits generated by BBC Worldwide, rather than the licence fee itself, would allow the BBC a level of security in knowing that its core licence fee is not subject to top-slicing.

Regulatory assets

- 4) Substantial parts of current PSB commitments are likely to be provided by broadcasters without them being required to, as Ofcom acknowledges in Phase 2 of this review. We are disappointed that Ofcom has not excluded the value of such programming when reviewing the appropriate level of public service commitment in return for regulatory assets, or explained why this has not been done.

Industry funding

- 5) We would support a review of whether there is financial benefit for commercial platforms in carrying PSB content, and if there is what the value of this is. There may be scope for revising the application of copyright law to enable content creators to better secure appropriate compensation for the use of their copyrights by third-party delivery services, such as through “must carry” obligations. This offers the potential to develop revenue streams for content production, either by returning revenues that accrue directly to the producer or by creating a contestable funding system for content production.
- 6) In the context of public service broadcasting, there may also be a case for such intervention on the grounds that commercial sector broadcasters potentially gain a commercial benefit from transmitting public service content under must carry obligations – such as increased audience share from popular programmes that have built audience awareness by exposure on the PSB services.
- 7) Ofcom might therefore recommend a review of several areas of UK “must carry” and retransmission rules, including:

⁴⁶ BBC Worldwide annual report 2006/2007.

- i) Currently, UK producers receive no benefit from the re-transmission of content they create by many UK broadcasters or service providers under Section 73 of the Copyright, Designs and Patents Act 1988.
- ii) Currently, UK content creators often do not receive payments when their content is sold to an overseas broadcaster but then relayed in the UK by a UK service. Digital Britain might consider the current effectiveness of the cable re-transmission rights of content owners under section 144A Copyright, Designs and Patents Act 1988 (collective exercise of certain rights in relation to cable re-transmission) and the definition of “cable operator” under that section.⁴⁷

Which of the potential approaches to funding for Channel 4 do you favour?

- 1) As we have outlined, we support urgent additional funding for Channel 4. We favour using funding re-allocated from the BBC (preferably from funds earmarked for digital switchover), new money from Government, or funding arising from industry, e.g. through a revision of retransmission copyright regulations – or a combination of these.
- 2) We do not agree with objections to funding Channel 4 via licence fee allocation or direct Government grants on the grounds of an increased regulatory burden for Channel 4. Despite the regulations that rightly come with licence fee funding, the BBC is perfectly capable of commissioning and broadcasting challenging and innovative content.

⁴⁷S 144A CDPA

(1) This section applies to the right of the owner of copyright in a sound recording or film to grant or refuse authorisation for cable re-transmission of a wireless broadcast from another EEA member state in which the work is included.

(6) This section does not affect any rights exercisable by the maker of the broadcast, whether in relation to the broadcast or a work included in it.

(7) In this section

“Cable operator” means a person responsible for cable re-transmission of a wireless broadcast; and

“Cable re-transmission” means the reception and immediate re-transmission by cable, including the transmission of microwave energy between terrestrial fixed points of a wireless broadcast.”

Matters for short-term regulatory decisions

Do you agree that our proposals for 'tier 2' quotas affecting ITV plc, stv, UTV, Channel TV, Channel 4, Five and Teletext are appropriate, in the light of our analysis of the growing pressure on funding and audiences' priorities? If not, how should we amend them, and what evidence can you provide to support your alternative?

- 1) We accept that PSB duties placed on broadcasters should be proportionate to their PSB benefits, and that this may necessitate reductions in PSB obligations.
- 2) However, Pact welcomes the consensus amongst stakeholders in response to Phase 1 that original production – i.e. UK-made programming - is at the heart of delivering PSB values.⁴⁸ We therefore agree that original production should be at the heart of ITV's PSB remit and that ITV's original production quota should therefore not be lowered.
- 3) We also welcome Ofcom's decision not to permit ITV to reduce its independent quota and its conclusion that independent productions "add diversity to ITV's schedule" and do not represent "a significant opportunity cost to ITV plc."⁴⁹ As we have argued, we have seen no evidence that independent productions commissioned under the Terms of Trade represent an opportunity cost, and in fact in our view the Terms of Trade are likely to be generating additional investment for programme production by enabling independent producers to raise gap financing.
- 4) Furthermore, the primary broadcaster secures a range of wide rights under the primary licence for no additional cost.
- 5) In ITV's case, the broadcaster has never acquired all rights outright to commissions, internal or external. Prior to the introduction of the Terms of Trade following the Communications Act 2003, the broadcaster acquired a

