Changing the Channel

Policy Exchange

A case for radical reform of Public Service Broadcasting in the UK

Mark Oliver
edited by Anna Fazackerley

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Mark Oliver is founder and chief executive of O&O, a boutique media strategy, investment and advisory company.

Since its foundation O&O has advised over 200 different companies in the UK and European television, radio, publishing, online and sports markets. O&O has provided advice to a number of Europe's leading private equity groups and has been involved in one way or another with most of the major developments and initiatives in the media, entertainment and sport sectors since 1995. Clients have included NBC Universal, BBC, BBC Worldwide, ITV plc, Channel 4, FIVE, Ofcom, Virgin Media, the FA Premier League, KKR, Goldman Sachs, All3Media, PACT, BTVision, Pro7Sat1, UEFA.

Prior to founding O&O, Mark was the BBC's first head of strategy from 1989 to 1995 where he advised the Director-General and the Board on all aspects of strategy and performance including developing the corporation's first digital strategy, its first comprehensive system of performance indicators, its commercial strategy, the introduction of an internal market and the medium term financial strategy (being a member of the Director General's finance committee).

Mark has also authored articles and reports on a number of media and entertainment industry issues and is often quoted and interviewed in the national press and on national TV and radio, as well as giving occasional keynote presentations at industry conferences and seminars.

Mark has been adviser to the Number 10 Policy Unit and the Department of Culture, Media and Sport. He began his career working as an adviser on regulation, privatisation, strategy and finance at NERA Inc (where he worked on projects for the Peacock Committee and OFTEL) and then Deloitte, Haskins and Sells (now part of PwC in the UK). He has a BA from Hertford College, Oxford.

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Mark Oliver – December 2009

Executive Summary

Why Does PSB Matter?

Public Service Broadcasting (PSB) aims to provide programmes that are in the interests of the public and society as a whole. Consumers do not always act in their best interests, especially if they don't see a short-term benefit. They are more likely to buy fast food, cheap holidays and chocolate than invest in education, pensions and health. It is the same with TV.

TV programmes influence people's behaviour and have an impact on society. Too much sex and violence for instance has a negative impact, while current affairs and documentaries give us a better understanding of other cultures and the world around us, leading to greater cultural cohesion, and a positive benefit for society.

PSB also fills in the gaps left by market-driven TV. Commercial channels focus more on popular entertainment, lifestyle and sports programmes that boost ratings and reap more in advertising revenue. While ITV is keen to keep Simon Cowell's talent contest in its schedules, it is dropping its interest in coverage of the arts, shown by the demise of the acclaimed South Bank Show. To fill the gap left by the market, PSB would invest in ambitious high cost UK drama, comedy, and factual programming. Intervention is needed to ensure commercial broadcasters produce programmes that have public value, rather than ones that simply chase ratings.

Public service broadcasting systems are also expected to lead to large scale investment in indigenous UK creative output that promotes cultural identity. A strong output of British produced programmes can be exported, which is good for trade and protects us from being swamped by imported US programmes, which are readily available. The UK has been more successful than most European countries in this instance because its protected and supported domestic content sector has emerged as an important second player behind the US across the globe.

However, the current UK broadcasting system which was set up in the 1950s is struggling to keep up with the extraordinary changes of the digital age. It is clear that the 20th century analogue institutions that were created are now worryingly out of date. We need a dramatic rethink if we are to continue to deliver public service broadcasting in an entirely new age.

Strains in the Current PSB System

The BBC has done well recently out of PSB. The commercial PSB channels have not fared so well. TV advertising revenue has seen growth slow significantly since the internet began to gain critical mass in 2002. Whereas in the early 1990s the leading commercial networks had most of the TV advertising market to themselves, new cable and satellite channels now take more than 20% of the revenue.

ITV1 has seen its audience share fall from 40% in 1992 to 20% in 2009. Even though ITV plc has managed to claw back some market share through the launch of new free to air spin-off channels like ITV2 and ITV3, its broadcasting revenues have been flat and its margins squeezed for most of the last 8 years. To make matters worse ITV has not been allowed to increase its ad prices to compensate for falling audiences (as many leading networks in the US and Europe have done), due to the Contract Rights Renewal (CRR) system imposed in 2003. CRR was put in place to reassure the advertisers when Carlton merged with Granada and involves strict rules about how much ITV can charge for advertising.

A beleaguered ITV has already dropped some of the public service obligations with the highest opportunity costs: namely UK children's programming and smaller regional news opt outs. Going forward it is seriously considering walking away from most of its remaining specific PSB requirements or handing back its PSB licence.

> "A beleaguered ITV has already dropped some of the public service obligations with the highest opportunity costs: namely UK children's programming and smaller regional news opt outs"

Meanwhile, Channel 4 has seen its high margins on key acquisitions and popular programme formats like Big Brother being eroded while the opportunity costs of its more heavily public service programming have risen. While the launch of free to air spin-off channels such as E4 and More 4 have helped it maintain its share of audience over the last 5 years, and its young audience demographics and the imposition of the CRR on ITV1 have helped it maintain its advertising yields, the core PSB network is no longer profitable.

While Channel 4 can survive in the short term by cutting costs and drawing on its financial reserves, it needs to find a new economic model if it is to survive and prosper in the medium to long term. Its recently departed Chief Executive pinned his hopes on a Government sponsored bail out – either from gaining a slice of the licence fee or merging with some of the BBC's profitable commercial operations, but neither has yet been forthcoming, leaving its new Chairman – Lord Burns – and its new Chief Executive with the task of finding a viable alternative future.

Five – the much heralded third commercial network in the UK whose launch was recommended by the Peacock Committee in 1985 but which took a further 10 years to licence and launch, has only been profitable in three of its thirteen years of trading and has been hit very hard by the recent downturn as it lacks the "must have" status of Channel 4 and ITV in advertisers' budgets. It is generally recognised that Five's only sustainable long term future is a merger with either Channel 4 or ITV and it too is cutting its programming budget and its overheads and biding its time.

All this pressure on the main commercial PSB networks has led to a 17% reduction in their spending on originated UK programming from 2006 to 2009 (a 25% reduction in real terms). While there has been some programming investment by the new spin-off channels, it has not been sufficient to bridge this gap. In practical terms, this has meant more entertainment programming and global format reality and lifestyle programming and less originated drama, comedy and documentaries across commercial network TV.

Reforming the BBC

The BBC is still a highly regarded public institution in the UK. A recent poll found that 76% of respondents felt the BBC was a UK institution "to be proud of", while 62% said the BBC was "trustworthy" (which puts the BBC well ahead of many other UK institutions). However, 60% of those polled agreed the BBC was "dumbing down", while only 56% thought it provided value for money (the poll was conducted in the wake of the debate over senior BBC executive and talent pay).[1] A Policy Exchange poll on tax and spending in September 2009 backed this up, showing that 67% of people would support a decrease in funding for the BBC.[2]

Despite the increasingly fragmented nature of the market, the BBC still occupies an incredibly privileged and important position. It accounts for 34% of all TV viewing in the UK (compared to 40% 10 years ago), and 54% of all radio listening in the UK (similar to 10 years ago). Across its services it reaches a staggering 90% of people in every week. The BBC website, www.bbc.co.uk, is the UK's leading web content site and accounts for about 30% of online news consumption in the UK, similar to the combined share of all UK national newspaper sites.

There is an elaborate and superficially open process to ensure the BBC maximises public value from the licence fee while minimising any unnecessarily negative market impact. But the public value test framework is not really working. There are four main reasons for this.

1. A lack of contestability

The processes of licence fee setting every 3 to 7 years and the system of on-going public value testing of all existing and new services involve little actual contestability. BBC management come up with a broad plan – in the case of the licence fee settlement – or specific proposed services – in the case of the public value tests – and this is either accepted, accepted with amendments or rejected by the BBC Trust. At no stage are non BBC providers allowed to make proposals as to what they could do with similar levels of funding, nor are rival BBC departmental proposals truly assessed against each other by the Trust for their comparative impact on public value.

The main input from industry rivals to the BBC funding processes is on the commercial market impact of the proposals. While this is a necessary part of the process it actually focuses the whole approval process on negative market impact not on maximising public value from any given level of licence fee.

2. Regulatory capture

There has been a general recognition in UK regulation over the last 20 years that single body or sub-sector regulators are less effective than more generic regulators. Separate energy regulators were replaced with a general body – Ofgem – while separate broadcasting and telecom regulators were replaced with Ofcom. Most recently, the government has proposed Postcom's role in holding the mail services to account be subsumed into Ofcom.

This consolidation of regulators may be driven in part by a need to save money, but it is also a recognition that where regulators end up regulating just one organisation or one sub-sector of a converged market, they end up being ineffectual. Such a body either ends up at loggerheads with the institution they are regulating, or

1 Comres Poll for BBC Newsnight, 26th November 2009. For polling on Trust of different UK institutions see Ipsos Mori annual trust survey, which often puts the BBC near the top of the most trusted UK institutions.

2 Yougov poll for Policy Exchange, September 2009, see http://www.policyexchange.org.uk/

more likely, being captured by the management of the organisation, ending up protecting it from outside criticism.

This has become the case with the BBC Trust where it has ended up making joint submissions and responses to Government with BBC management. This "regulatory capture" when combined with the lack of contestability on decisions about new BBC services and funds allocation means that there is little effective testing of the BBC's ability to maximise public value in between licence fee settlements.

3. A bias towards reach

The BBC universal licence fee places upon it an implicit obligation for the BBC to provide something for all households in the UK. This means the BBC has to provide not just for BBC loyal groups in the population – generally over 40 ABC1s - but also for the 16 to 35 age group, and the mid-market C1C2DE groups, which are generally the focus of commercial broadcasters across TV and radio.

BBC management obtain ratings on a daily basis, while monthly and weekly reach are the focus of management resource allocation decisions. Worst still, BBC value for money exercises often focus on cost per viewer or listener hour rather than comparing cost with quality and distinctiveness delivered.

This all tends to make the BBC an organisation that tries to maximise reach first and quality/distinctiveness second. It should, instead, be an organisation that seeks to maximise quality and distinctiveness, subject to a certain realistic minimum requirement for reach and share of overall consumption.

The problems arising from the BBC's bias towards reach are shown by its strategy in sport, where it still chooses to pay significant sums for events such as the FA Cup and Formula 1, both events which would end up on ITV or Five in much the same form if the BBC were not to bid. Meanwhile, it has failed to bid for domestic test match cricket on TV since 1998. Formula 1 and FA Cup matches attract an under 40, C1C2 male audience to the BBC, an audience it finds difficult to attract with its home grown programming, while Test Match cricket tends to attract a largely over 40 male ABC1 audience.

Perhaps the most high profile case in peak time entertainment was the BBC's claimed £5.6 million a year contract with Jonathan Ross in competition with Channel 4 and ITV. The problem is not so much what the BBC paid, but rather what the BBC was doing in the bidding ring in the first place.

In programme imports, Sky and Channel Four have complained that the BBC pays huge amounts for US drama series like The Wire, Heroes and Mad Men. Channel Four claim this has forced up the price for them for other popular US imports like Desperate Housewives. Sky argue that the £400,000 an episode the BBC pay US giant, NBC, for the series Heroes could be spent on home-grown UK-produced drama.

4. A lack of independent Market Impact Assessment in key areas

The current public value test requires Ofcom to conduct the market impact assessment on new services but not on existing services or new platform/delivery plans (such as Project Canvas). In addition, market impact complaints against BBC Worldwide are handled in the first instance by the Fair Trading Unit of the BBC, which is part of the BBC management structure not the BBC Trust.

This might not be an issue were it not for the problems of regulatory capture, lack of contestability and obsession with reach highlighted above, but given these problems it is fairly clear that independent assessment of market impact should be extended to all BBC activities.

Recommendation – Quality First, Reach Second - a new vision for the BBC

The BBC needs to focus its assessment of new and existing services on quality and differentiation rather than reach. It needs to stop expending significant resources on sports rights, 16 to 35 targeted services, popular entertainment talent, and acquisitions with the sole or main purpose of extending reach. Instead it should concentrate its resources on maximising the quality and distinctiveness of what it provides to all groups.

Recommendation – Abolish the BBC Trust and replace it with a BBC Joint Board

The BBC Trust has not held the BBC to sufficient account and has taken a narrow institutional approach to the delivery of PSB in the UK. This is not the fault of any individuals but rather a result of the position the BBC Trust found itself in. Whatever the history, it is clearly unsuitable for the 21st century.The BBC management should be accountable on day to day matters and the delivery of their objectives to a BBC Board, with a BBC Chairman and non executive directors.

Recommendation – Introduce a level of contestability to BBC resource allocation

First, there should be more internal contestability with a list of BBC in house proposals for achieving given reach, quality and distinctiveness being shared with regulatory bodies. Second, there needs to some third party contestability with external channels and content providers able to put a rival case for public funding or public co-funding to the body charged with determining the size and shape of the BBC.

Such external contestability would focus on areas where BBC plans were most in danger of crowding out commercial schemes rather than helping to raise standards and ambition across the sector. Children's programming, arts programming and local news might all be candidates.

In the first instance, any funding for third party services and output would still be channeled through BBC management and operations, but the management would be separately accountable to regulators for the effective use of these funds. BBC senior management would have their performance judged not just on the reach and performance of the BBC's wholly owned services but also on the performance of BBC sponsored partnerships and co-funded output.

This "bottom slicing" of the BBC licence fee funding has a precedent – the funding of 520 hours of output on S4C with an attributable value of £24 million a year. An example of the way this would work is that the BBC could decide that investing £20 million to £30 million in programming first shown on Channel 4 or E4 might be a better way to reach the 16 to 35 year old audience with programming of public value than spending £100 million a year on BBC Three.

In the next licence fee settlement, likely to run from 2013 to 2018 or 2020, the BBC management should be set a target level of third party output and service funding of 5% of total licence fee income by 2018 (about £175 million at 2009 levels).

Recommendation – Establish a Public Service Content Trust to promote PSB across all TV, radio and broadband

The PSC Trust will be the lead body for monitoring the delivery of BBC services in line with its licence fee settlements, Charter and Agreement. It will also review the effectiveness of the BBC's co-funding obligations which have been set out in Chapter 2. At key times in the BBC role and scope setting process – Charter, Agreement, licence fee settlements etc, the PSC will advise Government on the best way to promote public value across the BBC and other activities, but the BBC Board will make its own case to Government on the level of funding they need to carry out their remit.

The PSC Trust would be the first body in the UK to oversee the funding and delivery of all PSB intervention. It would in effect become the champion of public service programming.

Recommendation – Shift the responsibility for delivering public access

The BBC has played an important role in helping to drive platforms towards analogue switch off and, in particular, of ensuring that that all public service providers – the BBC and commercial providers, gain widespread access to consumers in the digital age. However, it is clear that while BBC distribution interests largely coincide with those of commercial PSB providers they are not identical. In addition, the BBC's recent preoccupation with access and distribution issues has probably helped divert management's focus away from their core purpose – providing quality content on compelling services.

Responsibility for promoting universal access distribution and high levels of discoverability in the web 2.0 age should, therefore, pass to the regulatory body overseeing the BBC and commercial PSB (the PSC Trust) which would execute these duties through a special division – the Public Access Division (PAD).

The PAD would be charged with ensuring PSB services and content gained the widest possible distribution. This distribution would be free of any incremental charges. It would take direct control of allocating digital transmission capacity between public service broadcasters and content providers. It would take over any remaining need to promote 2Mbit/sec roll out to more than 95% of the UK.

Given its focus on distributing content, the PAD would take over lead responsibility for Freeview, Freesat and Project Canvas from BBC management. It would work with all PSB providers to ensure their content is widely distributed. They would also have the right to require the BBC to link non BBC PSB providers to the BBC's main Web 2.0 services in the UK.

Reforming Commercial PSB

Trying to prop up public service broadcasting across all of the commercial networks is increasingly unsustainable and unenforceable. We need a more focused system which would concentrate access privileges mainly on one of the commercial network operators and provide financial support to specific programming areas where either an alternative to the BBC is needed (such as regional news provision) or where the commercial operator is perhaps better placed to achieve reach and impact than the BBC (such as public service programming for younger and ethnic audiences).

Recommendation – Allow ITV1 and Five to opt out of the PSB system after 2012

ITV1 and Five should be allowed to opt out of the PSB system in 2012 – two years prior to the end of their licences but after digital switchover. If they did opt out they would no longer have to keep any of their specific PSB commitments, they would keep their high reach digital terrestrial access but they would have to pay for the digital terrestrial frequency they had previously been gifted. Prices for this capacity would be set by regulators with regard to its opportunity cost. The proceeds would be reallocated by a new Public Service Content Trust (PSC Trust). Both ITV1 and Five would retain their right to remain on top slots in all electronic programme guides.

However, if ITV1 and Five did opt out of the PSB system they would lose some currently gifted digital terrestrial capacity which would be handed back to the PSC Trust to be reallocated to the remaining commercial public service broadcasters.

Recommendation – Relax ownership and competition constraints in return for programme investment commitments

A new competition regime should be applied to TV in the UK which allows individual owners to control large shares of the advertising market. This would allow the merger of Five and Channel 4, or ITV and Five for instance but subject to new programme investment conditions. Such conditions already exist in France. These programme investment conditions would be set as a share of revenue and be based on the previous level of investment by the main commercial broadcasters over the last 5 years. In particular, the CRR mechanism should be removed from ITV1 in return for a programme investment commitment from ITV. This should be achieved by changing the remit of the competition authorities over broadcasting and requiring them to weigh consumer (viewer) and public value issues when determining advertiser funded broadcasting mergers and acquisitions rather than only the interests of advertisers.

Recommendation – Channel 4 should retain its PSB status, be allocated more access privileges and be privatised

Channel 4 should be privatised in 2012 but retain a PSB licence for at least 10 years. The majority of any proceeds of this privatisation would remain with Channel 4 to strengthen its balance sheet. It should receive extra digital capacity, reallocated from ITV and perhaps some from the BBC. It could choose to use or sublease this but retain the income from it. Channel 4 should also be granted cross promotional and linked access to BBC new media services such as www.bbc.co.uk, the iPlayer and Project Canvas.

Channel 4 would be allowed to merge with Five under a more relaxed ownership and competition regime, but should it do so, the combined entity must be required to make a minimum level of investment in new programming in order to prevent consolidation leading to less UK programming investment.

Channel 4's PSB licence and allocation of frequencies would be administered by the PSC Trust which through its Public Access Division would control all the currently gifted digital terrestrial spectrum. As a PSB broadcaster, Channel 4 programming would also have a "most favoured nation" status for BBC Co-Funding and PSC Trust public funding. Such funds would still have to be bid for on a contestable basis, but Channel 4's high reach, PSB licence and access privileges would make it a favoured outlet.

Channel 4 has a strong brand and valuable audience demographics so the combination of access to risk capital, access to contestable public programme related funds and BBC co-funding would leave Channel Four in a strong position. Given the huge uncertainties of the Web 2.0 age it is far better for Channel 4 to be privatised than to remain in the public sector, but with a more sustainable and enforceable commitment to PSB.

Implementation and Timing

The UK needs to prepare for the new system now, not wait until 2014. This is especially the case if the proposals for Digital Britain go ahead.

The review of the current BBC licence settlement in 2013/2014 coincides with the ending of the current broadcast licences of ITV1, Channel 4 and FIVE (in 2014), by which time digital switchover will have been completed for approaching two years and true on demand TV will have been around for 8 years.

This period provides the UK with an ideal opportunity for the first time to address the PSB system as a whole and to put in place structures, systems and institutions that will make it appropriate to the challenges of the on demand digital age.

The new structure described in this report would need to be in place by mid 2012. This would suggest legislation in 2011 and a White Paper in the autumn of 2010. The BBC's Charter and Agreement review date would have to be brought forward to meet this deadline, as it currently runs to 2017.

Other Recommendations

These are just a sample of the key recommendations in a very detailed report. We tackle a number of other issues in detail, including broadband, protecting content in the digital age and regulating PSB. We present a comprehensive new vision for PSB broadcasting in the UK, with 32 recommendations in total. These are listed in full in the conclusion.

Introduction

The current UK broadcasting system which was set up in the 1950s is struggling to keep up with the extraordinary changes of the digital age. It is clear that the 20th century analogue institutions that were created are now worryingly out of date.

The digital TV switchover began in 1998 and will end in 2012. Advertisers have migrated away from TV to the internet leaving less cash to make programmes. Audiences no longer rely on a handful of channels brought to their living room by the analogue signal. They can watch iPlayer, Sky Plus, DVD box-sets, downloads via broadband or TV-on-demand. The vast choice open to them is fragmenting audiences which means fewer people watching more shows. A 5 minute clip can start on a television show and then be virally passed on to millions of global viewers overnight, as illustrated vividly by Susan Boyle, the 47-year old Scottish singer whose audition for ITV's Britain's Got Talent 2009 was watched by tens of millions on You Tube. This has implications for content providers who can see the value of their work eroded as it is shared virally or copied by pirates. These structural changes are hitting TV and radio commercial broadcasters hard. The recession has meant a further drop in advertising revenue and the strains on the current system are beginning to show.

These changes pose many crucial questions we can no longer afford to ignore. Is our public service broadcasting (PSB) system working if we can provide full public funding for *Formula 1* coverage and the *Jonathan Ross Show* but can't necessarily save the *South Bank Show* or *Channel 4 News*? Do we want a BBC that is driven to chase ratings in order to justify its existence and its universal licence fee against a barrage of criticism? Why is it that the US now leads with high quality drama like *The Wire*, *The Sopranos* or *The West Wing* when the UK's flagship drama like *Jewel in the Crown*, *The Singing Detective*, and *Edge of Darkness* appears to be in the past? Why aren't excellent examples of PSB content such as the *Sky Arts Book Show*, or the *Clive James Interview* available to all? When the analogue signal is switched off in three years how will Channel Four survive?

The picture is clearer, the sound is sharper – but the broad question for the viewer is - is there anything worth watching? With the enormous choice offered by hundreds of channels and different delivery platforms it seems to be becoming harder to find programmes of public value that are widely available and easy to discover. The UK's indigenous TV content sector, proportionately the largest in the world, and the only significant exporter globally other than the USA – with almost £1 billion in international revenue in 2008 – has begun to stagnate.

Many thought the Government's recently published Digital Britain Report[3] would provide the answers. It didn't. Instead it seemed intent on fast-forwarding us into the digital age without addressing the challenges of falling advertising revenue and fragmenting audiences. This paper argues for a much more radical approach to PSB. We need to develop flexible organisations that deliver more public value more efficiently.

3 *Digital Britain* – A Report by the Department of Culture, Media and Sport and Department for Business, Innovation and Skills

1
An Introduction to PSB

Why do we need Public Service Broadcasting?

Public Service Broadcasting (PSB) aims to provide programmes that are in the interests of the public and society as a whole. Consumers do not always act in their best interests, especially if they don't see a short-term benefit. They are more likely to buy fast food, cheap holidays and chocolate than invest in education, pensions and health. It is the same with TV.

TV programmes influence people's behaviour and have an impact on society. Too much sex and violence for instance has a negative impact, while current affairs and documentaries give us a better understanding of other cultures and the world around us, leading to greater cultural cohesion, and a positive benefit for society.

