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Dear Siobhan,

Thank you for your recent letter in response to ours of 26 July 2019 about minor changes to our operating licence. We welcome your intention to bring forward these changes.

We support without qualification proposals two, three, four and five as set out in your letter of 14 August. As we explained in our letter of 26 July 2019 when requesting these changes, we consider that transparency is best served by ensuring that the operating licence is continually updated and accurately reflects how we measure and report our performance to Ofcom. With respect to proposals two and five specifically, these changes would also ensure greater consistency by bringing the BBC into line with the data collected on other broadcasters, meaning that the data is directly comparable and gives greater insight.

We continue to strongly support the intention behind proposal one. We reiterate that the existing requirement, being a legacy of the BBC Trust's service licence for Radio 3 and historic BBC funding allocations, is outdated and does not reflect how we currently operate. We agree with Ofcom that amendment of the licence to exclude the centrally allocated expenditure on performing groups is preferable to continuing the current approach. Ofcom's proposal would align Radio 3 with the other radio stations for which we report spend outside of London in Condition 2.64 and would therefore be more consistent, proportionate and transparent, as well as more accurately reflecting the intention of this condition to capture programme spend outside of London.

However, we do have concerns about the level at which Ofcom would set any revised quotas for both Radio 3 (Condition 2.66) and UK Public Services Radio (Condition 2.64) spend outside of London. As a technical change to the BBC's operating licence, any new quotas must be consistent with the BBC's recent performance and existing operational headroom. We therefore consider that – based on our performance over the past five years and the level of the existing quota – it would only be appropriate to set the revised

requirement in Condition 2.66 at 28% (not 30% as proposed) and to revise the requirement in 2.64 to 30% (not 33.3%) to account for the impact of removing the central orchestras' subsidy from both these calculations. Ofcom's proposal assumes that existing performance on its own would be an appropriate level at which to set these conditions, ignoring the existing headroom we currently have.

Removing this headroom would increase significantly the risk that we were unable to meet the quotas in any given year due to unforeseen events or even natural fluctuations commissioning spend. This is particularly relevant given our requirement to open up more of the Radio 3 schedule to competition to meet our December 2022 requirement. As you would expect, we have based our plans around existing operating licence quotas and targets. Ofcom's current proposal would in effect require us to exceed existing performance levels simply to allow us to have the same operational flexibility we currently operate with. This would not be a minor change to our operating licence. We would not be prepared to support any change that would immediately and significantly increase the risk of the BBC not being able to comply with its regulatory requirements. We have set out further details in Annex 1.

With respect to the timing of implementation of these changes, assuming they do not have any impact on what the BBC is expected to deliver, we are happy with Ofcom's proposal. We would welcome the changes being implemented as soon as reasonably practical.

Finally, we confirm that we are happy for you to publish our letter of 26 July 2019 which originally requested these changes.

We would welcome the opportunity to meet with you to discuss any of your proposals in greater detail if you would find it useful.

Yours sincerely,

Chris Rowsell,

Head of Regulation, BBC

## **Annex 1: Radio 3 spend out of London**

### *Ofcom's proposal:*

*"2.66 In respect of **Radio 3**, the BBC must ensure that in each Financial Year at least ~~40%~~ **30%** of relevant expenditure is incurred outside the M25 Area. For the purpose of this requirement "relevant expenditure" means expenditure on programme production (not including expenditure on centrally funded costs) and Radio 3's allocation of the central orchestras' subsidy.*

We accept the BBC's explanation of the change in funding of the Performing Groups, namely that this condition was carried over from the historic BBC Trust service licence and the central orchestras subsidy no longer exists. It is clear that this condition does not reflect how the Performing Groups are now funded and therefore Radio 3's expenditure outside of London. We consider the best way to address this is to amend the level of expenditure in the condition so it only applies to Radio 3's expenditure and excludes the centrally funded Performing Groups, which will not result in any changes in practice to the amount Radio 3 spends on programme production outside of London. This would be consistent with how we have defined 'relevant expenditure' in relation to the other conditions in this section of the Licence, so we would no longer need to define this term for the purposes of condition 2.66 and therefore propose removing this text.

In your letter you stated that the BBC was willing to provide a voluntary commitment in your Annual Plan that 40% of relevant expenditure across Radio 3 and the Performing Groups will be incurred outside of London. In light of our proposed amendments to this condition, we do not consider such a voluntary commitment would be necessary."

### *BBC Response:*

We strongly welcome your intention to change this condition to exclude BBC spend on the central orchestras' subsidy from our reporting for BBC Radio 3's spend outside of London. We note that making this change would bring our reporting for BBC Radio 3 into line with how we report spend outside of London for the other relevant radio stations as required by Condition 2.64. This change would therefore be both more proportionate - in that it will eliminate additional effort that our finance teams currently need to undertake each year to account for BBC expenditure that does not flow through Radio 3 – as well as more transparent in enabling stakeholders to see what proportion of Radio 3's spend outside of London is on programme costs. Reporting with the central orchestras' subsidy, as we currently do, distorts this picture. We note that under these proposals we would still report Radio 3 spend directly with the BBC's performing groups on programming (e.g. paying for programme costs under the BBC's tariffs) as we would spend with any non-BBC performing group. We consider this would more accurately fulfil the intention behind this condition of capturing spend on programmes made outside London.