⁴⁸ Ofcom's Second Public Service Broadcasting Review – Phase 2: preparing for the digital future, page 18.

⁴⁹ Ibid, page 114.

five-year licence to external commissions which included limited repeat rights. Portfolio services such as ITV2 would have to acquire a programme at additional cost. This system was created following concerns raised by ITV's network subsidiaries that ITV should not own the content they create in perpetuity. ITV is actually better off under the new Terms of Trade: it now receives a share of revenues in perpetuity from any exploitation of content that it commissions from third-parties, something which did not happen under the previous system, in addition to rights to further repeats.

Children's programming

- 6) Ofcom confirms in Phase 2 that children's is one of the few areas of PSB where there is already a gap in provision – "gaps in delivery are appearing in some areas, including programmes for the UK's nations and regions and children's."⁵⁰ In Phase 1, Ofcom identified a £30m-£50m annual funding gap in children's, with a particular failure in provision for older children.
- 7) Most of Ofcom's short-term proposals would not address this funding gap in any significant way. Indeed, we are concerned that children's is at risk of being overlooked in this review's conclusions.
- 8) However, of the short term options, we do see potential for addressing the children's funding crisis in the short-term in Five's proposal to make a formal commitment to children's programming through its annual statements, providing this results in a substantially enhanced offering, both in terms of investment levels and in terms of age-range of programming. We understand that the value of Five's public assets has risen by circa £10m this year, and suggest that is reflected in a substantially increased children's offering by Five.
- 9) One of our key concerns with an enhanced service from Five, however, is that its current business model may not transfer successfully to making programming for older children, as it provides a relatively low proportion of programme production costs. For Five's current service, pre-school programming for young children, producers are able to use their rights under

⁵⁰ Ofcom's Second Public Service Broadcasting Review – Phase 2: preparing for the digital future, page 13.

- the Terms of Trade to raise gap financing to cover the resulting shortfall as there are more possibilities for commercial licensing. In drama and factual for older children, the key areas Ofcom has identified as experiencing a shortfall, this is not possible to such a degree, and Five may have to be willing to provide a substantially greater share of the production costs.
- 10) Of the other short-term options, the BBC's ongoing investment in this area is welcome, but its overall spend on children's is likely to remain at best flat over this Charter period, and so it will not address the £30-£50m funding gap that Ofcom has identified. Increases in the BBC's online spend will merely offset cuts made as part of the BBC's general round of cutbacks following the last Charter agreement.
- 11) Regarding Ofcom's second short-term proposal, Channel 4's new children's initiative has already failed. Channel 4 has frozen children's commissioning as part of its recent decision to cut its overall spending. Even if this were not the case, the broadcaster would invest just £5m a year, again not enough to plug Ofcom's £30m-£50m gap.
- 12) Amongst the other proposals, S4C's investment of £10 million per year in children's programming represents a substantial level of funding and a proven commitment to the genre, but opportunities to use this investment for the production of English-language programming have to date been limited. It is possible that S4C could play a significantly greater role in English-language content as a co-producer and we would welcome any developments in this area. To date, however, we have not seen anything that, in the short term, represents a genuine answer to the £30-£50m funding gap for English-language children's provision.
- 13) Long term, however, we would welcome consideration of S4C's remit being expanded to cover English-language programming to a greater degree, though recognise that this should not undermine its core, Welsh-language mandate. If this remit were to include English-language content, S4C, or producers commissioned by S4C, should be considered for any contestable funding that is available for children's programming.