PSB also fills in the gaps left by market-driven TV. This is because the market-driven, commercial channels focus more on popular entertainment, lifestyle and sports programmes that boost ratings and reap more in advertising revenue. Britain's Got Talent, which has 18 million viewers for its final in May 2009, is a classic example. While ITV is keen to keep Simon Cowell's talent contest in its schedules, it is dropping its interest in coverage of the arts, shown by the demise of the acclaimed *South Bank Show*.

So to fill the gap left by the market, PSB would therefore invest in ambitious high cost UK drama, comedy, and factual programming. Intervention is needed to ensure commercial broadcasters produce programmes that have public value, rather than ones that simply chase ratings.

Public service broadcasting systems are also expected to lead to large scale investment in indigenous UK creative output that promotes cultural identity. A strong output of British produced programmes can be exported, which is good for trade and protects us from being swamped by imported US programmes, which are readily available. *The Wire* may be critically acclaimed for its social realism, but it is set in West Baltimore, Maryland. The UK has been more successful than most European countries in this instance because its protected and supported domestic content sector has emerged as an important second player behind the US across the globe. PSB underpins the processes of democracy and plurality that create healthy, politically accountable, and free societies. This is especially relevant in areas of news and current affairs. News programmes like the *Today programme* are often scrutinised for their impartiality.

Britain has a strong tradition of public service broadcasting that dates back to 1922. Not only the BBC, but the main commercial channels, Channel Four and ITV, have public service broadcasting obligations. The BBC plays a key role in encouraging PSB content across all channels where a degree of interdependence exists between the BBC and the commercial broadcasters - this is often referred to as the UK's PSB ecology.[4]

It is important to acknowledge that views of the importance of PSB do differ. Some would argue that we should take a more laissez faire (and less expensive) attitude to broadcasting, making sure that there is some content of public value available and assuming that those who want it will find it, and those who prefer to watch only reality television should be left to their own choices. This is not the view of this paper. For the reasons outlined above we believe public service broadcasting to be a fundamentally good thing for the UK (and not simply the preserve of the middle classes) that must be protected. However, it is clear that if we are to have strong PSB in the future, the entire system needs a dramatic rethink.

The History of PSB

From 1945 to the early 1980s the prevailing wisdom was that broadcasting could not be left to the market so the analogue signal was only available to a few broadcasters. The Second World War had just ended and there was concern about the potential power of the medium to influence opinions and build or corrupt the national culture. In addition TV programmes were very expensive to make. A large broadcaster could achieve significant economies of scale which meant the system favoured monopolies.

The UK chose to have a strong publicly funded broadcaster and a highly regulated commercial TV sector, funded by advertising. There were two premises. Firstly, broadcasters were to compete for audiences not revenue. Secondly, commercial TV was to fill in the market gaps in regional and local broadcasting and keep the quality high in terms of drama, documentary and comedy. The commercially funded TV sector developed as a strong direct rival to the BBC.

> “We believe public service broadcasting to be a fundamentally good thing for the UK (and not simply the preserve of the middle classes) that must be protected”

At the heart of the UK commercial PSB system was a deal. Broadcasters would be allowed to exploit the lucrative TV advertising market in the UK if they delivered public service programming. To ensure good behaviour ITV franchises were to be assessed every 10 to 15 years. Conditions were tightened up in 1968 and again in 1981 when one leading ITV franchise lost its licence. Channel 4 was introduced in 1982, as a protected public service broadcaster with specific requirements for minority programming and innovation with its funding coming from ITV selling its airtime.

From the early 1980s, however, a new prevailing wisdom emerged. Technology meant that the amount of spectrum (the range of frequencies) available increased. By the late 1980s, encryption meant that satellite and cable pay TV had arrived, with people able to receive hundreds of channels just by attaching a small satellite dish to the side of their house. It became widespread at low cost. The pan European footprint of these satellites meant that

4 Andrew Graham was the first to popularise this notion of the UK's broadcasting ecology and the key role the BBC plays in supporting and encouraging all PSB content in the UK in his 1999 paper with Gavyn Davies "*Broadcasting, Policy and Society in the Multi-Media Age*"

individual countries lost a degree of control over their domestic broadcasting ecology.

Public intervention was predicted by many to move to the margins as cable and satellite penetration increased and spectrum scarcity more or less disappeared. Many believed that the UK was heading closer to the US model, where Public Broadcasting Service (PBS) in the USA only accounts for about 3% of total TV sector revenue and less than 3% of viewing.

While people still recognised some need for programming of public value for the good of society as a whole, it was believed the market would provide more and more of what individual consumers – not just advertisers – wanted.

In this spirit, the Peacock Committee set up by the Home Office in 1985/86 ushered in a number of more free market initiatives which were implemented in the 1990 Broadcasting Act. The most notable of these were:

- the provision of a new commercial terrestrial broadcaster with more limited public service obligations (i.e. Channel 5);
- the allocation of ITV regional licences through competitive tender (rather than the public service beauty contest of previous franchise rounds);
- the separation of Channel 4 advertising sales from ITV;
- the imposition of a 25% independent production quota on all public service networks;
- the launch of national commercial radio using a new FM frequency and reallocated BBC AM frequencies plus the roll out of more commercial local FM services.

The Peacock Committee also suggested a long term vision for PSB which involved much less than the current estimated £4 billion of PSB funding[5]. Some industry analysts still adhere to this long-term vision[6].

By 1998/1999, the mood had changed. The Davies Review (led by Gavyn Davies, later to become Chairman of the BBC) believed there would still be a significant role for public intervention in broadcasting in the digital age. PSB would provide programmes with public purpose, prevent the UK being swamped with US imports and supply certain high cost programmes that consumers wanted but which the market could not supply profitably at acceptable levels of risk.

While the review recognised that the commercial TV sector would be under too much financial pressure to maintain its provision of public service programming, it saw the BBC as the main means to guarantee adequate provision in the future. It also saw the BBC as the best institution to manage the UK's transition to digital media and to ensure that no one was excluded from this revolution.

As a result the BBC's licence fee went up to cover their expansion across platforms and channels in the digital age. The BBC was allowed to deliver content via the internet on a large scale – first a leading news service, then audio on demand and finally video on demand through the i-Player. Significant amounts of digital terrestrial TV (DTT) and Digital Audio Broadcasting (DAB) radio frequency were given to the BBC which started and developed new more focused digital TV

5 The £3.5 billion of licence fee income for the BBC and an estimated £300 million to £400 million of assets gifted to PSB operators which in turn encourage a similar amount of extra investment in PSB output – (for a summary of this estimate see *"Ofcom's Second Public Service Broadcasting Review – Phase One: The Digital Opportunity"* April 2008 – Section 7, Figure 46). This analysis omits any calculated value of gifted assets to commercial radio groups in return for PSB requirements on local information and content.

6 For a recent articulation of this view see " Public Service Broadcasting in the Digital World" – Mark Armstrong and Helen Weeds in " The Economics and Regulation of Broadcasting Markets – Evolving Technology and Challenges for Policy" Edited by Paul Seabright and Jurgen Von Hagen – Cambridge University Press – 2007

(BBC3, BBC4, CBeebies etc) and radio channels (1Xtra, 6 Music etc). Digital TV was delivered by a BBC led platform - Freeview, a free box that sat on top of the television set, which helped new BBC and commercial PSB owned channels ensure they secured universal reach. This was followed by Freesat, a non pay TV satellite service.

How does the current system operate?

Public service broadcasting in 2009 now covers three levels of activity at a total cost of £4 billion a year. Despite the twists and turns of policy in the last 25 years, these activities still tend to compete for audiences rather than directly for revenue – the principle first set out in the 1950s. The three levels are:

A range of BBC services funded by the licence fee at a cost of £3.5 billion per year:[7]

The main commercial TV networks (ITV, Channel 4 and Five) and commercial FM/MW radio stations which have a specific list of public service obligations. ITV1's obligations have traditionally included national and regional news; children's, religious, arts and current affairs programmes, and a minimum of 65% UK originated output. For Five the obligations have been largely to national news and a minimum 53% UK originated content. Channel Four's commitments are more general and relate to a requirement to deliver minority tastes and interests, programming that differs from other commercial networks and a minimum of 60% UK originated content.

They adhere to these obligations in return for access to people's homes through analogue spectrum and digital terrestrial spectrum. The total value of these privileges is £300 million to £400 million a year.

Other channels and stations (including the extra free to air services provided by the commercial TV networks on digital only) which only have to abide by minimum standards and output requirements (in the case of TV the ones set down by the European Commission in the late 1980s).

The only real anomaly in this three tier broadcasting system is S4C (the Welsh language channel) which receives direct funding from Government (around £90 million a year), takes some advertising and is gifted 520 hours of programming – for no charge – by the BBC.

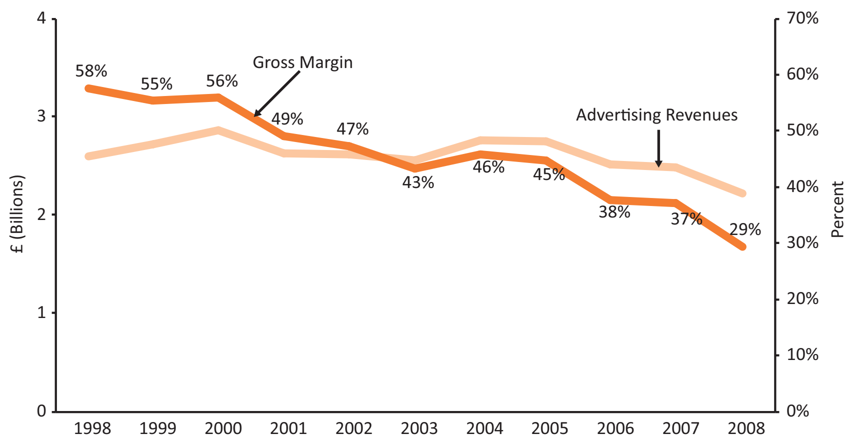
Signs of severe strain

The BBC has done well recently out of PSB. The commercial PSB channels have not fared so well. TV advertising revenue which grew faster than GDP for most of the 1990s, has seen growth slow significantly since the internet began to gain critical mass in 2002. Whereas in the early 1990s the leading commercial networks had most of the TV advertising market to themselves, new cable and satellite channels now take more than 20% of the revenue.

7 Some funding does come indirectly through BBC Worldwide as co-investment in programming in return for rights and some funding comes from co-producers – but there is no direct broadcast funding apart from the licence fee.

Figure 1: Commercial PSBs Declining Gross Margins

Commercial PSB networks combined revenues, and gross margin - i.e. revenue less programming costs but before overheads and admin (nominal terms), 1998 to 2008



Source: Company Reports, OFCOM, Oliver & Ohlbaum Analysis

While the 15 individual ITV companies relicensed by competitive auction in 1991 have been allowed to merge (with all but the Scottish, Channel Islands and Northern Ireland licence holders now a part of ITV plc) and, thereby, reduce overheads and cost duplication, ITV1 has seen its audience share fall from 40% in 1992 to 20% in 2009. Even though ITV plc has managed to claw back some market share through the launch of new free to air spin-off channels like ITV2 and ITV3, its broadcasting revenues have been flat and its margins squeezed for most of the last 8 years.

To make matters worse ITV has not been allowed to increase its ad prices to compensate for falling audiences (as many leading networks in the US and Europe have done), due to the Contract Rights Renewal (CRR) system imposed in 2003. CRR was put in place to reassure the advertisers when Carlton merged with Granada and involves strict rules about how much ITV can charge for advertising. ITV argue that the TV landscape has been transformed since 2003 and the CRR needs to be scrapped.

A beleaguered ITV has already dropped some of the public service obligations with the highest opportunity costs: namely UK children's programming and smaller regional news opt outs. Going forward it is seriously considering walking away from most of its remaining specific PSB requirements or handing back its PSB licence.

Channel 4 has seen its high margins on key acquisitions and popular programme formats like Big Brother being eroded while the opportunity costs of its more heavily public service programming have risen. While the launch of free to air spin-off channels such as E4 and More 4 have helped it maintain its share of audience over the last 5 years, and its young audience demographics and the imposition of the CRR on ITV1 have helped it maintain its advertising yields, the core PSB network is no longer profitable.

While Channel 4 can survive in the short term by cutting costs and drawing on its financial reserves, it needs to find a new economic model if it is to survive and prosper in the medium to long term. Its recently departed Chief Executive pinned his hopes on a Government sponsored bail out – either from gaining a slice of the licence fee or merging with some of the BBC's profitable commercial operations, but neither has yet been forthcoming, leaving its new Chairman – Lord Burns – and its new Chief Executive with the task of finding a viable alternative future.

Five – the much heralded third commercial network in the UK whose launch was recommended by the Peacock Committee in 1985 but which took a further 10 years to licence and launch, has only been profitable in three of its thirteen years of trading and has been hit very hard by the recent downturn as it lacks the "must have" status of Channel 4 and ITV in advertisers' budgets. It is generally recognised that Five's only sustainable long term future is a merger with either Channel 4 or ITV but in the mean time it too is cutting its programming budget and its overheads and biding its time.

While much of the malaise among the commercial PSB networks has been driven by changes in market structure and competition, they have not been helped by a regulatory regime which often works against them. The Competition Commission has made a series of decisions which have restricted their ability to charge more for their advertising or to co-operate in the launch of new on demand TV platforms.

In addition, as discussed in more detail later in this report, UK commercial networks are not entitled to retransmission fees from cable networks or digital satellite platforms for the relay of their main channels (such arrangements do apply in the US and much of Europe). Indeed, the commercial networks actually pay the Sky platform for carriage of their main channels in the UK.

The allocation of digital terrestrial frequency has also favoured the BBC. While the BBC has been gifted the capacity to transmit BBC 1 and BBC 2 in standard and high definition and its six extra digital channels in standard definition, the commercial networks have only been gifted enough capacity to retransmit their main networks in standard and high definition and 3 to 4 extra channels between them. This has left them having to bid high to keep extra digital terrestrial capacity out of the hands of their rivals.

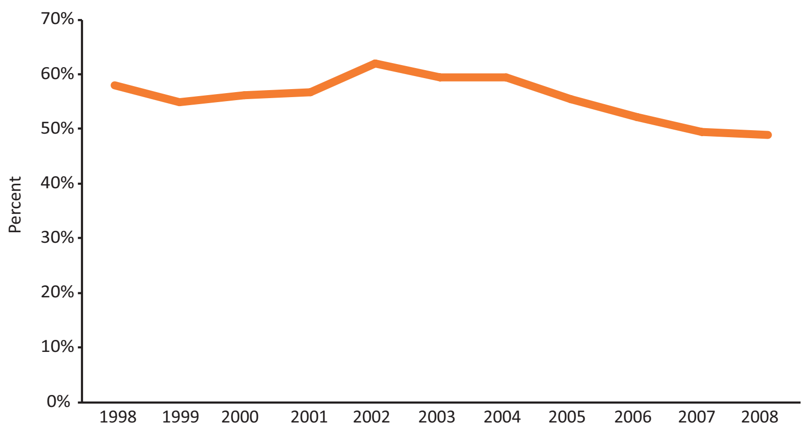
All this pressure on the main commercial PSB networks has led to a 17% reduction in their spending on originated UK programming from 2006 to 2009 (a 25% reduction in real terms). While there has been some programming investment by the new spin-off channels, it has been not sufficient to bridge this gap. In practical terms, this has meant more entertainment programming and global format reality and lifestyle programming and less originated drama, comedy and documentaries across commercial network TV. To make matters worse, while the BBC's revenue has been increasing a smaller proportion of its income is ending up with new programming on TV and radio. Instead, the BBC has been spending more of its licence fee on new digital platforms (such as the i-Player, Project Canvas, Freesat etc), the promotion of the switch to digital and its move of several production departments to Salford.

Beyond the decline in new programming investment, there is perhaps an even deeper malaise across the PSB ecology in the UK. Two notions that underpinned the UK system are now being questioned. First, whether PSB provision can be reconciled with commercial business models in the more competitive digital age or whether we should simply accept that the fight for financial survival will "crowd out" any sense of public service and altruism that existed in commercial public service broadcasting.[8]

Second, whether in much more constrained financial circumstances the BBC's ability to raise quality expectations among audiences actually does force rivals to invest more in programming than they would if the BBC was not present.[9]

Figure 2: BBC Programme spend proportion

BBC direct spend on television programming as a proportion of all license fee income, 1998 to 2008



Source: BBC Annual Reports, OFCOM, Oliver & Ohlbaum Analysis

Digital Britain

The Government response to all this uncertainty was the *Digital Britain* Report, which proposed universal broadband for all. As a whole this solution would cost £3.5 billion. Disappointingly, the report did not fully address the challenges of the digital age and the role of public service intervention.

In particular, *Digital Britain* does not provide adequate protection to the UK's globally renowned and successful content creation sector. Universal broadband would compound the risks UK content providers face of fragmented audiences, piracy and of content value being eroded by powerful aggregators like Google, Amazon and Apple.

Digital Britain also proposed the principle that BBC licence fee income will no longer be the sole preserve of the BBC. It will instead be redirected, by legislation, to pay for universal broadband and support regional news. This undermines the independence of the BBC, putting them in direct conflict with the UK Government. Indeed the BBC Trust has come out in force against this proposal.

The report proposed that £130 million[10] of the licence fee be set aside to support local news on commercial outlets after 2013/14. The BBC Director-General has questioned – quite reasonably – why local news has been selected when two years ago it was children's output that needed help, and 12 months ago Channel 4.[11] Such political intervention to support the cause of the moment is a

8 See " *Motivation, Agents and Public Policy- Of Knights, Knaves, Pawns and Queens*" – Julian Le Grand, 2006

9 In their article " *Public service broadcasting in the digital world*" Armstrong and Weeds , constructed a model whereby advertiser funded broadcasters compete for audiences through programme spending which is linked to quality. This is driven by both a fixed amount of investment to achieve a minimum level of accepted quality and output, and a marginal element which drives incremental audiences and quality. The authors assume that the presence of the BBC impacts the marginal costs of extra audience and quality but not the fixed minimum level. They therefore conclude rather unsurprisingly that the BBC crowds out investment by rivals. Of course, if the BBC influences the minimum level, one could equally argue the BBC has a multiplier effect (see appendix 4.1 of their article –a duopoly model of programme quality).

10 The £130 million is strictly speaking based in an assumption that the current allocation of the licence fee to the Digital switchover would continue but be diverted, this arguing it is not a diversion from content spend. Of course since the £130 million is a fixed amount while the next licence fee settlement has not been concluded, it is unclear where precisely this money would come from in 2014.

11 Mark Thompson interview with BBC Radio 4's 'The Media Show' – June 24th, 2009

worrying new trend. £130 million also seems a significant sum and suggests an assumption that commercial revenue streams can make little or no contribution to local news services.

Later in this report we will outline far less costly proposals for delivering broadband Britain than contained in the Digital Britain report. These include local broadband community hubs in the short to medium term and the sharing of high speed broadband infrastructure in urban areas in return for a roll out in rural areas in the longer term. Neither of these initiatives should require a telecom tax or diversion of licence fee funding suggested in *Digital Britain*.

We also advocate the setting up of new bodies and associations to focus on promoting better distribution and access and better financial protection for UK content providers.

2
Reforming the BBC

The BBC is still a highly regarded public institution in the UK. A recent poll found that 76% of respondents felt the BBC was a UK institution "to be proud of", while 62% said the BBC was "trustworthy" (which puts the BBC well ahead of many other UK institutions). However, 60% of those polled agreed the BBC was "dumbing down", while only 56% thought it provided value for money (the poll was conducted in the wake of the debate over senior BBC executive and talent pay).[12] A Policy Exchange poll on tax and spending in September 2009 backed this up, showing that 67% of people would support a decrease in funding for the BBC.[13]

All services run by the BBC are paid for by the licence fee (which raises a net income after collection costs of about £3.4 billion). Each UK household that has the capacity to receive a TV signal is required to pay the £142.50 annual fee (the charge in 2009) although the over 75s have this paid by the Department for Work and Pensions. Non-payment of the licence fee where receipt of a TV signal can be proven results in prosecution and fines, and where a fine is not paid, imprisonment. The BBC receives no other direct broadcasting funding (unlike many licence fee funded broadcasters in Europe who take some limited advertising).

From the *Today programme* on Radio Four to the *Teletubbies*, all programmes are governed by the BBC Charter and Licence Agreement and classified as public service output.

Similarly, all channels funded by the licence fee are classified as public service and run by the BBC under its Charter and Licence Agreement. These services are:

- UK wide TV channels (BBC1, BBC2, BBC 3, BBC4, CBBC, Cbeebies, BBC News 24, BBC Parliament);
- UK wide radio networks (Radio 1, Radio 2, Radio 3, Radio 5, Radio 5 Live, BBC 6 Music, BBC 7, BBC 5 Live Sports Extra, BBC Asian Network, 1Xtra);
- National radio Services (Radio Wales, Radio Wales, BBC Radio Scotland, BBC Radio Northern Ireland, BBC Alba);
- Local services (38 radio stations in England, local, national and regional TV news and current affairs opt outs across the UK, and non news and current affairs TV programme opt outs in Wales, Scotland and Northern Irelans);
- BBC Future Media and Technology (www.bbc.co.uk, BBC i-Player)

Despite the increasingly fragmented nature of the market, the BBC still occupies an incredibly privileged and important position. It accounts for 34% of all TV viewing in the UK (compared to 40% 10 years ago), and 54% of all radio listening in the UK (similar to 10 years ago).

12 Comres Poll for BBC Newsnight, 26th November 2009. For polling on Trust of different UK institutions see Ipsos Mori annual trust survey, which often puts the BBC near the top of the most trusted UK institutions.

13 Yougov poll for Policy Exchange, September 2009, see http://www.policyexchange.org.uk/

Across its services it reaches a staggering 90% of people in every week. The BBC website, www.bbc.co.uk, is the UK's leading web content site and the only site that comes close to generating the same levels of traffic in the UK as the global giants of the internet – Google, MSN, Yahoo, Amazon and Ebay. The BBC accounts for about 30% of online news consumption in the UK, similar to the combined share of all UK national newspaper sites.

The BBC i-Player introduced at the end of 2007 has quickly emerged as the UK's leading catch-up TV video streaming service with almost two thirds of UK internet households having used the service in the last 12 months.

With the transfer of broadcasting from analogue to digital the BBC has also taken on the role of helping to build and promote new free access digital platforms (see below). It is a shareholder in Freeview, Freesat and Project Canvas (which will enable viewers to catch up on TV programmes on their TV set rather than just their PC) while also working with commercial radio on the roll out of DAB, and it has a specific role in helping the most vulnerable and technophobic to convert to digital TV.

Outside of its core broadcasting and delivery roles, the BBC is responsible for about 45% of all commissioned TV programme spending in the UK, by far the largest source of buying. Its in-house production divisions account for about 30% of all new programming made in the UK by value.