However, we have two concerns around this proposal that we want to highlight to Ofcom:

1. The level at which the quotas for Radio 3 should be set based on the BBC's current performance; and
2. The potential knock-on impact of this change on the BBC's ability to deliver against Condition 2.64.

We previously wrote to Ofcom setting out that in 2018/19 our spend on Radio 3 outside of London excluding the central orchestras' subsidy was 31% of total programme spend. We understand this was the basis of Ofcom's original proposal that in excluding these costs this quota should change to 30% (i.e. it would reflect our current/recent performance). We also understand – and welcome – Ofcom's intention that in making these changes the BBC should not be expected to deliver over and above the level of performance set out in the current licence conditions and our current performance (i.e. these are technical changes and Ofcom has no intention to require us to deliver more or less in future years than we currently need to).

As set out previously, removing the central orchestras' subsidy from the Radio 3 calculations for spend outside of London reduces the overall out of London percentage. While the central orchestras' subsidy is slightly weighted out of London (57% of expenditure), it is currently a significant component of total expenditure, which then has a significant impact on both the Radio 3 outturn as well as the all-Radio outturn. In both cases it leads to a reduction in spend outside of London because proportionally the split of funding for orchestras is more heavily weighted outside of London than either Radio 3 overall or all relevant Radio stations.

Looking at the past five years, we have calculated the impact of this change on Radio 3 in Table 1. Specifically we note that we currently have - and have historically operated with - some headroom above Ofcom's current 40% target, which would be eliminated if Ofcom were to implement this proposal.

**Table 1: BBC Radio 3 percentage spend out of London 2015-2019**

	2015-16	2016-17	2017-18	2018-19	2019-20	5 year average
Radio 3 - including orchestras subsidy	46.1%	43.7%	45.3%	45.7%	44.0%	45.0%
Quota	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%
Headroom above quota	6.1%	3.7%	5.3%	5.7%	4.0%	5.0%
Headroom as a % of quota						12%
Radio 3 - excluding subsidy	32.4%	30.4%	31.5%	31.0%	30.1%	31.1%
Ofcom proposed quota	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%
Headroom above proposed quota	2.4%	0.4%	1.5%	1.0%	0.1%	1.1%
Headroom as a % of proposed quota						3.6%

Changing the quota to 30% would result in significantly less headroom against this quota than the BBC currently enjoys, based on this five year average and therefore has the risk of penalising the BBC when compared to current requirements, against which we have a degree of headroom and therefore operational flexibility.

The central orchestras' subsidy component of the current requirement is just that – a relatively fixed annual subsidy that does not significantly vary year to year in the way programme expenditure does. It is centrally allocated and does not reflect commissioning decisions and programme deliveries which can cause annual fluctuations in spend. Its removal from these calculations will therefore have the effect of also making it more difficult for the BBC to manage compliance on an ongoing basis. This compounds the issue noted above about the lack of operational headroom.

This headroom is essential to allow the BBC to effectively manage compliance on an ongoing basis, including managing the impact of unforeseen events, as well as annual variations in commissions and therefore spend. As we look to open up more of the Radio 3 schedule to competition – in line with the requirements in Schedule 3 of the BBC's Agreement with DCMS – it may also be harder for the BBC to ensure we can commission relevant radio programmes across the UK when compared to in-house production over which we have more control. Were Ofcom instead to set the quota at 28% (which would provide the same 12% headroom we have had on average over the past five years) it would provide the same operational flexibility for the BBC that we currently enjoy. Given Ofcom's intention to maintain as far as possible existing performance requirements we consider a quota of 28% would be consistent with current requirements. It can only be appropriate to base any new quotas on the BBC's recent performance against existing quotas, not solely on our recent performance as per Ofcom's proposal. Our plans have been based on the existing regulatory requirements and the levels of operational

flexibility we have within these, we consider it essential to avoid any change that would immediately set us up to fail.

We also note that Ofcom’s proposal does not assume that any change would be required to the all-Radio requirement under 2.64 to ensure a third of relevant expenditure is incurred outside of London. However, in measuring our performance with this condition historically we have included the central orchestras’ subsidy within BBC Radio 3 expenditure. Table 2 below sets out the impact on our overall headroom against the current requirements with the removal of the central orchestras’ subsidy:

**Table 2: BBC Radio percentage spend out of London 2015-2019 – all relevant stations**

	2015-16	2016-17	2017-18	2018-19	2019-20	5 year average
Total % spend across relevant Radio stations - current	40.8%	37.9%	39.4%	38.5%	38.0%	38.9%
Quota	33.3%	33.3%	33.3%	33.3%	33.3%	33.3%
Headroom above quota	7.5%	4.6%	6.1%	5.2%	4.7%	5.6%
Headroom as % of quota						17%
Total % spend - excluding orchestras	37.1%	34.2%	35.6%	34.1%	33.9%	35.0%
Quota	33.3%	33.3%	33.3%	33.3%	33.3%	33.3%
Headroom above quota	3.8%	0.9%	2.3%	0.8%	0.6%	1.7%
Headroom as % of quota						5%

The issue identified above for BBC Radio 3 is replicated for the all-Radio requirement (i.e. there is a significant reduction in headroom). If we were to assume the BBC were unaffected by these changes in terms of the total headroom we have under this requirement – on average 17% over the past 5 years – this would result in Ofcom having to reduce the all-Radio quota in Condition 2.64 to 30%. Again, if Ofcom’s intention in making these changes is to have no impact on our operations, we consider this would be the only reasonable course of action open to Ofcom.