In addition to its publicly funded activities, the BBC operates a number of commercial spin-off activities in the UK and overseas under its wholly owned commercial subsidiary BBC Worldwide, which has a total turnover of about £1 billion and an EBITDA[14] of over £200 million (making it about the same size as Channel 4 Corporation and a good deal more profitable). The main activities of BBC Worldwide are:

- a channels division which includes overseas thematic channel operations and the UKTV thematic channel joint venture with Virgin Media which accounts for about 4% of all UK viewing and makes extensive use of the BBC's archive;
- a global programme sales division, the largest of its kind outside the US studio system;
- a UK DVD publishing and wholesaling division (which was co-owned with Woolworths but which will soon be 100% owned by BBC Worldwide), which is the UK's largest DVD publisher/wholesaler;
- a magazines and exhibitions division based around the *Radio Times* and programme/genre linked magazines such as *Top Gear* and *Good Food*;
- a book publishing division; and,
- a TV content production division making programmes overseas for commissioning channels the most prominent of which has been the *Strictly Come Dancing/Dancing with Stars* franchise which has become a leading prime time show on the ABC network in the USA.

Recent years have seen impressive growth across BBC Worldwide achieved partially through a push both upstream (to secure more third party non BBC intellectual property) and downstream (to secure more direct control of outlets to the consumer). Both these moves have resulted in complaints from competitors. The move upstream has entailed buying 25% stakes in newly set up UK independent producers and the acquisition

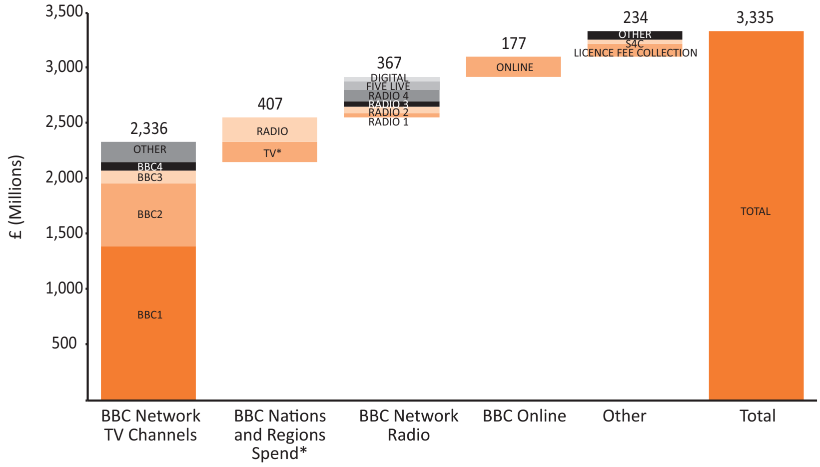
14 Earnings before Interest, Taxes, Depreciation, and Amortization.

of the Lonely Planet Guide. The move downstream has involved the aborted Kangaroo video on demand joint venture with ITV and Channel 4, the setting up of a global network of local TV producers and an expansion in the overseas channel portfolio.

The BBC benefits from any dividend stream from BBC Worldwide as well as through direct investment in BBC programming in return for the commercial rights. However, BBC Worldwide pays no specific fee to the BBC for use of the BBC brand, nor for its "first look" deal on all in-house BBC programming (where BBC Worldwide is given first opportunity to invest in return for the rights).

Figure 3: BBC Spending

BBC UK public services expenditure by type (includes total costs of each service – programming, transmission, marketing, management and administration costs), FY2008/09



Note: Nations and Regions TV spend is calendar year 2008, as reported by OFCOM, and is already included in spend data presented by service and so represents double counting

Source: BBC Annual Report and Accounts 2008/09 Part Two: The BBC Executive's review and assessment (page 119), OFCOM CMR 2009: Nations and Region Television Presentation

The BBC goes Digital

Since 1998/1999 the BBC has been given the remit to expand its TV, radio and new media portfolio for the digital age. To fund this expansion the BBC licence fee rose from 1999 to 2002.

The **BBC's website** www.bbc.co.uk has 50 million users, with 20 million in the US. It has high quality news coverage and takes advantage of the BBC's immense news gathering capacity. It faces fierce competition online from established US players.

BBC iPlayer allows you to catch up on BBC programmes you may have missed via the BBC website. It's often referred to as "catch up TV". It has internet links to all the BBC TV and radio channels, highlighting yesterday's viewing and the most popular programmes from the last 7 days. Programmes can also be selected by genre: comedy, drama, entertainment, factual, news, films. The only problem is you have to watch them on your PC, rather than on the TV set, or get a broadband enabled games console. BBC also aims to sell its products to the US via an iPlayer pay-per-view. Series like *Doctor Who, Torchwood* and *Top Gear* are all popular in the US. Some programmes are already available on Apple's iTunes for a small fee. The global iPlayer would also host "premium catalogue material" including historical material from the BBC's archives and catch-up material from overseas channels. It would not show the BBC's domestic iPlayer content because of international rights clearance required, however, it could host programmes shown by other UK broadcasters such as Channel 4. Proposals to share the iPlayer platform with other content owners for no fee (so called Project Marquis) were rejected by the BBC Trust in November 2009. The BBC Trust suggested any third party access needed to be on an arms-length, fair and non discriminatory basis in order not to distort the market.

Project Canvas hopes to be launched by Christmas 2010. Rather than having to catch up on TV programmes on BBC iPlayer you can watch them on your TV set. All you need is a Freeview or Freesat box and a broadband connection. Put more technically this is a proposal to deliver on-demand programming alongside digital terrestrial television services. The BBC is a shareholder alongside ITV and BT and the fourth partner may be Channel 4, Channel Five or an internet service provider. The market impact assessment for Project Canvas is still being conducted by the BBC Trust.

Freesat is owned by BBC and ITV. It delivers free digital TV from those channels to your TV set. It provides 140 digital TV and radio channels including BBC Three, BBC Four, ITV2, ITV3, More 4 and Film Four. There are 0.7 million households using free satellite platforms for their main TV set reception (but this includes people who have Sky boxes but no longer subscribe to Sky). Freesat claims 400,000 sales so far which would cover main and other TV set reception bills.

Freeview delivers free digital TV to your television set via a digital box. This free to air digital terrestrial platform has the BBC shareholding alongside ITV, Arqiva, Channel 4 and BSkyB. It launched in October 2002. It also provides free-to-air digital radio stations and interactive services. There is no monthly subscription payable. Freeview Plus allows you to record programmes, much like Sky Plus. Freeview HD (High Definition) plans to bring sharper clearer pictures and requires a Freeview HD box which will be available in early 2010. Freeview is the main means of reception for 9.7 million homes in the UK making it the largest digital TV platform in the UK. Freeview also accounts for over 70 per cent of all digital reception by extra sets in UK homes.

How do we enforce the BBC's PSB remit?

Public service broadcasting at the BBC is enforced through the BBC Charter. The Charter and Agreement are between Government and the BBC, and although the debate over the future of the BBC is often scrutinised by Select Committees of both Houses of Parliament, there is no actual Parliamentary vote on the BBC's Charter and Agreement. Similarly, members of the BBC Trust (formally the BBC Governors) are effectively nominated and approved by Government. In general, Charter/Agreements tend to be for longer periods of time – 10 to 15 years typically, and are seldom much modified between reviews. The most recent Charter and Agreement were settled in 2006/07 for 10 years (i.e. to end of March 2017).

Discussions on the level of the licence fee are usually led by Department for Culture, Media and Sport (DCMS) with input from the Treasury. Licence fee settlements have tended to be for between 3 and 7 years. The most recent licence fee settlement was in January 2007 and runs to the end of March 2013.

BBC licence settlements are based on both current and planned new services as the underpinning for the BBC's financial case with various assumptions on cost inflation, the contribution of commercial investment monies from BBC Worldwide and efficiency targets built in.

The Conservative Government set up the Peacock Committee in 1985 to review the funding of the BBC from 1986 and then reviewed the level of the licence fee again in 1995 as part of the Charter Review process. More recently the Labour Government commissioned the Davies Committee to look at the future funding of the BBC in 1998/99, and the Burns Review to assess the BBC's next Charter/Agreement and level of licence fee funding in 2005/06.

The latest settlement (after the Burns Review) was not as generous as the previous Davies Committee inspired settlement,[15] and limited annual licence fee rises to between 2 and 3% a year (about the expected level of inflation at the time). It also made a special one off provision for digital switchover costs and the move of departments to Salford and left the level of increase in the final year of the settlement -2012/2013 – for a further interim review. This final year is after analogue switch off and enables the DCMS to make a one off reduction reflecting the end of digital switchover or to direct the BBC to use these earmarked funds for some other purpose. A decision on this final year level would have to be made in early 2012.

Between licence fee reviews the funding, role and scope of existing and new BBC services is the responsibility of the BBC Trust. They are charged with subjecting all BBC services – existing and new ones proposed by management – to a public value test.[16] The public value test involves some quantification of the public value created by a BBC service and an assessment of the likely market impact[17] of that service. The net impact – public value created plus or minus positive/negative market impact – is then called the public value test. BBC services should only be approved and/or continued in their present format if the public value test finds a strongly positive outcome.

How does the BBC decide what is in the public interest?

The BBC Trust have four main criteria for assessing public value: Reach (how far will the proposal extend the BBC's reach and usage?) Quality (is the proposal high quality and distinctive?) Cost/Value for Money (how much will the proposal cost and will it deliver value for money?) and Impact (will the proposal create consumer and citizen benefit – the latter through its public purposes).

The BBC's six public purposes are –

- Sustaining citizenship and a civil society,
- Promoting education and learning,
- Stimulating creativity and cultural excellence,
- Representing the UK's nations and regions and communities,
- Bringing the world to the UK and the UK to the world,
- Helping to deliver the public benefit of emerging technologies.

15 Statement by the Secretary of State DCMS, January 18th, 2007

16 On new services as they are proposed by management, and for each existing service at least once every five years.

17 In the case of new BBC services it is Ofcom who carry out the market impact part of the test.

The last of these covers the BBC helping migrate people to new platforms and technologies.[18]

The public value test is then completed through a market impact assessment to set against the public value assessment in order to obtain a net public benefit assessment. Since the BBC Trust began[19] it has conducted five public value tests on new services: High Definition Television (HDTV) services (approved with conditions); Local video proposals (rejected); On demand services (the i-Player) (approved with conditions); Gaelic Digital Service – BBC Alba (approved with conditions); and, Project Canvas (still ongoing).

In its rolling review of all existing services, the BBC Trust has so far carried out three major reviews. A review of services for younger audiences (Radio 1, 1Xtra, BBC Learning, BBC Switch and BBC 3) where some minor adjustments to the services were suggested. A review of Radio 2 and BBC 6 Music (still on-going) and a review of BBC One, BBC Two and BBC Four (still on-going). These last two reviews that are still ongoing by the BBC Trust are taking place at the same time as BBC management's own strategic review of all its services which is likely to conclude in March 2010.

During each public value test the BBC Trust carry out specific consumer research and invite submissions from interested parties through a consultation exercise.

Why the public value test framework is not working

Despite all these measures and criteria and a fairly elaborate and superficially open process, the public value test framework is not really working as a way of ensuring the BBC maximises public value from the licence fee while minimising any unnecessarily negative market impact. There are four main reasons for this.

First, there is no contestability in determining what the BBC should do, either when the licence fee is set or during the service reviews conducted by the Trust. Second, there is a degree of inevitable "regulatory capture" of the BBC Trust by the BBC management which reduces the level of scrutiny applied. Third, the BBC as an institution funded by a universal licence fee has an in-built bias to reach over quality and public purposes when determining its mix of services and programmes. This has been particularly marked in areas where the BBC seeks to attract a younger or more mass market audience. Fourth, there is no independent market impact assessment of the major existing services or, indeed, of the BBC's various platform initiatives. Each of these areas is outlined briefly below.

A lack of contestability

The processes of licence fee setting every 3 to 7 years and the system of on-going public value testing of all existing and new services involve little actual contestability. BBC management come up with a broad plan – in the case of the licence fee settlement – or specific proposed services – in the case of the public value tests – and this is either accepted, accepted with amendments or rejected by the BBC Trust. At no stage are non BBC providers allowed to make proposals as to what they could do with similar levels of funding, nor are rival BBC departmental proposals truly assessed against each other by the Trust for their comparative impact on public value.

18 Ofcom's criteria for public service broadcasting when judging commercial channel PSB are similar to the BBC Trust's public value assessment. They are High quality, Original, Innovative, Challenging, Engaging, and Widely Available. Both Ofcom and the BBC currently carry out research projects to evaluate this. Recent research for Ofcom suggests that highest levels of public value were ascribed to news, current affairs and UK documentaries. It also found that homegrown, UK-produced comedy, drama and children's programmes had more value than imports in the same genres.

19 Prior to the setting up of the BBC Trust in 2006/07 the BBC was regulated by the BBC Governors, while the initial market impact tests applied to the BBC's new services since 2001, were conducted by the DCMS.

The main input from industry rivals to the BBC funding processes is on the commercial market impact of the proposals. While this is a necessary part of the process it actually focuses the whole approval process on negative market impact, not on maximising public value from any given level of licence fee.

This problem of a lack of contestability is likely to get worse if various areas of public service provision disappear from commercial PSB networks. Not only will BBC management be up against no direct rivals for funding, but there will be few external benchmarks against which to judge the level of quality and innovation offered by the BBC proposals.

Regulatory capture

There has been a general recognition in UK regulation over the last 20 years that single body or sub-sector regulators are less effective than more generic regulators. Separate energy regulators were replaced with a general body – Ofgem – while separate broadcasting and telecom regulators were replaced with Ofcom. Most recently, the government has proposed Postcom's role in holding the mail services to account be subsumed into Ofcom.

This consolidation of regulators may be driven in part by a need to save money, but it is also a recognition that where regulators end up regulating just one organisation or one sub-sector of a converged market, they end up being ineffectual. Such a body either ends up at loggerheads with the institution they are regulating, or more likely, being captured by the management of the organisation, ending up protecting it from outside criticism.

This has become the case with the BBC Trust where it has ended up making joint submissions and responses to Government with BBC management. This "regulatory capture" when combined with the lack of contestability on decisions about new BBC services and funds allocation means that there is little effective testing of the BBC's ability to maximise public value in between licence fee settlements, with the only effective testing at licence fee settlement time provided by one-off inquiries such as the Burns Review or Peacock Committee.

A bias towards reach

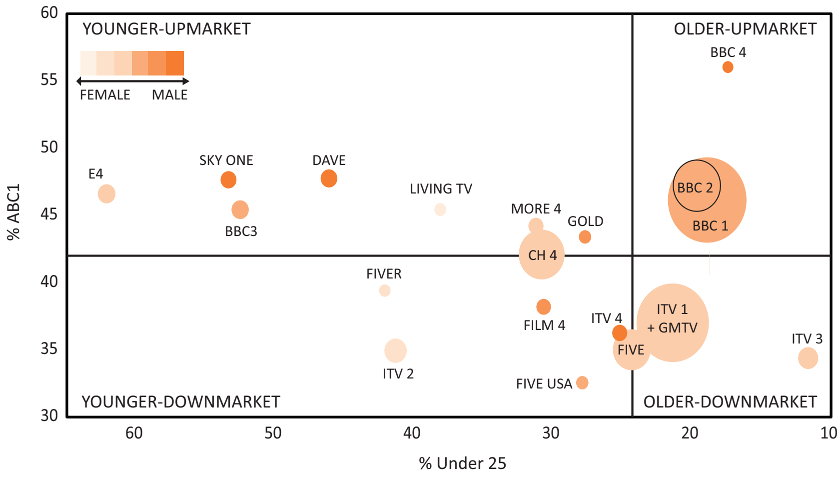
While the processes designed to hold the BBC to account are not working properly, even where they do bite, they tend to be ineffectual due to an in-built bias within the BBC's funding and mission towards reach over other measures such as quality, distinctiveness and impact.

The BBC universal licence fee places upon it an implicit obligation for the BBC to provide something for all households in the UK. This means the BBC has to provide not just for BBC loyal groups in the population – generally over 40 ABC1s - but also for the 16 to 35 age group, and the mid-market C1C2DE groups, which are generally the focus of commercial broadcasters across TV and radio.

This chase for reach is exacerbated by the lack of accurate and regular measures for achieving quality, distinctiveness and impact. BBC management obtain ratings on a daily basis, while monthly and weekly reach are the focus of management resource allocation decisions. Worst still, BBC value for money exercises often focus on cost per viewer or listener hour rather than comparing cost with quality and distinctiveness delivered.

Figure 4: BBC Core Audiences – TV

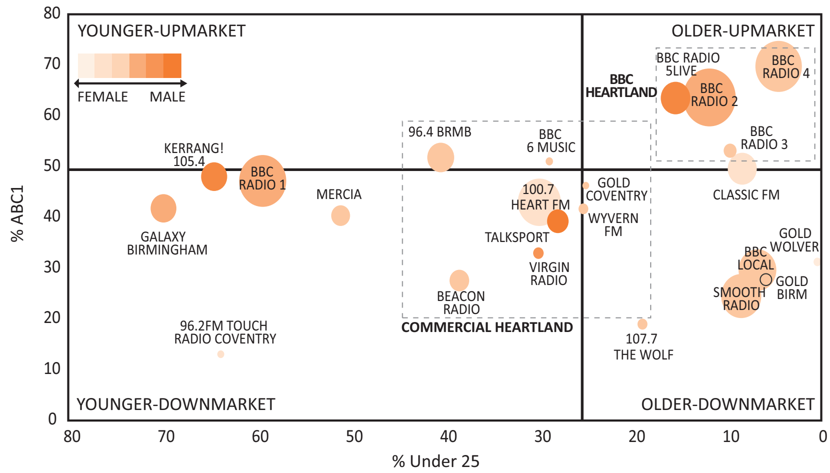
Demographic positioning of main networks and thematic channels, 2008



Source: BARB, Attentional

Figure 5: BBC Core Audiences in Radio

Demographic positioning of radio stations e.g. West Midlands market Q108



Source: Oliver & Ohlbaum Analysis, Rajar, Hallet Arendt

This all tends to make the BBC an organisation that tries to maximise reach first and quality/distinctiveness second. It should, instead, be an organisation that seeks to maximise quality and distinctiveness, subject to a certain realistic minimum reach and share of overall consumption required.

The problems arising from the BBC's bias towards reach have been best demonstrated by recent BBC strategy in five areas: sport, programming for the under 35s, programme imports, platform development and mass entertainment programming.

In each of these areas many of the BBC's actions have proved contentious both in terms of the quality and distinctiveness achieved and the negative market impact issues raised.

In the area of sport, the BBC still chooses to pay significant sums for events such as the FA Cup (which it recently lost to ITV) and Formula 1, both events which would end up on ITV or Five in much the same form if the BBC were not to bid. Meanwhile, it has failed to bid for domestic test match cricket on TV since 1998. Formula 1 and FA Cup matches attract an under 40, C1C2 male audience to the BBC, an audience it finds difficult to attract with its home grown programming, while Test Match cricket tends to attract a largely over 40 male ABC1 audience.

In the area of peak time entertainment the BBC has ended up bidding against ITV and Channel 4 for key on screen talent, and against commercial radio for key breakfast and drive time presenters, in order to attract either a 16 to 35 audience or a more mass market C1C2 audience. In many cases, this talent would have produced very similar shows on commercial free to air outlets had the BBC not secured their services. Perhaps the most high profile case in this area was the BBC's claimed £5.6 million a year contract with Jonathan Ross in competition with Channel 4 and ITV. The problem is not so much what the BBC paid (a report for the BBC Trust suggested they may have offered slightly less per hour to the star than Channel 4 or ITV) but rather what the BBC was doing in the bidding ring in the first place.

In the area of programme imports, Sky and Channel Four have complained that the BBC pays huge amounts for US drama series like *The Wire*, *Heroes* and *Mad Men*. Channel Four claim this has forced up the price for them for other popular US imports like *Desperate Housewives*. Sky argue that the £400,000 an episode the BBC pay US giant, NBC, for the series *Heroes* could be spent on home-grown UK-produced drama.

With services and programming for the 16 to 35 age group the BBC may well be adding some public value in terms of quality and distinctiveness through outlets such as Radio 1, BBC 3, BBC Switch and 1Xtra, but in an area where the commercial market already offers E4, Sky One, Dave, MTV and Kiss FM. The BBC ends up spending disproportionately high amounts on these services not to provide quality and distinctiveness but merely to reach a group that is not naturally inclined to visit the BBC for any service. Would not the licence payer be better served by using the commercial outlets that do reach these audiences to offer public service programming – perhaps in partnership with the BBC - rather than expending millions of pounds developing a specific BBC service that is always going to be "swimming against the tide" when trying to attract these audiences?

While the BBC is charged with driving new technologies in order to facilitate universal access, its bias towards achieving reach for its services at all costs has led the corporation to develop platforms such as Freeview, DAB and the i-Player, and initiatives such as project Canvas, with little thought as to how these platforms might help provide commercially sustainable business models – either through targeted advertising or micropayments. Instead, the BBC seems intent on rolling out these platforms free of any charge or advertising as rapidly as possible to help them deliver services to underserved niches with little regard for the consequences for commercial and pay broadcasters.

While the goal of universal access may be a primary feature of all public service provision and a legitimate goal to achieve, the BBC's obsession with the reach of its own services often undermines any non BBC commercial provision on these universally available platforms.

A lack of independent Market Impact Assessment in key areas

The current public value test requires Ofcom to conduct the market impact assessment on new services but not on existing services or new platform/delivery plans (such as Project Canvas). In addition, market impact complaints against BBC Worldwide are handled in the first instance by the Fair Trading Unit of the BBC, which is part of the BBC management structure not the BBC Trust.

This might not be an issue were it not for the problems of regulatory capture, lack of contestability and obsession with reach highlighted above, but given these problems it is fairly clear that independent assessment of market impact should be extended to all BBC activities.

In the case of BBC Worldwide, the Trust has just completed its own review of its activities following pressure from the Joint Select Committee in Parliament. While this has led to a number of measures to contain BBC Worldwide activities there has been no public discussion as to the best ownership structure for BBC Worldwide going forward.

In particular, there has been no public debate about whether it might be better in terms of value to the licence payer and overall UK media policy to allow BBC Worldwide to continue to expand by moving rapidly upstream and downstream or through direct access to the capital markets (i.e. privatisation) and with a more arms length and properly priced relationship with the BBC.

Implications and recommendations

The main implication of these problems is that the BBC is probably creating too negative a market impact whilst not maximising public value. By competing in search of reach rather than differentiating its services and partnering with third parties in key areas such as programming for the 16 to 35s, sport, entertainment etc it is probably creating a greater negative market impact than is desirable. By not allowing for any level of contestability in assessing new and existing services it is probably not developing ideas that maximise public value.

Recommendation – Quality First, Reach Second - a new vision for the BBC

The BBC needs to focus its assessment of new and existing services on quality and differentiation rather than reach. It needs to stop expending significant resources on sports rights, 16 to 35 targeted services, popular entertainment talent, and acquisitions with the sole or main purpose of extending reach. Instead it should concentrate its resources on maximising the quality and distinctiveness of what it provides to all groups.

If this implies fairly low reach of certain segments of the population then it should consider using licence fee funds to support or partner with third party services that can more effectively reach these groups as a way of providing better value for money (see further recommendations).

Recommendation – Introduce a level of contestability to BBC resource allocation, with more internal contestability and targeting BBC management with spending 5% of BBC licence fee income supporting third party services and programming by 2018.

A degree of contestability needs to be introduced to any assessment of current and planned BBC services. First, there should be more internal contestability with a list of BBC in-house proposals for achieving given reach, quality and distinctiveness being shared with regulatory bodies. Second, there needs to be some third party contestability with external channels and content providers able to put a rival case for public funding or public co-funding to the body charged with determining the size and shape of the BBC (see later sections for the recommendation of replacing the BBC Trust with a Public Service Content Trust (PSC) to oversee this contestability).

Such external contestability would focus on areas where BBC plans were most in danger of crowding out commercial schemes rather than helping to raise standards and ambition across the sector. Children's programming, arts programming and local news might all be candidates.

In the first instance, any funding for third party services and output would still be channeled through BBC management and operations, but the management would be separately accountable to regulators for the effective use of these funds. BBC senior management would have their performance judged not just on the reach and performance of the BBC's wholly owned services but also on the performance of BBC sponsored partnerships and co-funded output.

This "bottom slicing"[20] of the BBC licence fee funding has a precedent – the funding of 520 hours of output on S4C with an attributable value of £24 million a year. In many ways it is simply an extension of the BBC's large scale funding of third party producers through the independent production quota and the more recent "window of creative competition (WOCC)". It would extend current BBC funding of third party programming on its own channels to the funding of programming that might appear at some point – even in some instances first - on other public service channels and internet based services. But a condition of any BBC co-funding should be that the partner outlet – or at least the co-funded output – is available free of charge to consumers in the UK if it has the primary window. So for instance, the BBC could fund a programme to be shown first on Sky Arts or Discovery if that channel offers its signal free to air when the output in being aired. On a larger scale, the BBC could decide that investing £20 million to £30 million in programming first shown on Channel 4 or E4 might be a better way to reach the 16 to 35 year old audience with programming of public value than spending £100 million a year on BBC Three.

> "There needs to be some third party contestability with external channels and content providers able to put a rival case for public funding or public co-funding"

In the next licence fee settlement, likely to run from 2013 to 2018 or 2020, the BBC management should be set a target level of third party output and service funding of 5% of total licence fee income by 2018 (about £175 million at 2009 levels). If BBC management failed to reach this target in 2018 then the responsible regulatory body could recommend to government that funds be allocated directly to third parties rather than through BBC management from 2018 onwards.

20 Some commentators have used the term "bottom slicing" to refer to diverting some of BBC Worldwide's profits and/or assets to help third parties. This is not how the term is used in this report.

While some might object that this "bottom slicing" would leave the BBC funding output where it ceded editorial control of the channel or service that scheduled the output, this is no different in kind to current BBC co-funding of output with HBO (*Band of Brothers* and *Rome*), Showtime (*The Tudors*) or Discovery (*Life*) with US broadcasters. If it is OK for the BBC to co-fund with US commercial broadcasters why should it not be possible to co-fund with UK broadcasters, especially if those broadcasters have a PSB remit (see proposals for Channel 4 in Chapter 3).

Recommendation – Shift regulatory oversight to a sector wide body

With the BBC allocating some funding to third party services and a more contestable public value test process, the BBC should be regulated by a new body – the Public Service Content Trust (see Chapter 4 for more details). Responsibility for monitoring the market impact of the BBC across all services – existing and new ones – should pass to Ofcom, while the National Audit Office should have the remit to assess value for money and efficiency issues at the BBC.

Recommendation – Shift the responsibility for delivering public access

The BBC has played an important role in helping to drive platforms towards analogue switch off and, in particular, of ensuring that all public service providers – the BBC and commercial providers, gain widespread access to consumers in the digital age. However, it is clear that while BBC distribution interests largely coincide with those of commercial PSB providers they are not identical. In addition, the BBC's recent preoccupation with access and distribution issues has probably helped divert management's focus away from their core purpose – providing quality content on compelling services.

Responsibility for promoting universal access distribution and high levels of discoverability in the web 2.0 age should, therefore, pass to the regulatory body overseeing the BBC and commercial PSB (the PSC) which would execute these duties through a special division – the Public Access Division (PAD). (See Chapter 4 for more detail).

The PAD would be charged with ensuring PSB services and content gained the widest possible distribution. This distribution would be free of any incremental charges and would take direct control of allocating digital transmission capacity between public service broadcasters and content providers. It would also take over any remaining need to promote 2Mbit/sec roll out to more than 95% of the UK.

In addition it would lead negotiations over retransmission fees for public service content. Legislation would be needed so that content providers could charge for retransmission by leading platform providers. Ofcom would arbitrate over these charges. (See Chapter 5 for a full discussion of retransmission fees in the UK).

Given its focus on distributing content, the PAD would take over lead responsibility for Freeview, Freesat and Project Canvas from BBC management. It would work with all PSB providers to ensure their content is widely distributed and would also have the right to require the BBC to link non BBC PSB providers to the BBC's main Web 2.0 services in the UK.

The PAD would spread broadband to remote parts of the UK through community hubs. These hubs would be in public libraries, community centres and post offices and would replace the costly "universal broadband" proposals of the Government's *Digital Britain* report. The cost of community hubs would be about £300 million in comparison to the Government's proposals – to move from 60 to 90% of the UK on a household broadband rate of 50 Mbit/sec – which would cost £3.5 billion. These community hubs would also recognise the social and educational needs of more remote communities, vulnerable groups and the technophobic rather than seeking to isolate them still further in their own homes with no support or ongoing advice on how best to use broadband.[21]

The PAD would also have a more general standards role across the internet for promoting discoverability of PSB content and the protection of children. It would promote high quality, reliable content by using a "kitemark" symbol and would ensure due prominence for this, by working with internet search engines.

The PAD would decide which non BBC providers should link to the BBC's own web site - for example, a nominated local news provider could link to the BBC's local news pages. Similarly it would decide which non-BBC providers of public service content would be displayed on BBC i-Player and would be able to enforce this with the BBC.

The PAD would subsume digital helpline activities, the distribution and device applications work of BBC Future Media and Technologies, and would represent the UK on various content delivery standards organisations in Europe.

The Public Access Division would be set up with the aim of reducing the cost of replaced activities.

The Public Access Division should be able to save monies by bringing a range of separate activities and initiatives together. However, as some of these are currently funded by the licence fee, there may have to be a rise in direct Government funding, but this should also result in a reduction in the required level of the licence fee to at least match the increase.

Recommendation – Privatise BBC Worldwide but with conditions

BBC Worldwide is the UK's leading TV related intellectual property (IP) exploitation business with an impressive recent growth record. Rather than tying the hands of this business as a condition of BBC ownership (as the BBC Trust has suggested)[22] BBC Worldwide should be fully privatised so that it can raise the risk capital necessary to expand both geographically and up and down the value chain.

However, the privatisation of BBC Worldwide should be done in such a way that it is not in a position to crush competitors merely because of the privileges it enjoys through access to the BBC brand and 'first-look' access to all new BBC IP. Any privatisation should be accompanied both by transparent charging for its privileges – such as a fee for use of the BBC brand and an upfront payment for 'first look' rights - and by sunset clauses on these privileges, after which the BBC would be free to tender out to third parties. For instance, its use of the BBC brand for magazines could be on a 7 to 10 year licence, while its 'first look' deal on all new BBC drama and factual output might end in 5 to 7 years time.

21 There is already such a scheme with local libraries but it is piecemeal and not as geographically extensive as the hub network proposed in this report.

22 BBC Trust statement on "New limits to BBC Worldwide activities" – November 24th, 2009

3
Reforming Commercial PSB

How things work now

Each of three public service commercial networks in the UK has access to scarce analogue spectrum (up to digital switch over in 2012) and privileged access to digital terrestrial spectrum to at least 2014 (when the PSB broadcast licences come up for renewal). In return for low charges for this access each network takes on certain programming commitments.

Taken together, the three commercial public service channels now account for about 34% of the all TV viewing (down from 45% 10 years ago) and about 70% of all TV advertising. Combined they account for about 40% of all originally commissioned programme spending in the UK, but only about 20% of all commissioned programming supplied (only ITV has a wholly owned TV production activity, Channel 4 has no in-house production and Five uses mainly third party producers rather than its sister company Fremantlemedia).

In recent years each of the network owners has developed a portfolio of digital channels (e.g. ITV2, More4, Fiver) which together account for another 6% of TV viewing. None of these channels has any specific public service obligations although some do benefit from their parent company's privileged access to digital terrestrial spectrum and are heavily cross-promoted on the PSB networks' schedules.[23]

ITV1

Profile – ITV

ITV1 is the biggest commercial television network in the UK. It has public service broadcasting obligations, mainly related to regional news and minimum levels of originated output. It competes most directly with BBC1. Programmes for ITV1 are provided by ITV's in house production unit and by the independent sector. Network programming covers a full range of genres, including drama, entertainment, news, current affairs factual and sport.

ITV's popular shows are dramas, entertainment, lifestyle, TV classics and soaps. Dramas tend to be star-led, like *Doc Martin* while the entertainment output includes popular talent contests like *The X Factor* and *Britain's Got Talent*. Lifestyle programmes include chat-shows with Philip Scofield interviewing celebrities like David Hasselhof. Popular soaps include *Coronation Street, Emmerdale* and *The Bill.*

23 The current Government is planning to extend Channel 4's public service role to all its channels

ITV1's Public Service obligations

In the case of ITV1 this has traditionally included national and regional news; childrens', religious, arts and current affairs programmes, and a minimum level of UK originated output (65% of all hours).

ITV1 is subject to a series of public service obligations and regulations concerning its relationships with producers and companies in the ITV Network. As well as network programming, each of the ITV licences provides regional programming to cater for the interests of people living in each area of the UK. ITV is made up of 15 regional licences which allow ITV Broadcasting Limited (ITV plc) in England and Wales, UTV in Northern Ireland and STV in Scotland to broadcast terrestrially.

Their PSB obligations, include a requirement to provide regional news services, which has the biggest opportunity cost. The obligation to ensure 65 per cent of output is made up of UK originations is currently less onerous as ITV1 currently achieves a ratio of 80% of all programming. However, it has indicated this may not be the case as competition intensifies in the coming years.

The regulator, Ofcom believes that as the digital TV roll-out gathers pace across the UK, the value of this access to the spectrum is declining. Ofcom has said that new funding will be required if regional news on ITV1 is to be maintained and that the costs of the ITV licences to provide ITV television programmes across the UK will outweigh the benefits by 2012.

ITV plc also owns the digital channel portfolio - ITV2, ITV3, ITV4, CiTV which are entirely advertiser funded and available across all digital TV platforms. ITV Plc also provides a range of new media and interactive services via the internet. ITV2 has US imports like *Gossip Girl* and *American Idol*, alongside reality TV shows like *Peter Andre: Going it Alone* while ITV3 shows crime thrillers. ITV4 shows drama, films and sport with a male audience appeal. Some of these extra digital spin-off channels benefit from privileged access to spectrum, while others pay for their capacity on the open market (about £8 million to £10 million per channel).

ITV1 accounts for over 40% of the UK TV advertising market and more importantly accounts for nearly all the very high rating shows that key advertisers need to reach a large audience quickly with a new campaign. This potential pricing power on mass reach campaigns led the Competition Commission to impose a restriction on how ITV1 sells it airtime as a condition of the merger of Granada and Carlton in 2003, which brought a number of ITV licensees into one company and crucially brought the London weekday licence (Carlton TV) and the London weekend licence (LWT) – owned by Granada- together for the first time. Following the merger, large advertisers lost the leverage they enjoyed by switching mass reach campaigns between the ITV1 weekday and weekend schedules (i.e. Carton Sales and Granada Sales competed vehemently for these campaigns and kept the price down).

The sales restriction on ITV1 is called the Contract Rights Renewal mechanism and it effectively prevents ITV1 from raising the price of its advertising when it loses market share. It is worth noting that in all other developed TV markets leading networks have been able to raise prices as ratings fall to partially compensate for audience loss. The OFT and Competition Commission have recently reviewed the CRR mechanism and are due to make a final decision in February 2010. While they are minded to make some minor changes, the overall constraint is likely to remain as ITV1 still has most of the very high ratings shows in the UK, and neither the OFT nor the Competition Commission is charged with assessing the impact on viewers (as opposed to advertisers) of the CRR mechanism. In a quirk of the competition system, the ITV1 consumers that the competition authorities are charged with protecting are the advertisers, the impact on viewers – who receive the service free of charge – is not part of their consideration.

The CRR mechanism has put substantial extra financial pressure on ITV1 in the last 6 years and the outgoing Executive Chairman, Michael Grade, argued that the regulation of ITV is burdensome and needs updating. Grade has stated that without regulatory reform UK broadcasting will be dominated only by two giants – the BBC and Sky.[24]

Profile – Five

Channel Five (renamed Five) was launched as Britain's fifth and final terrestrial broadcaster on the 31st March 1997. Since July 2005 Channel 5 has been wholly owned by RTL Group part of Bertelsmann AG. RTL is the largest TV and radio broadcaster in Europe with 39 TV channels and 29 Radio stations in 10 countries.

Nearly all Five's programmes are made by outside suppliers. It shows a number of US and Australian dramas and soaps. US dramas include the CSI forensic pathologist franchise and medical drama *House* with Hugh Laurie. It also shows US comedies like *Californication* and *30 Rock*. Current affairs include Donal MacIntyre's CCTV cities and *The Wright Stuff*, a topical daily discussion programme. Five shows a number of property and design programmes (*Own Britain's Best Home* and *Best House on the Street*) which look into interior design and a number of UEFA CUP Football games.

Five has the fifth highest audience share (about 5%), ahead of all the multi channels including ITV2 and Sky 1. But with the growth of digital it is losing its reach lead over channels such as ITV2 and E4 and has suffered particularly badly in the recent recession as advertisers find they can largely dispense with the channel and still run an effective campaign.

Five's Public Service Broadcasting obligations

Five's commitment is largely to national news, children's programming and to keep to a minimum level of UK originated content (53% of all hours).

Five's PSB programmes include Five News, which is produced for the channel by Sky News with presenter Natasha Kaplinsky. It also has an obligation to provide children's programming. The children's strand 'Milkshake!' shows over 600 hours of original production.

Five has only made an operating profit in three out of the thirteen years it has been trading. Its owner, pan-European TV giant and radio broadcaster RTL, has kept the channel going as a strategic foothold in the important UK TV market. But RTL's profits have been squeezed by the downturn in the European ad market and they will need to decide whether they want to keep a loss making network going in the UK. RTL (along with then Channel 4 head Mark Thompson) made an attempt to persuade the UK regulators to let Five merge with Channel 4 about 5 years ago, and it is often rumoured that they would like to buy ITV1, as in most

24 Michael Grade speaking at the RTS Cambridge Convention, September 18th, 2009

European markets RTL occupies the number one commercial broadcaster slot, not the number three slot.

Five was given gifted capacity for 2 to 3 channels on digital terrestrial but decided to lease out its spare capacity rather than use it. I then had to pay again to gain capacity for its two spin-off channels FIVE USA and FIVER.

Channel 4

Profile – Channel Four

Channel 4 was founded 27 years ago but it is now under pressure due to the digital revolution and the severe economic downturn.

Film4, its film arm, won 8 Oscars and numerous BAFTAs in 2009 for *Slumdog Millionaire*, a rag to riches tale set in present day Mumbai, India and directed by Danny Boyle. In 2008 Channel 4 won more BAFTA and Royal Television Society programme awards than any other channel, more International Emmys than all other UK broadcasters put together, and was voted Channel of the Year at the Broadcast Awards.

Channel 4 states that it contributes to democratic life through high-quality news and current affairs programmes like *Channel 4 News* and *Dispatches*. *Channel 4 News* has won accolades for its hour long format, strong international perspective (40% of the content) and commitment to in-depth journalism. *Dispatches* and *Unreported World* have highlighted issues from countries as diverse as Somalia, Sudan, Thailand, Nigeria, Russia and Mexico. *The Big Food Fight* looks at social issues like diet and animal husbandry. Topics covered include the dangers of intensively farmed chicken and the challenge of setting up your own chicken farm. Their *Disarming Britain* seasons looked into young people's involvement in gun and knife crime, the effect of this disturbing trend on offenders, victims and society at large.

Channel 4 partners with more independent companies than any other UK broadcaster. Its digital channels include wholly-owned channels E4, More4 and Film4, and joint venture music channels with Bauer Media (under the Box Music name) and are available free-to-air on all digital platforms while E4 was launched as a basic-tier subscription service, and was taken free-to-air in May 2005. More4 launched as a free-to-air service in October 2005. Film4 was relaunched as a free-to-air channel in July 2006; previously, FilmFour was a suite of premium subscription channels. In July 2007 Channel 4 acquired a 50% stake in the Box TV music channels.

Channel Four's outgoing chairman Luke Johnson is keen to stress that Channel 4 has significant cash reserves and no debt. The 2008 annual accounts show Cash assets at £205 million and no debts. Channel Four Group made a loss of £0.5 million in 2008 on a turnover of £906 million but the core Channel made a loss of £24 million. Johnson also believes that the BBC faces true competitive tension from Channel 4 which makes it more creative and efficient.

Channel 4's portfolio of channels have a relatively upmarket and young audience compared with ITV and FIVE and are often used as a complement to these channels by advertisers who are keen to reach young and upmarket viewers in sufficient numbers to counter the older down market audience of the other networks. Channel 4 has the highest advertising yield per viewing hour of all the networks and has seen its price rise in recent years even though the audience share of the main channel has fallen. Overall, its share across all its channels has remained fairly constant over the last 5 years at about 11%.

However, relatively low total TV ad market growth followed by recession plus the rising cost of the US imports it used to rely on for many of its largest audiences, have put a financial squeeze on Channel 4 – group sales fell by £38 million in 2008. This financial squeeze led its now departed Chief Executive, Andy Duncan, to pursue first public funding, and then to promote a potential merger with part of BBC Worldwide. He dismissed a merger with FIVE as like "mixing oil and water".[25] (FIVE's chief executive, Dawn Airey, countered this, however, arguing that it would be like mixing "gin and tonic".[26])

But when it appeared neither of these options was likely to happen in the short term, Channel 4 had to reduce its core channel programme budget in 2008 by £20 million, save a further £25 million by reducing other operating costs and cut its workforce by over 25%. Ofcom's PSB report and *Digital Britain* confirmed that the authorities believe that Channel 4 remains the key complement to the BBC. There has been much speculation that some type of merger with part of BBC Worldwide might still be possible, although no such merger has yet been announced.

Channel 4's Public Service Broadcasting obligations

Channel 4's commitments are general and relate to a requirement to deliver programming for minority tastes and interests, programming that differs from other commercial networks, and a minimum level of UK originated output (60%).

Channel 4 is regulated by Ofcom as a commercial PSB licensee and so is not required to make any payments for its use of spectrum. In addition, over and above its specific licence requirements, the Channel 4 Board (whose Chairman is appointed by the UK Government with reference to Ofcom) is mandated to set out an overarching public service remit for all its services as a not-for-profit Government owned organisation.

However, Channel 4 does not have a Charter or Agreement like the BBC, and it has always been unclear what its enforceable duties and obligations were.

The Channel's public service remit was most recently defined in the 2003 Communications Act as the provision of a broad range of high quality and diverse programming which demonstrates innovation, experiment and creativity, appeals to the tastes and interests of a culturally diverse society, includes educational programmes and exhibits a distinctive character.

The current Government has decided to broaden and codify Channel 4's remit as part of the Digital Economy Bill. Its public service roles are going to extend to all its channels and new media services, not just the main channel. It will get a formal role in film funding and a more precise list of aims and objectives.

As a publisher-broadcaster, Channel 4 is prohibited from producing its own programmes so it commissions them from more than 300 independent production companies across the UK. Channel 4's foundation in 1982 was the first great

25 See http://www.guardian.co.uk/media/2009/jan/15/andy-duncan-dismisses-channel-4-merger-with-five

26 See http://www.guardian.co.uk/media/2009/feb/09/interview-dawn-airey

boost to the UK's independent production sector, which was boosted further in the 1990 Broadcasting Act with a 25% independent producer quota on the BBC and ITV, and then again in 2003 with protected terms of trade (giving producers more rights to their programmes).

The problem of enforceability at ITV1

ITV and Five have a large number of PSB obligations, but not many benefits in return which makes the current commercial PSB system difficult to enforce.

Their main benefits are access to the analogue signal and digital capacity but the value of these is declining rapidly. The only credible threat Ofcom has is to revoke ITV's licence. If it does that it would wipe out commercial PSB completely on ITV. Ofcom is therefore in a relatively weak position when enforcing the remaining PSB obligations.

ITV has successfully lobbied to drop original childrens' content on ITV1 while in 2008 it announced a reorganisation of its regional news programming with 17 regions merged into nine and hundreds of job cuts. It is also looking to reduce other costly PSB obligations like peak time arts programming such as the newly axed *South bank Show*, and most recently its volume of high quality drama. ITV can make more money if they put on a fully commercial schedule instead and the harsh reality is that Ofcom cannot do much about it.

ITV is not too worried about losing its other benefits as these are rather piecemeal. One, for example, relates to its guaranteed position in the electronic programme guides across cable, freeview and satellite.

The problem of sustainability at Channel 4

Channel 4 is a not-for-profit publicly owned organisation and as a result it should always want to broadcast public service output as long as it can afford to do so. Its schedule is full of cross subsidy with loss-making drama, comedy, news and current affairs funded by profit making *Big Brother*, *Location, Location, Location* and *The Simpsons*.

However, competition for ideas, imports and talent has intensified, reducing the margins made on its more populist programming and the cross subsidy available for its more public service programming. While much of this intensified competition has come from commercial rivals and pay TV channels, the BBC's pursuit of younger TV audiences through its entertainment, comedy, drama and US acquisitions policy across BBC 2 and BBC 3 has probably also contributed to Channel 4's problems.

But as a Government-owned organisation Channel 4 cannot go to the City for more money. This means it doesn't have the cash to develop new media applications to move into the new platforms of the digital age.

Ofcom has estimated that Channel Four will need between £60 million and £100 million a year in either public subsidy or synergies from a merger of some kind by 2012 to break even. While this level of projected loss does not fully reflect the scope for operating efficiencies at Channel 4 - efficiencies it has decided to pursue following the failure of its efforts to gain public funding support- if a long term solution is not found for Channel 4 this will put pressure on its distinguished public service content.

Problem of enforceability and sustainability at Five

While Five still probably receives more in benefits from the PSB system than the cost of its obligations, it increasingly appears to be unsustainable as an independent business entity as digital switchover approaches. This is likely to put increasing pressure on its main public service commitment – adhering to the 53% originated content quota. It has already announced a £45 million programme budget cut in 2009/10.

Recommendation – Establish a new more focused commercial PSB system

Trying to prop up public service broadcasting across all of the commercial networks is increasingly unsustainable and unenforceable. If such provision is to remain it needs to be through a more focused system which would concentrate access privileges mainly on one of the commercial network operators and provide financial support to specific programming areas where either an alternative to the BBC is needed (such as regional news provision) or where the commercial operator is perhaps better placed to achieve reach and impact than the BBC (such as public service programming for younger and ethnic audiences).

Recommendation – Allow ITV1 and Five to opt out of the PSB system after 2012

ITV1 and Five should be allowed to opt out of the PSB system in 2012 – two years prior to the end of their licences but after digital switchover. If they did opt out they would no longer have to keep any of their specific PSB commitments, they would keep their high reach digital terrestrial access (including access to HD capacity) but they would have to pay for the digital terrestrial frequency they had previously been gifted. Prices for this capacity would be set by regulators with regard to its opportunity cost. The proceeds would go to the PSC Trust for re-allocation to PSB content (See Chapter 4). STV and Ulster would be given the same option to opt out of PSB – although it is less clear that they would choose to take it. Both ITV1 and Five would retain their right to remain on top slots in all electronic programme guides.

However, if ITV1 and Five did opt out of the PSB system they would lose some currently gifted digital terrestrial capacity which would be handed back to the PSC Trust to be reallocated to the remaining commercial public service broadcasters.

Recommendation – Relax ownership and competition constraints in return for programme investment commitments

A new competition regime should be applied to TV in the UK which allows individual owners to control large shares of the advertising market. This would allow the merger of Five and Channel 4, or ITV and Five for instance but subject to new programme investment conditions. Such conditions already exist in France. (See Chapter 4 on regulation and regulators for more detail on competition policy) These programme investment conditions would be set as a share of revenue and be based on the previous level of investment by the main commercial broadcasters over the last 5 years. In particular, the CRR mechanism should be removed from ITV1 in return for a programme investment commitment from ITV. This should be achieved by changing the remit of the competition authorities over broadcasting and requiring them to weigh consumer (viewer) and public value issues when determining advertiser funded broadcasting mergers and acquisitions rather than only the interests of advertisers. (See Chapter 4 for details of Ofcom's role in leading a sector specific competition regime).

Recommendation – Channel 4 should retain its PSB status, be allocated more access privileges and be privatised

Channel 4 should be privatised in 2012 but retain a PSB licence for at least 10 years. It should receive extra digital capacity, reallocated from ITV and perhaps some from the BBC. It could choose to use or sublease this but retain the income from it. Channel 4 should also be granted cross promotional and linked access to BBC new media services such as www.bbc.co.uk, the iPlayer and Project Canvas.

Channel 4 would be allowed to merge with Five under a more relaxed ownership and competition regime, but should it do so, the combined entity must be required to make a minimum level of investment in new programming in order to prevent consolidation leading to less UK programming investment.

Channel 4's PSB licence and allocation of frequencies would be administered by the PSC Trust which through its Public Access Division would control all the currently gifted digital terrestrial spectrum (including that charged to ITV and Five, and that allocated to Channel 4 and the BBC). As a PSB broadcaster, Channel 4 programming would also have a "most favoured nation" status for BBC Co-Funding (See Chapter 2) and PSC Trust public funding. Such funds would still have to be bid for on a contestable basis, but Channel 4's high reach, PSB licence and access privileges would make it a favoured outlet.

Channel 4 has a strong brand and valuable audience demographics so the combination of access to risk capital, access to contestable public programme related funds and BBC co-funding would leave Channel Four in a strong position. This is a much more viable proposal than the Channel Four organisation becoming a partially directly publicly funded institution with no access to risk capital. Given the huge uncertainties of the Web 2.0 age it is far better for Channel 4 to be privatised than to remain in the public sector, but with a more sustainable and enforceable commitment to PSB.

The proceeds of any sale of Channel 4 should largely remain with Channel 4 itself to provide it with the strength of balance sheet necessary to deal with the challenges ahead. The exact proceeds from any sale would depend in part on whether Channel 4 was perceived as a future merger/acquisition target and the likely conditions of such an acquisition (the new merger regime for the sector is dealt with elsewhere). But a sale price of between £500m and £800m is likely.

While there would be a tension between the new private ownership structure of Channel 4 and its PSB obligations (as there has been at ITV1 for the last 5 to 10 years), this tension would be more manageable because, first, Channel 4 would be receiving a whole host of benefits as the only remaining commercial PSB licensee, and, second, the opportunity costs of some PSB type programming on Channel 4 is probably less than that for ITV (overall programme margins at Channel 4 as a more niche but upmarket broadcaster are likely to be lower than at ITV1).

Furthermore, should Channel 4 and Five decide to merge, the commitment to original programme investment would be built into the merger conditions, something that has not applied to ITV1.

Recommendation – S4C (and STV and Ulster TV should they chose to do so) to retain PSB status and be accountable to the PSC Trust

S4C's capacity and funding would be allocated through the PSC Trust (including the BBC Co-Funding of S4C news that already exists). If STV and Ulster TV were to opt to retain PSB status, they would also be allocated more privileges – in terms of capacity and access to BBC services.

However, it should be recognised that an ITV1 free of any PSB obligations would be able to broadcast its schedule into Scotland and Northern Ireland directly using open market capacity. This means that PSB orientated STV and Ulster TV would need to affiliate to Channel 4 rather than the ITV network.

Recommendation – Make public funds and BBC co-funding available to content carried on commercially funded outlets (but favour Channel 4 in that allocation)

BBC co-funding (see proposals in Chapter 2) and public funds from other revenue sources controlled by the PSC (see Chapter 5 proposals) would be made available for content on commercially funded channels and internet based services. But this would only apply to programming types which are clearly loss making on a commercial basis to avoid the prospect of publicly funded output that could be commercially viable.

The allocation of BBC co-funding and other public funds would favour (but not be limited to) programming transmitted on universal reach channels and, in particular, commercial channels with PSB status (i.e. Channel 4, S4C, STV and UTV).

Recommendation – Digital terrestrial access to be allocated to up to 40 local news providers across England and Wales. These providers (along with a PSB STV and UTV), would become affiliated to the Channel 4 Network. Local press and commercial radio owners would be allowed to own local news providers.

With a commercial ITV1 withdrawing from PSB, local news providers should be allocated daytime and late night capacity on digital terrestrial frequencies. These local news providers would also be allocated a transmission slot on Channel 4 in early peak time where revenue would be shared between Channel 4 and the local news provider. There would be up to 40 local news providers in England and Wales (in areas similar to those the BBC was planning to use for its ultra local web 2.0 news services – a plan rejected by the Trust). Channel 4's transmission network may need to be changed slightly to allow advertising in each of the 40 local markets covered.

STV and UTV would be reserved their own digital terrestrial frequency in Scotland and Northern Ireland, but would also be given an early peak and late night news slot on Channel 4 in Scotland and Channel 4 Northern Ireland.

Public funding and BBC co-funding would be made available to these local news providers through the PSC Trust, but licences outside of Scotland and Northern Ireland would be awarded on a contestable basis for 7 to 10 years with minimising public subsidy an important criteria for licence award. Local press and commercial radio owners would be allowed to own local TV news service providers.

STV and Utv would change their network affiliation from ITV1 to Channel 4, as a non PSB ITV would be able to broadcast into Scotland and Northern Ireland without having to go through STV or UTV. They would be awarded new 10 year licences in return for their confirmed PSB status and affiliation with Channel 4.

4

Regulating PSB

A new PSB system for a new age

The previous sections have set out a new role for the BBC, a refocused commercial PSB proposition, creating a tiered licence fee, and taking a series of measures designed to encourage access and discoverability. This new structure of PSB will need a new regulatory system.

The problem with the BBC Trust

The BBC Trust was established 3 years ago following the Hutton Inquiry, and subsequent resignation of the BBC Chairman and Director-General and the BBC Charter Review of 2006. In Chapter 2 we suggested that since its establishment the BBC Trust has been placed in the almost impossible position of being both regulator of the BBC and champion of the organisation when dealing with external criticism.

The Burns Review of the BBC Charter in 2006 actually recommended the establishment of a Public Service Trust with a wider remit than the existing system of BBC Governors. This Burns recommendation was rejected by the then Secretary of State, Tessa Jowell, partly because there was no appetite at the time to establish a public service body with a remit over more than just the BBC given that Ofcom had only just taken over the role of overseeing commercial PSB. It was also rejected because many thought defence of the BBC against government pressure (post the fall out from the Hutton Inquiry) was more important than entirely independent regulation of PSB objectives.

As Dame Patricia Hodgson (a BBC Trustee and former head of the ITC – the commercial TV regulator before Ofcom) has stated, the key factor in the decision to have the BBC Trust as both regulator and BBC champion was the ability of the Trust Chairman to resign either in defence of the BBC's independence or due to appropriate criticism of the BBC's performance, something a PSB Trust Chairman would not be compelled to do.[27]

However, the desire to create a body that would protect the independence of the BBC has left us with an organisation which champions the institution itself (the BBC) rather than championing public value. The organisation's first instinct is to deflect criticism from the BBC, only yielding to investigate matters properly after the build up of substantial amounts of public criticism. It often, therefore, appears reactive, defensive and opportunistic rather than proactive and principled.

In July 2009 for instance the BBC Trust froze the pay of its top presenters but only after adverse media coverage about how much they earned. This came 18 months after the leaking of the level of BBC payments being made to specific on

27 Statement by Dame Patricia Hodgson at the RTS Cambridge Convention, September 2009

screen talent had led to a public outcry which forced the BBC Trust to eventually launch an investigation on payment levels. But this investigation dealt just with the issue of over payment versus the commercial market, not whether the BBC should be in the bidding ring at all for some of its talent who were also valuable to commercial TV operators.

The recent criticism by Michael Lyons, Chairman of the BBC Trust, of the BBC for its 'competitive scheduling' of *Strictly Come Dancing*, which was moved to go head to head with ITV's *X Factor*, only came after other external criticism, and made the Trust seem like more of a reactive publicity machine than a proactive organisation protecting public value.

The Trust's initial unwillingness to reign in BBC Worldwide's commercial expansion, particularly the controversial acquisition of Lonely Planet, was followed 9 months later by its report suggesting that BBC Worldwide should afterall be reigned in. Again it looked defensive and opportunistic rather then principled and transparent.

A recent Select Committee report stated "*We were especially concerned about the apparent arrogance of the BBC Trust who appeared to believe that they had no case to answer. We consider that the BBC has a duty and responsibility to properly account for exactly how its commercial activities benefit the licence fee payer.*" Two months later the BBC Trust produced a report suggesting that it will restrict future activities.

Most recently, the BBC Trust has come out vigorously against "top slicing" the BBC licence fee to support commercial PSB, rather than making a considered submission on how public value might be maximised from the licence fee in a new age.

While the BBC certainly does need a Board and a Chairman able to defend the BBC against unfair criticism and to take the blame if the organisation gets things wrong, the country needs a body to champion public value and public access across the whole sector not just to argue the case for the BBC.

The problem with Ofcom

If the BBC Trust has ended up in the uncomfortable position of being both regulator and champion of the BBC, Ofcom has ended up in the equally difficult position of promoting effective competition across the UK media yet sharing responsibility for the execution of competition policy with the OFT and Competition Commission and in preserving commercial PSB yet with limited influence over the largest provider of PSB in the UK – the BBC.

This situation has resulted in competition authority decisions that seem to have little regard to the special conditions that apply in the broadcasting sector or the objectives and sustainability of commercial PSB (such as the CRR and Project Kangaroo decisions of the Competition Commission). Recommendations on the future of commercial PSB have also put it at loggerheads with the BBC Trust.

Ofcom has five separate roles when it comes to the current UK broadcasting sector:

- spectrum allocation,
- the award and monitoring of broadcast licences (PSB and non PSB),
- reviewing the performance of the PSB system,
- the assessment of the market impact of BBC services, and
- the promotion of effective competition.

Across all five areas the scope of its regulatory powers over the BBC is considerably less than the rest of the broadcasting sector.

Spectrum allocation

Ofcom takes the lead in developing spectrum use policy (making recommendations to government) across broadcasting and telecoms and then in either auctioning off spectrum or setting an administered price for access. Currently the only significant broadcaster payments to the government for spectrum are the fees paid by ITV1 and FIVE for their access to analogue spectrum, fees that were set in the 1990s in an initial auction process and then adjusted over time to reflect the impact of digital switch over. Digital terrestrial spectrum has been allocated directly to PSB broadcasters for no specific charge, and to two "multiplex" operators, SDN (owned by ITV plc) and the Freeview consortium (led by Arquiva but also involving the BBC and BSkyB) through a "beauty contest" auction in 1997 and 2002 respectively.

The BBC, however, receives its analogue spectrum and its gifted digital terrestrial spectrum directly from government (the BBC also has access to extra spectrum through its involvement in the Freeview consortium).

In radio, Ofcom allocates both analogue (FM and AM) and DAB capacity to the commercial sector (in the case of local and regional radio through a "beauty contest" and in the case of national radio (Classic FM, TalkSport and Absolute Radio) an initial auction and then an administered price process). Again the BBC has its own direct access to FM, AM and DAB frequencies.

Awarding, monitoring and enforcing broadcast licences

Ofcom has both a general role in issuing and monitoring all broadcast services operating from the UK and a specific role in enforcing the requirements of commercial PSB licences linked to the allocation of analogue and digital terrestrial frequency to specific organisations (ITV1, C4 and FIVE).

Ofcom's general remit covering all broadcasters operating from the UK covers the enforcement both of minimum EU wide quota requirements (most notably a 50% European output quota where "practicable", and a 10% independent producer quota) and UK specific taste and decency requirements (referred to as Tier 1 UK regulations).

At Tier 1, Ofcom sets standards in matters such as offence, protection of children, and political impartiality; this applies to PSBs –including the BBC - and all other broadcasters licensed by Ofcom. For example, Ofcom fined the BBC £150,000 for the obscene phone message broadcast in a late night BBC Radio 2 show with Jonathan Ross and Russell Brand which described it as "gratuitously offensive, humiliating and demeaning." In July 2008, Ofcom fined the BBC £400,000 for faking phone-ins linked to Comic Relief where viewers were urged to phone in to enter competitions they had no chance of winning.

Ofcom's powers and duties with respect to PSB licences (not including the BBC) are at two levels (referred to as Tier 2 and Tier 3 regulations). Tier 2 requires Ofcom to set quotas for particular types of output. Tier 3 refers to other area of public service output, where Ofcom has no power to set quotas, and broadcasters are primarily responsible for deciding what volume of output to deliver relating to high quality and diversity.

Ofcom is required to set minimum requirements (or quotas) for the following 'Tier 2' genres: news and current affairs programmes on ITV1, Channel 4 and Five; nations and regions programming on ITV1; and schools output on Channel 4. Ofcom requires non BBC channels to have 25% independent output and 53-65% original output. Ofcom state that UK content has greater public value than foreign imports.[28] They must also provide high quality international, national and regional news and current affairs programmes.

"Tier 3" responsibilities to encourage quality and diversity do sometimes come with specific requirements such as children's programming on ITV1 and ethnic and educational programming on Channel 4. Ofcom has the power to fine broadcasters for not complying with Tier 2 requirements, but its powers to act if Tier 3 criteria are not met are less clear cut.

Ofcom also has the specific power to intervene over terms of trade between producers and commercial PSB broadcasters. It has used these powers to help independent producers secure better terms of trade, first in 2003, and again in 2006. It has no power to intervene over terms of trade for non PSB services. The only protection for the independent production sector outside the PSB system is the 10% EU wide requirement of all broadcasters.

Reviewing PSB

Ofcom is required to review the state of PSB in the UK (commercial and the BBC) every 5 years and to make recommendations to Government on any changes needed. Since Ofcom began in 2003, it has held two reviews of PSB, one in 2005 and one in 2008. The frequency of these two reviews reflects Ofcom's concerns over the failure of the commercial PSB system as digital switchover approaches (covered in Chapter 3). But its ability to influence the whole PSB offering is severely limited by its lack of power and influence over the BBC.

Assessing the market impact of the BBC

The only direct influence Ofcom has over the BBC is its involvement in the public value assessment of "new BBC services". As covered in Chapter 2, the public value assessment involves both a review of the public value created by a BBC service and an assessment of any market impact the service might have.

Ofcom have the role of performing the market assessments for new BBC services only with market impact assessments for existing BBC services (BBC1, Radio 1, BBC3 etc) and BBC delivery platform (Project Canvas) and support activities (talent spending) conducted by the BBC Trust.

Promoting effective competition

Ofcom's final role is to promote effective competition across broadcasting and telecoms markets. In the telecoms market its most significant decision was to force the separation of BT's local exchanges, wholesale and retail businesses and to open up the exchanges to third party broadband and telephony providers.

In the area of broadcasting, Ofcom's main interventions are in regulating and monitoring the terms of third party access to the Sky satellite pay TV platform and, more recently the review of BSkyB's premium pay TV services. The latest review resulted in a recommendation that BSkyB be required to wholesale its premium sports channels to all third party platforms and a price that allows such platforms

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to make a profit on this channel provision at a retail price similar to BSkyB's own price (the outcome of this review is still not finalised).

The main specific problems arising from Ofcom's powers have been fairly obvious over the last 6 years. Ofcom has found it difficult to enforce the Tier 3 requirements of commercial PSB broadcasters as licence revocation has not been a credible threat. It has also had little success in co-ordinating general PSB policy with the BBC.

Ofcom supposedly has an equal role to the OFT on competition regulation, but in reality decisions have been referred from the OFT to the Competition Commission, without understanding the dynamics of competition in broadcasting. They have also not taken into account the public service objectives of PSB broadcasters.

In the area of BBC market impact assessment it neither controls the eventual outcome of decisions on new services (the BBC Trust balances public value versus negative market impact), nor has any influence over the assessment of the impact of existing services or delivery platform initiatives.

The main problems with the current PSB system

The current system does not deal with PSB properly. Ofcom's ability to influence PSB on commercial networks is limited by the declining value of the frequencies it allocates and the hollow threat of licence revocation. No one body takes overall responsibility for the delivery of public value across the whole broadcasting market. This is made even more difficult by the different timings of licence fee reviews, Charter reviews and Ofcom PSB reviews – there has never been a period where all have been conducted simultaneously.

Where the BBC Trust does at least assess the public value generated by the BBC its processes are not contestable and therefore become less about maximising public value and more about minimising market impact. (Chapter 2 dealt with this issue in detail)

The current system also does not adequately deal with the specific competition issues of the broadcasting sector. PSB intervention is a recognition that normal competitive processes in broadcasting do not always lead to desirable market or social outcomes. Yet the OFT and Competition Commission tend to treat broadcasting like any other market when broadcast market competition issues and mergers are referred to them.

Lastly, there is no proper system for dealing with the interface of the PSB system and the rest of the commercial market. The system does not properly assess the market impact of the BBC, or indeed interventions in favour of commercial PSB, neither does it have a formal role in setting the terms of access for PSB broadcasters on delivery platforms.

A new PSB System for a new age

A new UK PSB system will need two focused institutions to make it work – an institution to promote public value and public access/discoverability, and an institution to promote effective competition but in a way that is consistent with maximising public value.

These two institutions must remain at arms length from Government and must be accountable but also independent. While it may have been correct to question Ofcom's policy making role and its spending, as David Cameron has done recently,[29] it would not be right to create a system whereby the Government of the day directly makes decisions as to the detailed distribution of public funding or the allocation of assets on a year by year basis, nor one where it can easily dismiss any media regulator that causes displeasure.

The rest of this chapter will suggest how the BBC Trust and Ofcom could be refocused and restructured to take on the two roles necessary for a future PSB regulatory system and how these successor institutions can be made politically accountable but also independent of government.

Promoting public value and public access

Following our recommended changes to the PSB sector, the UK will need an institution that can promote the provision of public value across the BBC and the remaining commercial PSB sector. This organisation will need to hold the BBC to account; administer the various levels of contestability suggested in previous sections, including the BBC's co-funding of commercial PSB content and services; receive funds from new sources of public funding (covered in detail in the next Chapter); monitor the interface between the BBC and other PSB providers; and allocate spectrum to all PSB providers.

> "The UK will need an institution that can promote the provision of public value across the BBC and the remaining commercial PSB sector"

The same organisation will need to promote access to PSB content and discoverability across all platforms – radio, digital TV and the internet.

The promotional role – of public value, access and discoverability - is very different from the normal function of an industry regulator, and will mean that the organisation will need to be more politically accountable than normal industry regulators.

Recommendation – Abolish the BBC Trust and replace it with a BBC Joint Board

The BBC Trust is a single body regulator with the sole task of holding the BBC to account. Such a structure has not held the BBC to sufficient account and has taken a narrow institutional approach to the delivery of PSB in the UK. This is not the fault of any individuals but rather a result of the position the BBC Trust found itself in. Whatever the history, it is clearly unsuitable for the 21st century.

The BBC management should be accountable on day to day matters and the delivery of their objectives to a BBC Board, with a BBC Chairman and non executive directors.

Recommendation – Establish a Public Service Content Trust (PSC Trust) to promote PSB across all TV, radio and broadband

The PSC Trust will be the lead body for monitoring the delivery of BBC services in line with its licence fee settlements, Charter and Agreement. It will also review the effec-

29 David Cameron speech at Reform on July 6th, 2009

tiveness of the BBC's co-funding obligations which have been set out in Chapter 2. At key times in the BBC role and scope setting process – Charter, Agreement, licence fee settlements etc, the PSC will advise Government on the best way to promote public value across the BBC and other activities, but the BBC Board will make its own case to Government on the level of funding they need to carry out their remit.

The PSC Trust would be the first body in the UK to oversee the funding and delivery of all PSB intervention. It would in effect become the champion of public service programming.

The PSC Trust will receive monies from the proposed re-transmission fees and spectrum charges that will form new sources of public funding directly (see Chapter 5). The BBC will still receive all licence fee monies – at least until the end of the next licence period (likely to be 2018 or 2020). However, the level of retransmission fees and spectrum charges will be determined by Ofcom not the PSC. Likely total income from spectrum charging and transmission fees would be in the range of £90m to £110m a year in 2012 rising to £140m to £160m by 2020.

The PSC will take the lead in allocating ear-marked frequencies for PSB services between the BBC and commercial providers and in allocating extra PSB funds from retransmission fees and spectrum taxes to commercial PSB content providers (alongside BBC co-funding). The PSC will also take the lead in ensuring the BBC co-operates with other PSB providers in terms of access and links to its web sites and on demand services.

Recommendation – The members of the PSC Trust should be nominated and appointed by the Government.

The PSC would be an *independent* trust whose members would be proposed by Government. The PSC Trust would be responsible for political as well as implementation issues (such as the allocation of public monies between PSB providers) and so would need to be accountable to Parliament and Government.

We recommend that the PSC would be subject to full scrutiny by the National Audit Office and the Public Accounts Committee.

The PSC would regularly report to the Government and Parliament on the delivery of public value and universal access in the UK.

Preserving minimum standards, policing the Interface of PSB and the commercial sector, and leading the promotion of effective competition and content creation

If the PSC is to take the proactive role of promoting PSB and access/discoverability, then Ofcom will be needed to set minimum standards and EC quotas across the whole sector, and to make sure the interface between the PSB sector and the commercial broadcasting sector works properly. Ofcom also needs to take a lead role in the application of competition policy to the broadcasting sector and in ensuring that adequate account is taken of PSB objectives in competition reviews and merger inquiries.

Ofcom's competition role should also extend to the content creation sector (currently it intervenes in these areas only through enforcement of commercial PSB licences) where it should have duty to promote effective competition consistent with both overall PSB objectives and the general economic health of the UK TV content sector (one of the UK's leading export industries).

Recommendation – Ofcom to have a new set of responsibilities that complement the PSC Trust's role

The application of competition policy to the media and communications sectors in the Web 2.0 age needs to take account of potential market failures and the need to encourage public value. Competition assessments and remedies may have to set conditions which are about trading off the interests of advertisers and consumers (such as the potential to allow mergers of ad funded networks with conditions related to investment in content).

At the same time, the PSC activities' which impact on the wider TV, radio and internet markets will also have to be subject to outside scrutiny and a body will be needed to adjudicate on the setting of retransmission fees and spectrum charges (the PSC cannot set these charges itself as it is the recipient of the monies).

We recommend that Ofcom should retain charge of the basic content rules applied to all UK broadcasters such as product placement, the EC 50% European origin quota and the 10% independent quota. Basic taste and decency issues, premium rate phone call rules etc should also all remain with Ofcom.

Recommendation – Ofcom should take the lead on competition issues as they impact the TV, radio and internet sectors – promoting effective competition but with reference to the promotion of public value and content Investment

At the moment the OFT and Competition Commission take the lead on competition issues across the sector. This responsibility should transfer to Ofcom. The Competition Commission would still be referred cases by Ofcom but not by the OFT (all initial competition investigations of mergers and acquisitions and sector reviews would be initiated by Ofcom across the telecoms, media and internet sectors). The Competition Commission would also be charged with taking into account public value issues (as well as the interests of both advertisers and consumers) in all cases.

Ofcom's competition role would also cover overview of the independent quota and terms of trade interventions which will have to be reviewed once ITV1 and Five opt out of their PSB status (the 25% quota and terms of trade rules only apply to PSB channels at the moment)

Recommendations – All specific ownership restrictions in the media sector should be removed

With Ofcom in charge of balancing competition objectives with public value objectives (including plurality and diversity) there would be no need for any remaining specific ownership restrictions on network ownership, local cross media ownership etc. Each merger would be judged on its own merits. This would be likely to lead to consolidation across traditional national and local media.

Recommendation – Ofcom should take the lead in setting spectrum charges and retransmission fees and in dealing with consumer privacy issues

Ofcom would be the arbitration body between the PSC Trust and Pay TV platforms for retransmission charges (see Chapter 5) and would be required to set a fair and non discriminatory price. Ofcom would also set the administered price that the non PSB ITV and Five would pay for their spectrum and the fees to be paid by SDN and Arquiva.

Ofcom would also take the lead on issues involving the use of consumer data by advertisers on the internet.

Limiting unnecessary expenditure

While a large number of changes to the current regulatory regime have been proposed in this report, all involve activities already undertaken in the UK. Overall the aim should be to achieve these reforms of the system at no extra cost to the tax payer or regulated industry (a large proportion of the regulation cost in the telecoms and media sector is covered by payments from companies involved).

Recommendation – Changes to Ofcom, the BBC Trust and PSC Trust should be achieved at no extra cost.

The current total cost of the BBC Trust and the media sector activities of Ofcom is about £50 million according to their annual reports. The aim should be to establish the new Ofcom and the PSC Trust at no extra cost.

5
Extending the Funding Base for PSB

Untapped Sources of Value Across UK TV

While the TV advertising market has stagnated over the last 5 years, and the commercial networks share of that market has fallen, pay TV revenues have been growing fast. Just over 50% of all UK households now have pay TV, creating a pay TV market worth over £4 billion, which has been growing at 4 to 8% a year over the last 5 years despite the recession.

Pay TV in the UK

Pay TV Services and Platforms

Pay TV in the UK is currently delivered by four platforms: BSkyB via direct broadcast satellite, Virgin Media via broadband cable, BT Vision via an upgraded broadband telecom network and Top Up TV via digital terrestrial. Pay TV services are typically offered (by the largest operators BSkyB and Virgin Media) for a monthly subscription of between £10 and £40 depending on what packages of channels are received. The packages usually consist of a bundle of thematic entertainment, factual, music and children's channels (often referred to as basic tier packages) and a selection of Sports and film channels. Top live sports events and recent movies are offered at a significant price premium to the basic packages and are often referred to as premium tier packages. In addition to these services some sports and movies are offered on a pay per view basis.

Smaller pay TV players such as BT Vision and Top up TV concentrate on providing on demand programming either for a price per programme or for a minimum monthly fee. BT Vision provides this programming through broadband links into the home, while Top Up TV provides this service by downloading programmes to be stored on viewers set-top boxes using digital terrestrial capacity.

Over the last 5 years pay TV operators have increasingly bundled their TV offerings with broadband internet access, and have upgraded them with high definition channels and Personal Video Recorder based storage, advertising skipping, pause and replay functionality.[30] Pay TV has become just one part of the so called "triple play" competitive battle of telephony, broadband and digital TV being fought out between BSkyB, Virgin Media and BT.

30 Known as Sky Plus and Virgin Plus

BSkyB

The largest player in the UK pay TV market is BSkyB, which accounts for 70% of all UK pay TV homes and over 80% of all household subscription revenue. Sky's strong position was built initially on it showing top sporting events like the Barclays Premiership football games, international Rugby Union, Test Match cricket, Grand-slam tennis and European tour golf live and exclusive.

BSkyB consolidated this position with a strong pay movie package and a wide range of basic tier thematic channels such as UK Gold, Sky one, MTV, Dave etc. It owns the rights to recently released blockbusters with big name stars. It provides 850 movies in 10 different genre channels including action, thrillers and comedies. Sky's basic package is a mixture of its own wholly owned channels – such as Sky One and Sky Arts, and third party channels provided by the likes of Discovery, Viacom, Disney, NBCUniversal, BBC Worldwide and Virgin Media.

Sky also wholesales its sport, movie and wholly owned basic tier thematic channels to Virgin Media and broadcasts a couple of wholly owned channels on the Freeview free to air platform. It has had plans to introduce its own pay TV service to digital terrestrial homes as an add-on to Freeview (called Sky Picnic). However, these have been put on hold as Ofcom would prefer Sky to wholesale these services – at a regulated price – to third party platforms which offer add-on services to digital terrestrial homes – i.e. BT Vision and Top Up TV.

Sky also has a number of subscribers in the Republic of Ireland as well as ex pat subscribers in France and Spain able to receive the BSkyB signal, and provides a service in the UK for pubs and clubs.

Over the last three years Sky has launched Sky Broadband which is now the ISP in about 30% of Sky pay TV homes; Sky Anytime, which downloads TV programming to the set-top box; and the Sky Player, which offers subscribers the chance to see their Sky channels on a PC in addition to their TV. This has helped Sky maintain impressive subscriber and ARPU (average revenue per subscriber growth) although they have seen their margins fall somewhat due to the costs of broadband roll out and new product marketing.

Virgin Media

Virgin Media (and its predecessor companies NTL and Telewest) has been a "triple play" provider of pay TV, internet and telephony for almost 15 years. It has a high capacity broadband network covering about 53% of the UK, focusing on major conurbations. In recent years it has used its high capacity network to offer superfast broadband to the PC (as high as 50Mbits/sec to premium customers), and video on demand to the TV (where subscribers can watch all the most recent programming and archive programming on demand on their TV set rather than just their PC).

Virgin's pay TV offer has been less successful than Sky's, even in geographic areas covered by their cable network. Their premium content offer is mostly made up of Sky Sports and Sky Movies channels which they offer at fairly high prices. They complain to Ofcom that they can't compete on price with Sky as Sky keeps its wholesale charge artificially high. Their basic tier offers are similar to Sky's but generally include less channels. Part of Virgin Media's lack of success in pay TV lies in the history of cable roll out in the UK. In the mid 1980s the UK Government developed cable as a series of local franchises allocated to a myriad of companies and it took a further 15 years for the industry to build their network and create a single national service offering to compete with the Sky satellite service. By this time Sky had already built a significant national subscriber base and developed the leading premium sports and movie services.

Virgin Media is much more successful as a broadband provider, nearly all Virgin Media pay TV homes also take their broadband service.

BT Vision

BT was a late arrival in the pay TV market (although they were originally partners with Sky when it first went digital in developing interactive services using the telephone line). BT Vision is primarily a video on demand service, that uses a broadband connection into a Freeview set-top box to add pay video on demand to the 32 channel free to air channel choice on Freeview. They offer movies, entertainment, music and factual programmes on demand for about £5 per month (but only if you are a BT Broadband subscriber). They also sell the ESPN sports on a live basis but this is delivered using digital terrestrial capacity not through BT's broadband system. BT would like to sell Sky Sports as well.

While BT Vision only provide their TV service to BT broadband customers until recently they were not allowed to offer broadband price discounts to BT Vision customers, as BT were deemed to be a dominant telecom supplier. BT Vision can be largely seen so far as BT's attempt to stop customer erosion at the expense of the triple play offerings of Virgin Media and Sky. So far this has only had limited success with less than 0.5 million customers.

Top Up TV

Top Up TV began life when it took over the set-top boxes of the closed down ITV Digital pay TV platform in 2002. This allowed it to offer a limited number of pay TV channels using digital terrestrial capacity – UK Gold, Setanta Sports etc – to Freeview homes that wanted a bit of pay TV choice on top. However, about 3 years ago it switched its service to become largely an on demand service (with the exception of Setanta and now ESPN sports). It delivers this service of mainly movies and entertainment programming through downloading programmes to a set-top box, mostly overnight, which can then be watched on demand for a fee.

ESPN (Entertainment Sports Programming Network) is a TV sports giant backed by US companies, Hearst and Disney-owned ABC. ESPN runs a premium sports channel service in the UK having replaced the failed Setanta Sports service in the summer of 2009. It bought a small package of rights to English Premier League football games for four seasons (46 out of 138 matches on offer in 2009/10 and 23 out of 138 matches from 2010 to 2013 – with most the matches and nearly all top matches retained by Sky Sports). All the UK pay TV platforms offer ESPN's premium service.

Retransmission Fees

Sky and Virgin Media not only provide customer households with reception of premium pay and basic tier pay channels, they also include in their offering the main free to air networks (BBC, ITV1, Channel 4 and Five) and the networks' free to air spin-off channels (such as ITV2, E4, BBC 3 etc). These channels are available free of charge to Freeview homes and Freesat homes and any Sky and Virgin media home could retain these channels should they stop subscribing by purchasing a Freeview or Freesat box.

Currently, the networks and the spin-off channels pay nothing for carriage on Virgin Media as cable has a must carry requirement in the UK. However, to be received in Sky homes through Sky set-top boxes these channels pay fees to Sky. These fees are paid either to have the channel encoded so they cannot be received overseas (where the channels often do not have the relevant rights to sports events, films and commissioned programmes) or to be regionalised (e.g. so viewers in Scotland get STV not ITV London, or BBC Scotland not the BBC London signal). Sky has no must carry rule for PSB networks or their spin-off channels.

Some free to air broadcasters have tried to avoid these fees for their spin-off channels in the past by agreeing these channels should be part of Sky's basic tier package. In return they receive a small fee from Sky per month but they have to accept that when subscribers stop paying they don't receive the channel. This led to the setting up of Freesat by ITV and the BBC, where they effectively offer homes that want satellite reception a way of retaining these channels without subscribing to Sky.

The UK's situation, where free to air channels and PSB networks either get no fee for platform "retransmission" or even have to pay for such retransmission is unusual in a global context. Many European countries set retransmission fees for cable networks to pay for the relay of the main free to air channels[31] on the basis that if the cable system did not have these channels they might not be as popular. In the USA, cable systems and direct broadcast satellite systems pay local TV station affiliates for retransmission of their signal, and in the past cable systems have had to offer the programming networks themselves (ABC, FOX etc) access to their basic pay tier for additional pay channels as a sort of payment in kind for carrying the free to air network programming on their system.[32]

Retransmission rates in the US are arbitrated by regulators and are currently being re-negotiated. One of the most vociferous campaigners for high retransmission fees to be paid direct to free to air networks by cable and satellite systems is News Corp owned Fox TV. News Corp is the largest shareholder in BSkyB in the UK.

Recommendation – Introduce retransmission fees in the UK

Pay TV platforms clearly benefit from the retransmission of PSB networks and their spin-off channels. But the PSB networks have little capacity to withdraw their channels from these systems in protest at non-payment, due to the BBC's universality obligation and the commercial networks' need for very high reach to drive their advertising revenue. The UK should both recognise this benefit and the fact that market based negotiations alone cannot solve the problem (something even the US recognises by arbitrating on rates).

The UK should set retransmission fees for all the main free to air networks and their spin-off channels. Fees for carriage of BBC services and those of commercial

31 In Europe the main free to air networks receive about €100 million a year in fees for retransmission.

32 When most cable was analogue in the US and there was only room for 50 channels there were more channels wanting capacity then the cable systems could offer. The offer to the networks at this time to take extra pay channels from them represented a significant benefit in kind in return for retransmission rights.

PSB broadcasters should go to the PSC for reinvestment in PSB content. It should also be considered whether the PSC should retain any fees paid to ITV and Five, even if they opt out of the PSB system, in return for allowing them access to the higher reach slots on digital terrestrial as a set price (i.e. not putting the capacity out to competitive auction). Ofcom should arbitrate on the correct level of these retransmission fees.

For reference, US local stations earn about $6 (c£4) per cable/satellite household per year in retransmission fees. A similar fee in the UK would raise about £50m a year in 2012, rising to about £60m by 2020.

Allocated but uncharged spectrum

At the moment the UK Government charges broadcasters and those that control the multiplex capacity on digital terrestrial (an Arquiva led consortium and SDN) nothing for the spectrum used. Free spectrum for commercial PSB networks and their spin-off channels was one of the privileges underpinning the enforceability of commercial PSB undertakings. Free spectrum for the BBC was really more about tradition and practicality, the BBC having not been charged for access to analogue spectrum and the impracticality of charging a public body for spectrum only to have to up its licence fee to pay for it.

Free spectrum for SDN and the Arquiva was a result of the initial "beauty contest" for digital terrestrial frequency when no one was sure it would be of any value at all. As the Freeview platform has grown SDN and Arquiva have both been able to sell broadcast slots for £8 million to £10 million per slot, way above the incremental technical and administrative costs of transmission.

Spectrum charges to the main ITV1 and FIVE would be likely to be higher than the other users due to better coverage of the UK. This policy might raise about £30m to £35m a year from ITV and FIVE and a further £15m to £20m a year from other capacity owners.

Recommendation – Introduce spectrum charges for digital terrestrial spectrum to all providers but Channel 4 and the BBC

It has already been suggested in Chapter 3 that ITV1 and Five would be required to pay an administered/arbitrated price for their currently gifted slots on digital terrestrial. SDN and the Arquiva led consortium – (Arquiva/Sky/BBC) – should also start to pay an administered price from 2014 onwards for their digital terrestrial capacity. Prices should be set by Ofcom and income from the set prices should go to the PSC for reallocation to PSB content across a number of channels and PSB operators.

TV platform re-Use fees

Looking forward most pay TV homes in the UK will have Personal Video Recorder (PVR) functionality in the next few years (PVRs are already in 25% of TV homes in the UK). Pay TV systems are not only benefiting from the retransmission of the main networks and the spin-off channels, they are also offering their subscribers the ability to save and replay 80 to 100 hours of the best network programming – which is still the most popular programming on TV – at their leisure. The same principle of retransmission should apply to PVR storage and replay by pay TV platforms as for relay of free to air networks. A extra retransmission fee should be paid by pay TV platforms for platform re-use.

Recommendation – Proprietary TV platform re-use fees should be Introduced

All proprietary platforms offering PVR functionality would have to pay content retransmission fees. The rate would be arbitrated by Ofcom and the income would go to the PSC Trust for re-distribution to PSB content. But the rate would not kick in until PVR penetration was over 75 per cent of all homes so as not to act as a discouragement to new technology take up. A £2 fee per year per proprietary PVR home would probably raise about and £30m in 2020

6

Embracing the Challenges of Web 2.0 Age

The challenges

It has been clear for quite some time that the internet is much more than a new distribution outlet for traditional media. While the initial internet investment bubble may have burst in 2001/02, it reflected an anticipated and unprecedented shift in the structure of markets and value propositions that has been proven to be largely true across many markets by the time of this paper in 2009.

Utopian visions and dystopian fears

For some, the internet is the ultimate globalising free market force set to bring down trade and market barriers to entry and usher in a new age of productivity and efficiency. For others, it is the ultimate egalitarian force, destined to reduce the power of big business, and hand power back to the consumer and citizen.

For adherents of this world view the main public policy issue becomes ensuring maximum access to the internet at sufficient transmission speeds to allow for the receipt of a wide range of services and content. Any public subsidy should focus on the UK's broadband network – its capacity and universal coverage.

However, there is also a more dystopian view. The internet brings with it large scale piracy of content undermining incentives to create new intellectual property of value. The internet will make all its users into marketable commodities whose personal details and behaviour patterns can be accessed and influenced by those trying to sell us products and services we don't want or need. It will also undermine previously protected national cultures and institutions, leaving in its wake a homogenised global culture. It may usher in emerging global monopolies such as Google, e-Bay and Amazon which will squeeze out local players and be accountable to no national or even pan regional regulator. It will bring the market type mechanisms such as auctions and exchanges to all areas of human life previously influenced by individual and cultural sensibilities, from organ donation to child adoption and genetic matching.

For adherents of this view, the main focus on public policy should be the protection of privacy and the punishment of piracy.

Both these visions are very probably wrong. What is certainly true is that the internet has the capacity to change many traditional and national activities for better or worse in fairly small lengths of time by historic standards. Policy makers and regulators above all need to ready themselves for this uncertainty and develop the means by which they can "nudge" the internet towards helpful rather than harmful outcomes.

A starting point, is to understand how the internet is changing certain fundamental relationships that have underpinned traditional media and public service broadcasting and to think through the likely implications for policy.

Changing the consumer's relationship with the media

With traditional media the consumer is a largely passive participant in the creative process. Clearly, newspaper and TV channels have always had consumer forums such as letter pages, complaints programmes or phone ins, but these have been the exception rather than the rule and by and large these forum have been intermediated by employed professionals.

The internet creates places where people meet and share their own creativity or at the very least their views and interpretations of other people's creativity, and by finding it more economic to make, store and distribute content that only appeals to a small number of people at a given time – the so called "long tail" effect.

"Above all the internet can change the consumers' relationship with content, by making the users reaction to it part of the service itself, either providing the forum for mass creativity or for very individualised versions of consumption"

Above all the internet can change the consumers' relationship with content, by making the users reaction to it part of the service itself, either providing the forum for mass creativity or for very individualised versions of consumption. This poses significant challenges to traditional content providers.[33]

Any view of public service content and broadcasting going forward must take a view on this – in short deciding how far the "medium is the message" or not. Similarly, any view of public service content in the future will need to consider how far the internet does bring with it the ability to exploit a "long tail" to the benefit of providers of niche content previously under supplied by the traditional media markets, or whether the aggregating impact of the internet will actually create even larger global media phenomenon which in turn might squeeze out smaller scale activity.[34]

Changing the advertiser's relationship with the media

While the changing consumer relationship to content in the Web 2.0 age may have some long term effects on what is defined as public service broadcasting and quality content, changes in relationships with the advertiser brought about by the internet are already putting pressure on the traditional media in 2009.

At the broadest level the internet is bringing about a shift in marketing spend from brand advertising to more "transaction" and " intention" based advertising previously only offered by direct mail and classified type advertising. The exponential growth of online classified and search based advertising represents the

33 For a good overview of the thinking in this area see "*We Think*" by Charlie Leadbetter.

34 While early studies of music of the internet seemed to support the "long tail" effect more recent comprehensive studies have suggested that in value terms more actually accrues to the few big hits in the internet age – See Will Page and Eric Garland – PRS for Music, Economic Insight 14- 2009

arrival of far more cost effective and accountable ways for advertisers to encourage direct transactions.

This shift has left display advertising - like TV spot ads, radio spot ads and half page ads in newspapers- taken as a whole, as a low growth to flat advertising market. At the same time the internet's display advertising (banner ads etc) is taking share within the display market, turning real growth rates in traditional display advertising such as print, TV and radio negative even before the recession hit.

While the internet is putting a squeeze on all traditional display advertising media, its most direct impact has been on those media – such as local newspapers – that depend for a large part of their revenue on classified advertising. For such media, the traditional virtuous circle of content helping to attract readers that then attract more classified advertisers who then attract more readers looking for cars, jobs and properties, has been broken. The internet can introduce large numbers of buyers and sellers without the need for editorial content to lure people in and subsequently such media is under intense economic pressure.

While traditional media such as network TV will still play a role in general brand building that is hard to replicate on new media, there is no doubt that the internet is taking away a proportion of money previously earmarked for traditional media.

Fragmentation and increasing risk

First multichannel TV, then on demand TV and Web 2.0 content offerings have fragmented the audience to individual channels and services. While lead networks and services might find the scarcity value of their large audiences actually increasing in the medium term (most TV networks in the US and Europe have seen relative prices rise as audiences fragment) for many outside this top tier, advertising yields are coming under significant pressure.

Fragmentation of advertising revenue and lower barriers to entry can lead to reduced programming budgets and a dilution of TV schedules with imports, repeats and high volume low cost output driving out high cost local drama, comedy and documentaries.

The impact on higher cost programming can be lessened both by the move to global format programming (where an idea that has worked in one market is made again for another market thus lowering the risk of failure) and the multiple windowing of content across free and pay channels, on demand services and DVD sales. However, it is still likely that the risk profile of individual content strand investment will become more extreme with a few global hits and a lot of failures.

While the development of premium pay TV channels such as HBO can help reduce the impact of overall market fragmentation they tend to focus on only a few strands of programming a year and outside the US would struggle to fund more than a handful of originated local series a year.

And even if pay TV outlets can make up for some of the dilution on free to air commercial networks, the former are not, by definition, universally available, and so cannot be means for the widespread delivery of public service programming.

Piracy and Re-aggregation on the Web

The internet makes is possible for an individual user of content to share that content with millions of other users across the globe within seconds at more or less zero distribution costs. So-called "peer to peer file sharing" networks don't even have one central server that can be tracked and closed down to prevent the illegal distribution of material. These networks operate by using all the users' own PCs as a vast network of remote storage and re-distribution. This has had a devastating impact on the music sector where the relative small amounts of data in a music file plus the lack of any copy protection on CDs led to a flood of file sharing services from the late 1990s onward (Napster, followed by Bit torrent and then Pirate Bay etc). Music bodies have suggested that 80 to 90% of all music consumption on the internet is of illegitimate material, and that this has been the prime contributor to a dramatic reduction in music sales (notwithstanding the success of iTunes in creating a legitimate music downloading business model).

So far the film and TV sectors have been spared the level of value destruction experienced by the music industry. TV and film files are much larger than music files needing higher capacity broadband links and/or more patience to download. The film industry also copy protected its DVDs so that individuals cannot easily transfer their entire library on to a PC or mobile device for subsequent onward file sharing.

Most importantly for TV, its primary window for new content has always been free (ad funded or licence fee funded) reducing the incentives for piracy as a way of avoiding paying (which is not the case with CD albums and DVD/cinema exploitation). Many of the piracy problems for TV content are therefore most acute with either premium content providers such as the FA Premier League (where consumers have to pay to see the content on normal TV platforms), or with US material traditionally broadcast outside the US 3 to 9 months later than it is shown there. For example fans of the US series *Heroes* in Australia had already seen the most recent series of the programme by the time Seven Network came to broadcast it in the domestic market, thus reducing the audience significantly and forcing the programme out of the prime time schedules.

So far the content industries have had to deal with the problem of piracy by trying to pursue the organisations that run file sharing sites - the most recent high profile case being the massive fines levied and threatened imprisonment of the people running Pirate Bay in Sweden. But many of these organisations operate from countries where it is difficult to pursue and prosecute (e.g. Russia and the CIS) and such organisations can be moved and relaunched very quickly. This has led content providers to lobby to get Government's to punish the users of these services in their own countries. France and soon the UK are introducing a "three strikes and out" policy, where Internet Service Providers (ISPs) will monitor customers to spot persistent file sharers, then issue them two warnings and slow down their internet access speed. If they ignore these warnings for a third time the ISP will cut them off from the network and hand their name to content organisations who will then pursue prosecutions for copyright infringement.

However, most people recognise that this approach to piracy (i.e. punishment of users) is only one part of any solution. Users need affordable and accessible legitimate services on the internet to encourage them not to use illegitimate services. Put simply the fight against piracy needs carrots as well as a big stick.

But the challenge to content owners on the web not only comes from piracy and specific pirate services. The internet also creates huge opportunities for legitimate content aggregation sites to develop a mass following (most notably YouTube owned by Google). These sites simply allow access to vast quantities of uploaded video much of it generated by users and where copyright is not an issue. Some of the uploaded material is professional copyright and in these cases the attitude of the aggregator sites tends to be to offer copyright protected content owners the chance to either request the material be removed/blocked or to do a commercial deal with the aggregator where adverts are inserted to the uploaded material and the revenue shared between the aggregator and content owner. However, content providers claim that much of the damage has often been done before they get around to requesting the material be removed and that the terms of commercial ad deals offered by the aggregators are not generous to the content owner and do not reflect the full value of the content's availability to the aggregator site. Both the FA Premier League and Viacom have outstanding legal claims against YouTube.

This issue of legitimate but unfair aggregator access has also surfaced elsewhere in the media sector. Google has tried to do a deal with publishers and writer bodies in the US to digitise and provide access to so called "orphan works" – works which are in copyright but have no current published imprint. This deal has been blocked by the US courts on the basis that the collective bodies involved did not have the right to effectively sell the rights to orphaned works and thereby remove any ability of an author or publisher to sue Google for use of their work in the future.

The dispute between newspaper publishers and Google is another example of the problems that arise from aggregation of content. Publishers have called Google a "thief" and a "parasite" but Google sees itself as no different to a newsstand. Magazine publishers in the US have tried to pre-empt the "value leakage" problems that might arise from the wide spread introduction of e-readers (allowing readers to see downloaded full colour web versions of their glossy magazines) by getting together to collectively exploit their content and, if necessary, set up their own aggregation site.

Value enhancement versus value leakage

While the worst effects of fragmentation can be reduced by risk sharing, clever content windowing and the exploitation of new forms of payment for content in a normal TV environment, the advent of Web 2.0 business models bring with them the prospect of "value leakage" which may well prevent these natural balancing factors from becoming effective. The most notable area of "value leakage" is piracy. While advertising can make an accommodation with widespread piracy, pay revenue cannot. While TV is in a more fortunate position than many content markets in this respect – as its primary window (network TV) tends to be free while those for music (CDs) and films (cinema and DVDs) are not – it means that pay revenue may not make up for any fragmentation of advertising revenues.

However, there are other forms of "value leakage" from the traditional commercial broadcaster model, most notably the role played by content and advertising aggregators on the Web, who can claim much of the revenue before the content is even consumed. For example, Google provides consumers with access to newspaper site stories and claims most of the potential advertising revenue associated with the consumer before the consumer even gets to the newspaper's site. Device manufacturers can also lead to "value leakage" from content investment as they create and sell devices that store and replay content but which don't necessary have to make any contribution to that content (e.g. people can download their existing CD library to an i-Pod with no further payments for the content).

So while it is certainly true that the advent of the web may provide opportunities for new revenue streams and monetising quite niche content it may also create more "value leakage" from advertising and pay TV models alike. Markets left to themselves in this environment may be very innovative at creating new ways to retrieve, mash up, share and store existing content, but it may not provide sufficient new content leaving everyone to live off a past golden age of commercial and public service TV investment.

Changing business models and the new aggregator monopolies

The internet transforms and challenges existing business models and supply chains, creating new entrants and sometimes destroying incumbents. In many cases this is to the long term benefit of the consumer, bringing down prices and improving convenience. Services such as Amazon, Betfair and Google have helped transform the book trade, the betting market and intention based marketing for ever.

The rise of high capacity digital TV systems in the early 1990s and then broadband internet connectivity in the late 1990s has certainly reduced physical barriers to entry and allowed for more globalised competition. Yet it has also led to the emergence of new wave of powerful players in pay TV (BSkyB accounts for over 70% of all UK pay TV homes), Google accounts for over 80% of all search based advertising in the UK, Amazon for over half of all online book sales, Facebook for a majority of new social media registrations and Ebay for a large slice of UK online auction traded value.

The seeming paradox of lower barriers to entry and more market capacity leading to new monopolies is accompanied by a second more puzzling paradox. These new monopolies do not appear to behave like classic text book monopolies, restricting output, pushing up prices and reducing quality. In many cases, these players offer a vastly superior service to their physical predecessors and to their internet/digital TV rivals. Pay TV customers are not complaining about the quality of service from Sky (even if the entry level price is quite steep), and advertisers and consumers are not complaining about the quality or price of Google's service.

Yet while these new powerhouses of the global media sector seem to be offering better and cheaper services to traditional alternatives, the challenge their business models pose to the traditional media sector value chains and ecologies may well be storing up real consumer problems for the medium and long terms, problems that were hidden while traditional media sectors remained fairly healthy but are now being exposed by the current recession. If more monies shift to Amazon, BSkyB and Google and away from book publishers, TV channels/TV content producers and newspapers then in the end the consumer could suffer as the supply of the very product they are trying to get access to declines.

Greater uncertainties, greater risks, greater rewards

There is no doubt that the Web will bring greater accessibility to all kinds of content and greater freedom to manipulate and interact with that content. New innovative services will allow consumers the anywhere, anytime, anyhow functionality they desire. However, it is also likely to change radically the risk profile of new content investment and the ability of any broadcaster to sustain elements of public service obligations through effective cross subsidy.

A market like the UK, which still underwrites a significant amount of risk taking through its public service ecology can actually benefit enormously in the Web 2.0 age, especially if "value leakage" can be minimised. An ability for UK broadcasters to underwrite risk when global commercial markets are reducing their capacity for risk has probably helped UK producers and key talent conquer the US TV market with hits such as *Who Wants to Be a Millionaire? The Weakest Link, Dancing with Stars, Pop Idol, The X Factor* and *Supernanny*.

The capacity of public service broadcasters in the UK to continue underwriting that risk may be a key part of sustaining that global competitive advantage.

Implications for content provision

The implications of these changes brought about by the web 2.0 age for content depends upon the interplay of all the factors outlined above.

The internet may create opportunities to exploit the "long tail" through more windows of exploitation at one end of the scale and create greater global rewards for content success at the other end of the scale. But the shift of advertising spend to "content lite" transaction based media, and the "value leakage" that can occur due to piracy, the power of aggregation and the rise of new monopolies all threaten to reduce the level of investment in content and the risks involved in new content development.

Some of this reduction in content investment may well be a good and proper reflection of a shift in value added as how consumers use and interact with content becomes a larger component of total value than the professional content creation itself. But some of the shift might simply reflect a reduced capacity to monetise value created in a more complex and intermediated value chain, and a much higher level of risk than in the old media model where one media outlet tended to cover most or all of the costs of commissioning content.

The public policy agenda for the Web 2.0 Age

The preceding analysis suggests there are three main issues raised by the Web 2.0 age that public policy should address. First, how to encourage some form of universal access at a desired level of quality to what will become a fundamental part of the cultural and economic life of citizens of the UK (the access and universality issue). Second, how to ensure content providers can obtain an adequate return for their endeavours without stifling the innovation and creativity offered by the internet (the piracy and content aggregator issue). Third, how to ensure consumers get the highest levels of private and public value from the internet while not having their privacy needlessly invaded (the discoverability and privacy issues).

Digital Britain focused mainly on the first issue (access and universality), provided only a partial and rather authoritarian response to the second issue (piracy and aggregators), and did not really deal with the third issue at all (discoverability and privacy).

Access and universality

The first part of *Digital Britain*'s broadband vision – 2Mbits/sec fixed line connection to at least 95% of the UK - is only a modest increase on current levels and seems to be mostly justified on the grounds of social inclusion and ensuring universal access to public service content and the public services online. The universal broadband mobile ambition in *Digital Britain* seems to be justified on similar grounds.

The argument for going to 50 Mbits/sec across the 40% or so of the country unlikely to be provided on a purely commercial basis and funding this through a £6 a year fixed telecom line tax seems to be based on consumer uses not yet proven, social inclusion in as yet unproven uses and for the overall competitiveness of the UK economy. It also ties us to a fibre to the curbside (FTTC) solution of 50 Mbits/sec rather than a fibre to the home (FTTH) solution already adopted in South Korea and planned in France which should offer 100Mbits/sec or more.

The argument for using the licence fee rather than substantial amounts of central government money for the 2Mbits/sec universality requirement seems to be that this would provide universal access to public service content. But this system would also facilitate the provision of universal access to all public services, none of whom seems to be asked to make a contribution.

In so far as there are general competitiveness arguments or even general long term social inclusion arguments for extending the 50 mbits/sec network to most of the UK, the best way of funding this would surely be via general taxation, not a specific tax on current telephony lines. It is also not necessarily the case that any Government funding or extra taxes are needed to get 50 Mbits/sec to the extra 40% of the population not in major urban markets. An alternative way to achieve 90% plus coverage for a 50Mbits/sec network at no public cost has been proposed which involves allowing BT and Virgin Media to share infrastructure in urban areas and in return from this cost saving to require them to roll out the same level of capacity over time to the rest of the UK.

Clearly arrangements would have to be put in place to ensure third party access to the shared infrastructure in all areas to maintain competition, but these access charges would have to be set with a view to allowing the monopoly owner of the infrastructure in each region (which might not be the same monopoly infrastructure owner) to make a charge for access that gave them a fair rate of return.

If there are truly huge benefits to be gained in terms of reduced commuting times and congestion and much more cost effective ways of providing remote public services, then these benefits are likely to turn up in greater GDP (and therefore tax revenues) and/or reduced Government expenditure in the future.

Overall spending for *Digital Britain*'s broadband vision is around £3.5 billion. In the proposed telecom line tax of £6 a year there is little distinction made between people who use broadband and those who do not even want it. 30% of households in the UK are currently offline. Those who use a great deal of content will effectively be subsidised by those who never use it. It is an unfair tax. Digital Britain's argument for going to 50 Mbits/sec across the 40% of the country is not yet proven.

Recommendation – Drop the Telecom Tax

The need for £3.5 billion to build out high speed internet infrastructure to the whole UK is not yet proven but if the need does materialise it is likely to be a major benefit to all parts of the UK economy, including the public sector. In this case it should be funded out of general taxation, not a telecom tax.

Recommendation – Do not use the licence fee to fund universal broadband

Universal 2Mbits/sec access has broader benefits to society than simply the consumption of audio visual material. The licence fee forms a vital source of funding for the content creation sector which faces its own significant challenges in the Web 2.0 age and which is an almost £1 billion a year export sector. The last 10 years has seen more and more licence fee monies diverted to delivery and distribution rather than content.

The licence fee should remain a source of funding primarily for content and services not delivery. General taxation monies should, therefore, be used to achieve universal access to 2Mbits/sec broadband. Such funds would go to the Public Access Division (see Chapter 2 and below) not the BBC.

Recommendation – Create community broadband hubs to provide very high speed broadband to remote areas in the medium term, use network co-operation to provide universal roll out in the long term

The promotion of high speed internet access outside major conurbations should, in the first instance, be through the use of public libraries, community centres, post offices and other public buildings as high speed access hubs. This would replace the promotion or funding of direct connectivity to up to 8 million homes as suggested by Digital Britain. The cost of this initiative would be likely to be less than £300 million rather than the £3.5 billion associated with going from 60 to 90 per cent 50 Mbit/sec household accessability.

This network of broadband hubs would be much more extensive than the current public library network and would involve help and advice in the use of broadband services to the elderly, technophobic and disadvantaged in a community environment (rather than using broadband connectivity to the home which would keep these people even more isolated from mainstream society).

In the longer term the main network providers (BT and Virgin Media) might be encouraged to roll out high speed broadband to the whole of the UK by allowing the sharing of current infrastructure in the major conurbations (with significant cost savings) in return for an obligation to roll out new infrastructure to the rest of the UK.

Recommendations – Create a Public Access Division (PAD) of the PSC Trust to encourage all forms of universal access across TV, radio and the internet

Universal access to digital TV will be complete in 2012, but universal access to DAB radio is a long way off and needs a serious review. Access to on demand on the TV set through broadband access from the PC to the TV has only just begun and may or may not be a consequence of any push for universal broadband access.

Many of these systems overlap, while services may be able to use a number of systems to effectively achieve their own universality of access. At the moment each system seems to have its own organisation. DAB radio has had a Digital Radio Development Bureau which is just about to be upgraded to a DAB task force. Digital TV has Digital UK, the Freeview joint venture and the Freesat joint venture. Getting on demand content from the PC to the TV is currently focused around the project Canvas joint venture between BT, the BBC and ITV.

The BBC has some involvement in all these areas and is spending a significant amount of money driving forward these digital access initiatives. It is probably time to bring all these initiatives together and to refocus the BBC on quality content and services. A Public Access Division reporting into the PSC Trust should be created to bring all these initiatives together aiming to save on duplication and spending and to create a more platform and institution neutral approach to building public access across the UK to all types of content and services.

Piracy and content aggregation

Content owners face two main challenges from the internet. The first is piracy and is well known, however, the solutions are currently unbalanced. The second is "value leakage" through re-aggregation and extensive consumer re-use. This is less well understood and needs a new approach to some basic principles of current copyright established in the non internet age, and a new approach to collective/collusive behavior from competition authorities.

Rupert Murdoch's recent war of words with content aggregators and in particular Google, has drawn world attention to the fundamental challenge of the internet – the rapid dissemination and re-aggregation of content with little or no reward to the original content creator.

At the same time, new consumer devices can allow for mass storage and re-use of content for little or no initial payment. While content providers can try to prevent such re-use through pay walls (preventing unauthorised access on the web) or digital rights protection technology (preventing users sharing content or reusing it after a certain elapsed time), they need the co-operation of device manufacturers and web aggregators in these areas. Furthermore, it may well be the case that the best outcome for the content provider is not to restrict access through high pay walls or content encryption (as this will just further encourage piracy) but to develop new business models, along with the aggregators and device suppliers, that take a more permissive approach to reuse, but ones that better remunerate the content provider than is currently the case.

Recommendation – Amend "Fair Use" and consumer "Re-Use" copyright provisions and allow content providers to act collectively to extract fair terms from aggregators and consumers

Legislation should be passed to permit all content providers to make copyright charges to content aggregators and device manufacturers, like Google, for linking to or allowing the storage and re-use of their content. It would then be up to the main representatives of content creators in the UK – the broadcasters, PACT, writers and performers -to form collecting societies to agree the basis of such charges with aggregators and device manufacturers. For this process to work, the competition authorities need to allow content companies to come together to collectively negotiate terms, and there needs to be an independent arbitrator of any fee rate – most likely the Copyright Tribunal.

Individual content owners could decide to opt out of such a collective arrangement if they so wished, but the recognition of a right to charge and to set a sector wide per use or revenue based charge would provide a baseline for such negotiations. The costs of this collecting society would be deducted from income earned.[35]

To make this work, however, there needs to be greater clarity as to what can be re-used without extra charge in the internet age, which may require new copyright legislation to better define "fair" versus "unfair" reuse.

Recommendation – Take a more even handed approach to discouraging piracy

The Digital Economy Bill is introducing a "three strikes and out" approach to file sharers. Users who seem to be downloading and streaming vast amounts of illegitimate material would be first warned, then have their capacity restricted, and finally be cut off by ISPs.

Such an authoritarian approach to piracy is not only vulnerable to mistakes (such as pirates using innocent third parties' PC access to carry out illegitimate file sharing) but provides a very unbalanced approach to the problem. More international efforts need to be made to crack down on the organisers and providers of pirate services (such as the Pirate Bay case) and users need to be provided with more compelling legitimate ways of accessing high volumes of content.

The establishment of a collective content licensing regime – as suggested above – should help more providers offer legitimate content use at a variety of price points using different business models. It took the music industry about 10 years to react to widespread piracy by licensing and part owning a service like Spotify (which offers ad funded music and extra premium tiers for an unlimited music streaming service). While the TV sector has been quicker to react – for instance with TV clips on You Tube - it probably needs to be encouraged to get to that point even more rapidly.

Discoverability and privacy

There are now so many channels and platforms available that award-winning mind-broadening drama, documentaries or current affairs programme may be very difficult to locate for many consumers. Tech savvy consumers may be tipped off about a good programme by friends on Twitter, Facebook or at the water cooler. Imagine a viewer in their 70s, who still switches on the TV in the evenings hoping for

35 Music publishers already have such a system, and book publishers and writers are edging towards a similar position in the USA to take forward negotiations on so called Orphan works (where a work is in copyright but no one has the publishing rights). The European Commission has recent indicated that Europe should move towards more multi-territory licensing of copyright material on the internet through the creation of more collecting societies.

something good. They may be confronted by hundreds of digital channels, endless choice on BBC iPlayer or the complexity of operating a personal video recorder like Sky Plus. Bombarded with lifestyle programmes and popular entertainment, how will they ever find the public service programmes that have been expensively and carefully created for them?

While ISPs can offer parents the ability to block the access of children to harmful content on the internet, they have no system that helps parents find useful and educational content.

The internet has brought new and more effective advertising models which allow advertisers to better target consumers based on the behavior, intentions and demographics. This has been of great benefit to the corporate world and consumers, who, when the service works properly, will find the adverts they see and hear more relevant. However, the tracking of personal behaviour in all its forms raises issues of privacy. Search history, browsing behavior and site preference data should all be subject to a consistent regime that requires consumers to be informed about when and how tracking is taking place, and to be able to opt out of having their behaviour analyzed and predicted.

Recommendation – Create a consistent set of regulations governing all internet tracking behaviour – (i.e. by search engines, ISPs and ad networks)

Decisions on how long search engines can store individuals search histories, and under what circumstances ISPs can allow targeted advertising networks access their customers are being made on an ad hoc basis both within and across national markets. The UK needs a consistent and transparent policy in this area which gives advertisers greater effectiveness but protects individual privacy. This policy will need to be developed at a European and WTO level. responsibility for taking forward any agreed approach then needs to be given to one lead body – Ofcom.

Recommendation – Introduce a “Kitemark” scheme for internet content sites (especially those focused in children’s content)

There needs to be a more co-ordinated approach to discoverability and consumer protection and to this end, a Kite Mark scheme should be introduced to give consumers reassurance on the quality and veracity of the content and information they are using.

While some internet thinkers might protest that the “wisdom of crowds” can provide its own constraints on misleading information and poor quality content, there may be a need for a more positive approach where consumers can be given guidance as to the best content on the web (which may not always be the most popular). In some areas of internet activity this is more of a Fair Trading Issue (the OFT has been investigating price comparison web sites) but in areas of news provision and audio visual content the establishment of some kind of kitemark system for consumers might add significant value at very low cost. The Public Access Division could take the lead on establishing a kite mark system.

7 Implementation and Timing

Seizing the opportunity for timely reform – 2011 to 2014

The UK needs to prepare for the new system now, not wait until 2014. This is especially true if the proposals for *Digital Britain* go ahead.

The review of the current BBC licence settlement in 2013/2014 coincides with the ending of the current broadcast licences of ITV1, Channel 4 and FIVE (in 2014), by which time digital switchover will have been completed for approaching two years and true on demand TV will have been around for 8 years.

This period provides the UK with an ideal opportunity for the first time to address the PSB system as a whole and to put in place structures, systems and institutions that will make it appropriate to the challenges of the on demand digital age.

The new structure described in this report would need to be in place by mid 2012. This would suggest legislation in 2011 and a White Paper in the autumn of 2010. The BBC's Charter and Agreement review date would have to be brought forward to meet this deadline, as it currently runs to 2017.

Emergency funding might have to found before 2013/2014 for certain PSB activities under significant financial pressure, such as regional news in Scotland, but some of these pressures are likely to disappear if it becomes clear that commercial PSB is to be resurrected post 2014 and shareholders in these commercial companies can see an end to their current situation.

List of all Recommendations

The BBC

1. Quality First, Reach Second - a new vision for the BBC

The BBC needs to focus its assessment of new and existing services on quality and differentiation rather than reach. It needs to stop expending significant resources on sports rights, 16 to 35 targeted services, popular entertainment talent, and acquisitions with the sole or main purpose of extending reach and instead concentrate its resources on maximising the quality and distinctiveness of what it provides to all groups.

If this implies fairly low reach of certain segments of the population then it should consider using licence fee funds to support or partner with third party services that can more effectively reach these groups as a way of providing better value for money (see further recommendations).

2. Introduce a level of contestability to BBC resource allocation, with more internal contestability and targeting BBC management with spending 5% of BBC licence fee income supporting third party services and programming by 2018.

A degree of contestability needs to be introduced to any assessment of current and planned BBC services. First, there should be more internal contestability with a list of BBC in-house proposals for achieving given reach, quality and distinctiveness being shared with regulatory bodies. Second, there needs to some third party contestability with external channels and content providers able to put a rival case for public funding or public co-funding to the body charged with determining the size and shape of the BBC (see later sections for the recommendation of replacing the BBC Trust with a Public Service Content Trust (PSC) to oversee this contestability).

Such external contestability would focus on areas where BBC plans were most in danger of crowding out commercial schemes rather than helping to raise standards and ambition across the sector. Children's programming, arts programming and local news might all be candidates.

In the first instance, any funding for third party services and output would still be channeled through BBC management and operations, but the management would be separately accountable to regulators for the effective use of these funds. BBC senior management would have their performance judged not just on the reach and performance of the BBC's wholly owned services but also on the performance of BBC sponsored partnerships and co-funded output.

This "bottom slicing"[36] of the BBC licence fee funding has a precedent – the funding of 520 hours of output on S4C with an attributable value of £24 million a year. In many ways it is simply an extension of the BBC's large scale funding of third party producers through the independent production quota and the more recent "window of creative competition (WOCC)". It would extend current BBC funding of third party programming on its own channels to the funding of

36 Some commentators have used the term "bottom slicing" to refer to diverting some of BBC Worldwide's profits and/or assets to help third parties, this is not how the term is used in this report.

programming that might appear at some point – even in some instances first - on other public service channels and internet based services. But a condition of any BBC co-funding should be that the partner outlet- or at least the co-funded output- is available free of charge to consumers in the UK if it has the primary window. So for instance, the BBC could fund a programme to be shown first on Sky Arts or Discovery if that channel offers its signal free to air when the output in being aired. On a larger scale, the BBC could decide that investing £20 million to £30 million in programming first shown on Channel 4 or E4 might be a better way to reach the 16 to 35 year old audience with programming of public value than spending £100 million a year on BBC Three.

In the next licence fee settlement, likely to run from 2013 to 2018 or 2020, the BBC management should be set a target level of third party output and service funding of 5% of total licence fee income by 2018 (about £175 million at 2009 levels). If BBC management failed to reach this target in 2018 then the responsible regulatory body could recommend to government that funds be allocated directly to third parties rather than through BBC management from 2018 onwards.

While some might object that this "bottom slicing" would leave the BBC funding output where it ceded editorial control of the channel or service that scheduled the output, this is no different in kind to current BBC co-funding of output with HBO (*Band of Brothers* and *Rome*), Showtime (*The Tudors*) or Discovery (*Life*) with US broadcasters. If it is OK for the BBC to co-fund with US commercial broadcasters why should it not be possible to co-fund with UK broadcasters, especially if those broadcasters have a PSB remit (see proposals for Channel 4 in Chapter 3).

3. Shift regulatory oversight to a sector wide body

With the BBC allocating some funding to third party services and a more contestable public value test process, the BBC should be regulated by a new body – the Public Service Content Trust (see Chapter 4 for more details). Responsibility for monitoring the market impact of the BBC across all services – existing and new ones – should pass to Ofcom, while the National Audit Office should have the remit to assess value for money and efficiency issues at the BBC.

4. Shift the responsibility for delivering public access

The BBC has played an important role in helping to drive platforms towards analogue switch off and, in particular, of ensuring that that all public service providers – the BBC and commercial providers, gain widespread access to consumers in the digital age. However, it is clear that while BBC distribution interests largely coincide with those of commercial PSB providers they are not identical. In addition, the BBC's recent preoccupation with access and distribution issues has probably helped divert management's focus away from their core purpose – providing quality content on compelling services.

Responsibility for promoting universal access distribution and high levels of discoverability in the web 2.0 age should, therefore, pass to the regulatory body overseeing the BBC and commercial PSB (the PSC) which would execute these duties through a special division – the Public Access Division (PAD). (See Chapter 4 for more detail in the PSC).

The PAD would be charged with ensuring PSB services and content gained the widest possible distribution. This distribution would be free of any incremental charges. It would take direct control of allocating digital transmission capacity between public service broadcasters and content providers. It would take over any remaining need to promote 2Mbit/sec roll out to more than 95% of the UK.

It would also lead negotiations over retransmission fees for public service content. Legislation would be needed so that content providers could charge for retransmission. They would charge leading platform providers. Ofcom would arbitrate over these charges.(See Chapter 5 for a full discussion of retransmission fees in the UK).

Given its focus on distributing content, the PAD would take over lead responsibility for Freeview, Freesat and Project Canvas from BBC management. It would work with all PSB providers to ensure their content is widely distributed. They would also have the right to require the BBC to link non BBC PSB providers to the BBC's main Web 2.0 services in the UK.

The PAD would spread broadband to remote parts of the UK through community hubs. These hubs would be in public libraries, community centres and post offices and would replace the costly "universal broadband" proposals of the Government's Digital Britain report. The cost of community hubs would be about £300 million in comparison to the Government's proposals - to move from 60 to 90% of the UK on a household broadband rate of 50 Mbit/sec - would cost £3.5 billion. These community hubs would also recognise the social and educational needs of more remote communities, vulnerable groups and the technophobic rather than seeking to isolate them still further in their own homes with no support or ongoing advice on how best to use broadband.[37]

The PAD would also have a more general standards role across the internet for promoting discoverability of PSB content and the protection of children. It would promote high quality, reliable content by using a "kitemark" symbol and would ensure due prominence for this by working with internet search engines. It would also tackle privacy issues raised by behavioural targeting of advertising.

The PAD would decide which non BBC providers should link to the BBC's own web site. For example, a nominated local news provider could link to the BBC's local news pages. Similarly it would decide which non-BBC providers of public service content would be displayed on BBC i-Player. It would be able to enforce this with the BBC.

The PAD would subsume digital helpline activities, the distribution and device applications work of BBC Future Media and Technologies, and would represent the UK on various content delivery standards organisations in Europe.

5. The Public Access Division (PAD) would be set up with the aim of reducing the cost of replaced activities

The Public Access Division should be able to save monies by bringing a range of separate activities and initiatives together. However, as some of these are currently funded by the licence fee, there may have to be a rise in direct Government funding, but this should also result in a reduction in the required level of the licence fee to at least match this increase.

37 There is already such a scheme with local libraries but it is piecemeal and not as geographical extensive as the hub network proposed in this report.

6. Privatise BBC Worldwide but with conditions

BBC Worldwide is the UK's leading TV related intellectual property (IP) exploitation business with an impressive recent growth record. Rather than tying the hands of this business as a condition of BBC ownership (as the BBC Trust has suggested)[38] BBC Worldwide should be fully privatised so that it can raise the risk capital necessary to expand both geographically and up and down the value chain.

However, the privatisation of BBC Worldwide should be done in such a way that it is not in a position to crush competitors merely because of the privileges it enjoys through access to the BBC brand and 'first-look' access to all new BBC IP. Any privatisation should be accompanied both by transparent charging for its privileges – such as a fee for use of the BBC brand and an upfront payment for 'first look' rights - and by sunset clauses on these privileges, after which the BBC would be free to tender out to third parties. For instance, its use of the BBC brand for magazines could be on a 7 to 10 year licence, while its 'first look' deal on all new BBC drama and factual output might end in 5 to 7 years time.

Commercial PSB

7. Establish a new more focused commercial PSB system

Trying to prop up public service broadcasting across all of the commercial networks is increasingly unsustainable and unenforceable. If such provision is to remain it needs to be through a more focused system. Such a system would concentrate access privileges mainly on one of the commercial network operators and provide financial support to specific programming areas where either an alternative to the BBC is needed (such as regional news provision) or where the commercial operator is perhaps better placed to achieve reach and impact than the BBC (such as public service programming for younger and ethnic audiences).

8. Allow ITV1 and Five to opt out of the PSB system after 2012

ITV1 and Five should be allowed to opt out of the PSB system in 2012 – two years prior to the end of their licences but after digital switch over. If they did opt out they would no longer have to keep any of their specific PSB commitments, they would keep their high reach digital terrestrial access (including access to HD capacity) but they would have to pay for the digital terrestrial frequency they had previously been gifted. Prices for this capacity would be set by regulators with regard to its opportunity cost. The proceeds would go to the PSC Trust for re-allocation to PSB content (See Chapter 4). STV and Ulster would be given the same option to opt out of PSB – although it is less clear that they would choose to take it. Both ITV1 and Five would retain their right to remain on top slots in all electronic programme guides.

However, if ITV1 and Five did opt out of the PSB system they would lose some currently gifted digital terrestrial capacity which would be handed back to the PSC Trust to be reallocated to the remaining commercial public service broadcasters.

9. Relax ownership and competition constraints in return for programme investment commitments

A new competition regime should be applied to TV in the UK which allows individual owners to control large shares of the advertising market. For instance, this

38 BBC Trust statement on "new limits to BBC Worldwide activities" – November 24th, 2009

would allow the merger of Five and Channel 4, or ITV and Five but subject to new programme investment conditions. Such conditions already exist in France. (See Chapter 4 on regulation and regulators for more detail on competition policy.) These programme investment conditions would be set as a share of revenue and be based on the previous level of investment by the main commercial broadcasters over the last 5 years.

In particular, the CRR mechanism should be removed from ITV1 in return for a programme investment commitment (as a share of revenue) from ITV. This should be achieved by changing the remit of the competition authorities over broadcasting and requiring them to weigh consumer (viewer) and public value issues when determining advertiser funded broadcasting mergers and acquisitions rather than only the interests of advertisers. (See Chapter 4 for details of Ofcom's role in leading a sector specific competition regime).

10. Channel 4 should retain its PSB Status, be allocated more access privileges and be privatised

Channel 4 should be privatised in 2012 but retain a PSB licence for at least 10 years. It should receive extra digital capacity, reallocated from ITV and perhaps some from the BBC. It could choose to use or sublease this but retain the income from it. Channel 4 would also be granted cross promotional and linked access to BBC new media services such as www.bbc.co.uk, the iPlayer and Project Canvas.

Channel 4 would be allowed to merge with Five under a more relaxed ownership and competition regime, but should it do so, the combined entity must be required to make a minimum level of investment in new programming in order to prevent consolidation leading to less UK programming investment.

Channel 4's PSB licence and allocation of frequencies would be administered by the PSC Trust which through its Public Access Division would control all the currently gifted digital terrestrial spectrum (including that charged to ITV and Five, and that allocated to Channel 4 and the BBC). As a PSB broadcaster, Channel 4 programming would also have a "most favoured nation" status for BBC Co-Funding (See Chapter 2) and PSC Trust public funding. Such funds would still have to be bid for on a contestable basis, but Channel 4's high reach, PSB licence and access privileges would make it a favoured outlet.

Channel 4 has a strong brand and valuable audience demographics so the combination of access to risk capital, access to contestable public programme related funds and BBC co-funding would leave Channel Four in a strong position. This is a much more viable proposal than the Channel Four organisation becoming a partially directly publicly funded institution with no access to risk capital. Given the huge uncertainties of the Web 2.0 age it is far better for Channel 4 to be privatised than to remain in the public sector, but with a more sustainable and enforceable commitment to PSB.

While there would be a tension between the new private ownership structure of Channel 4 and its PSB obligations (as there has been at ITV1 for the last 5 to 10 years), this tension would be more manageable because, first, Channel 4 would be receiving a whole host of benefits as the only remaining commercial PSB licensee, and, second, the opportunity costs of some PSB type programming on Channel 4 is probably less than that for ITV (overall programme margins at Channel 4 as a more niche but upmarket broadcaster are likely to be lower than at ITV1).

Furthermore, should Channel 4 and Five decide to merge, the commitment to original programme investment would be built into the merger conditions, something that has not applied to ITV1.

11. S4C (and STV and Ulster TV should they chose to do so) to retain PSB status and be accountable to the PSC Trust

S4C's capacity and funding would be allocated through the PSC Trust (including the BBC Co-Funding of S4C news that already exists). If STV and Ulster TV were to opt to retain PSB status, they would also be allocated more privileges – in terms of capacity and access to BBC services.

However, it should be recognised that an ITV1 free of any PSB obligations would be able to broadcast its schedule into Scotland and Northern Ireland directly using open market capacity. This means that PSB orientated STV and Ulster TV would need to affiliate to Channel 4 rather than the ITV network.

12. Make public funds and BBC co-funding available to content carried on commercially funded outlets (but favour Channel 4 in that allocation)

BBC co-funding (see proposals in Chapter 2) and public funds from other revenue sources controlled by the PSC (see Chapter 5 proposals) would be made available for content on commercially funded channels and internet based services. But this would only apply to programming types which are clearly loss making on a commercial basis to avoid the prospect of publicly funded output that could be commercially viable.

The allocation of BBC co-funding and other public funds would favour (but not be limited to) programming transmitted on universal reach channels and, in particular, commercial channels with PSB status (i.e. Channel 4, S4C, STV and UTV).

13. Digital terrestrial access should be allocated to up to 40 local news providers across England and Wales. These providers would (along with a PSB STV and UTV), become affiliated to the Channel 4 network. Local press and commercial radio owners would be allowed to own local news providers.

With a commercial ITV1 withdrawing from PSB, local news providers should be allocated daytime and late night capacity on digital terrestrial frequencies. These local news providers would also be allocated a transmission slot on Channel 4 in early peak time where revenue would be shared between Channel 4 and the local news provider. There would be up to 40 local news providers in England and Wales (in areas similar to those the BBC was planning to use for its ultra local web 2.0 news services – a plan rejected by the Trust). Channel 4's transmission network may need to be changed slightly to allow advertising in each of the 40 local markets covered.

STV and UTV would be reserved their own digital terrestrial frequency in Scotland and Northern Ireland, but would also be given an early peak and late night news slot on Channel 4 in Scotland.

Public funding and BBC co-funding would be made available to these local news providers through the PSC Trust, but licences outside of Scotland and Northern Ireland would be awarded on a contestable basis for 7 to 10 years with minimising public subsidy an important criteria for licence award. Local press and commercial radio owners would be allowed to own local TV news service providers.

STV and UTV would change their network affiliation from ITV1 to Channel 4, as a non PSB ITV would be able to broadcast into Scotland and Northern Ireland without having to go through STV or UTV. They would be awarded new 10 year licences in return for their confirmed PSB status and affiliation with Channel 4.

Regulating PSB

14. Abolish the BBC Trust and replace it with a BBC Joint Board

The BBC Trust is a single body regulator with the sole task of holding the BBC to account. Such a structure has not held the BBC to sufficient account and has taken a narrow institutional approach to the delivery of PSB in the UK. This is not the fault of any individuals but rather a result of the position the BBC Trust found itself in. Whatever the history, it is clearly unsuitable for the 21st century.

The BBC management should be accountable on day to day matters and the delivery of their objectives to a BBC Board, with a BBC Chairman and non executive directors.

15. Establish a Public Service Content Trust (PSC Trust) to promote PSB across all TV, radio and broadband

The PSC Trust will be the lead body for monitoring the delivery of BBC services in line with its licence fee settlements, Charter and Agreement. It will also review the effectiveness of the BBC's co-funding obligations which have been set out in Chapter 2. At key times in the BBC role and scope setting process – Charter, Agreement, licence fee settlements etc, the PSC will advise Government on the best way to promote public value across the BBC and other activities, but the BBC Board will make its own case to Government on the level of funding they need to carry out their remit.

The PSC Trust would be the first body in the UK to oversee the funding and delivery of all PSB intervention. It would in effect become the champion of public service programming.

The PSC Trust will receive monies from the proposed retransmission fees and spectrum charges that will form new sources of public funding directly (see Chapter 5). The BBC will still receive all licence fee monies – at least until the end of the next licence period (likely to be 2018 or 2020). However, the level of retransmission fees and spectrum charges will be determined by Ofcom not the PSC.

The PSC will take the lead in allocating ear-marked frequencies for PSB services between the BBC and commercial providers and in allocating extra PSB funds from retransmission fees and spectrum taxes to commercial PSB content providers (alongside BBC co-funding). The PSC will also take the lead in ensuring the BBC co-operates with other PSB providers in terms of access and links to its web sites and on demand services.

16. The members of the PSC Trust should be nominated and appointed by the Government.

The PSC would be an independent trust whose members would be proposed by Government. The PSC Trust would be responsible for political as well as implementation issues (such as the allocation of public monies between PSB providers) and so would need to be accountable to Parliament and Government.

We recommend that the PSC would be subject to full scrutiny by the National Audit Office and the Public Accounts Committee.

The PSC would provide regular reporting to the Government and Parliament on the delivery of public value and universal access in the UK.

17. Ofcom to have a new set of responsibilities that complement the PSC Trust's role

The application of competition policy to the media and communications sectors in the Web 2.0 age needs to take account of potential market failures and the need to encourage public value. Competition assessments and remedies may have to set conditions around trading off the interests of advertisers and consumers (such as the potential to allow mergers of ad funded networks with conditions related to investment in content).

At the same time, the impact of the PSC's actions on the wider TV, radio and internet markets will also have to be subject to outside scrutiny and a body will be needed to adjudicate on the setting of retransmission fees and spectrum charges (the PSC cannot set these charges itself as it is the recipient of the monies).

We recommend that Ofcom should retain charge of the basic content rules applied to all UK broadcasters such as product placement, the EC 50% European origin quota and the 10% independent quota. Basic taste and decency issues, premium rate phone call rules etc should also all remain with Ofcom.

18. Ofcom should take the lead on competition issues as they impact the TV, radio and internet Sectors – promoting effective competition but with reference to the promotion of public value and content investment

At the moment the OFT and Competition Commission take the lead on competition issues across the sector. This responsibility should transfer to Ofcom. The Competition Commission would still be referred cases by Ofcom but not by the OFT (all initial competition investigations of mergers and acquisitions and sector reviews would be initiated by Ofcom across the telecoms, media and internet sectors). The Competition Commission would also be charged with taking into account public value issues (as well as the interests of both advertisers and consumers) in all cases.

Ofcom's competition role would also cover overview of the independent quota and terms of trade interventions which will have to be reviews once ITV1 and Five opt out of their PSB status (the 25% quota and terms of trade rules only apply to PSB channels at the moment)

19. All specific ownership restrictions in the media sector should be removed

With Ofcom in charge of balancing competition objectives with public value objectives (including plurality and diversity) there would be no need for any remaining specific ownership restrictions on network ownership, local cross media ownership etc. Each merger would be judged on its own merits.

20. Ofcom should take the lead in setting spectrum charges and retransmission fees and in dealing with consumer privacy issues

Ofcom would be the arbitration body between the PSC Trust and Pay TV platforms for retransmission charges (see Chapter 5) and would be required to set a fair and non discriminatory price. Ofcom would also set the administered price that the non PSB ITV and Five would pay for their spectrum and the fees to be paid by SDN and Arquiva.

Ofcom would also take the lead on issues involving the use of consumer data by advertisers on the internet.

21. Changes to Ofcom, the BBC Trust and PSC Trust would be achieved at no extra cost.

The current total cost of the BBC Trust and the media sector activities of Ofcom is about £50 million according to their annual reports. The aim should be to establish the new Ofcom and the PSC Trust at no extra cost.

Broadening the PSB Funding Base

22. Introduce retransmission fees in the UK

Pay TV platforms clearly benefit from the retransmission of PSB networks and their spin-off channels. But the PSB networks have little capacity to withdraw their channels from these systems in protest at non-payment, due to the BBC's universality obligation and the commercial networks' need for very high reach to drive their advertising revenue. The UK should both recognise this benefit and the fact that market based negotiations alone cannot solve the problem (something even the US recognises by arbitrating on rates).

The UK should set retransmission fees for all the main free to air networks and their spin-off channels. Fees for carriage of BBC services and those of commercial PSB broadcasters should go to the PSC for reinvestment in PSB content. It should also be considered whether the PSC should retain any fees paid to ITV and Five, even if they opt out of the PSB system, in return for allowing them access to the higher reach slots on digital terrestrial as a set price (i.e. not putting the capacity out to competitive auction). Ofcom should arbitrate on the correct level of these fees.

23. Introduce spectrum charges for digital terrestrial spectrum to all providers but Channel 4 and the BBC

This report suggests that ITV1 and Five would be required to pay an administered/arbitrated price for their currently gifted slots on digital terrestrial. SDN and the Arquiva led consortium – (Arquiva/Sky/BBC) – should also start to pay an administered price from 2014 onwards for their digital terrestrial capacity.

Prices should be set by Ofcom and income from the set prices should go to the PSC for reallocation to PSB content across a number of channels and PSB operators.

24. Proprietary TV platform re-use fees should be introduced

All proprietary platforms offering PVR functionality would have to pay content retransmission fees. The rate would be arbitrated by Ofcom and the income would go to the PSC Trust for re-distribution to PSB content.

Embracing the Challenges of the Web 2.0 Age

25. Drop the Telecom Tax

The need for £3.5 billion to build out high speed internet infrastructure to the whole UK is not yet proven but if the need does materialise it is likely to be a major benefit to all parts of the UK economy, including the public sector. In this case it should be funded out of general taxation, not a telecom tax.

26. Do not use the licence fee to fund universal broadband

Universal 2Mbits/sec access has broader benefits to society than simply the consumption of audio visual material. The licence fee forms a vital source of funding for the content creation sector which faces its own significant challenges in the Web 2.0 age and which is an almost £1 billion a year export sector. The last 10 years has seen more and more licence fee monies diverted to delivery and distribution rather than content.

The licence fee should remain a source of funding primarily for content and services not delivery. General taxation monies should, therefore, be used to achieve universal access to 2Mbits/sec broadband. Such funds would go to the Public Access Division not the BBC.

27. Create community broadband hubs to provide very high speed broadband to remote areas in the medium term, use network co-operation to provide universal roll out in the long term

The promotion of high speed internet access outside major conurbations should, in the first instance, be through the use of public libraries, community centres, post offices and other public buildings as high speed access hubs. This would replace the promotion or funding of direct connectivity to up to 8 million homes as suggested by Digital Britain. The cost of this initiative would be likely to be less than £300m rather than the £3.5 billion associated with going from 60 to 90% 50 Mbit/sec household accessability.

This network of broadband hubs would be much more extensive than the current public library network and would involve help and advice in the use of broadband services to the elderly, technophobic and disadvantaged in a community environment (rather than using broadband connectivity to the home which would keep these people even more isolated from mainstream society).

In the longer term the main network providers (BT and Virgin Media) might be encouraged to roll out high speed broadband to the whole of the UK by allowing the sharing of current infrastructure in the major conurbations (with significant cost savings) in return for an obligation to roll out new infrastructure to the rest of the UK.

28. Create a Public Access Division (PAD) of the PSC Trust to encourage all forms of universal access across TV, radio and the internet

Universal access to digital TV will be complete in 2012, but universal access to DAB radio is a long way off and needs a serious review. Access to on demand on the TV set through broadband access from the PC to the TV has only just begun and may or may not be a consequence of any push for universal broadband access.

Many of these systems overlap, while services may be able to use a number of systems to effectively achieve their own universality of access. At the moment each system seems to have its own organisation. DAB radio has had a Digital Radio Development Bureau which is just about to be upgraded to a DAB task force. Digital TV has Digital UK, the Freeview joint venture and the Freesat joint venture. Getting on demand content from the PC to the TV is currently focused around the project Canvas joint venture between BT, the BBC and ITV.

The BBC has some involvement in all these areas and is spending a significant amount of money driving forward these digital access initiatives. It is probably time to bring all these initiatives together and to refocus the BBC on quality content and services. A Public Access Division reporting into the PSC Trust should be created to bring all these initiatives together aiming to save on duplication and spending and to create a more platform and institution neutral approach to building public access across the UK to all types of content and services.

29. Amend "Fair Use" and consumer "Re-Use" copyright provisions and allow content providers to act collectively to extract fair terms from aggregators and consumers

Legislation should be passed to permit all content providers to make copyright charges to content aggregators and device manufacturers, like Google, for linking to or allowing the storage and re-use of their content. It would then be up to the main representatives of content creators in the UK – the broadcasters, PACT, writers and performers -to form collecting societies to agree the basis of such charges with aggregators and device manufacturers. For this process to work, the competition authorities need to allow content companies to come together to collectively negotiate terms, and there needs to be an independent arbitrator of any fee rate – most likely the Copyright Tribunal.

Individual content owners could decide to opt out of such a collective arrangement if they so wished, but the recognition of a right to charge and to set a sector wide per use or revenue based charge would provide a baseline for such negotiations. The costs of this collecting society would be deducted from income earned.[39]

To make this work, however, there needs to be greater clarity as to what can be re-used without extra charge in the internet age, this may require new copyright legislation to better define "fair" versus "unfair" reuse.

30. Take a more even handed approach to discouraging piracy

The Digital Economy Bill is introducing a "three strikes and out" approach to file sharers. Users who seem to be downloading and streaming vast amounts of illegitimate material would be first warned, then have their capacity restricted, and then be cut off by ISPs.

Such an authoritarian approach to piracy is not only vulnerable to mistakes (such as pirates using innocent third parties' PC access to carry out illegitimate file sharing) but provides a very unbalanced approach to the problem. More international efforts need to be made to crack down on the organisers and providers of pirate services (such as the Pirate Bay case) and users need to be provided with more compelling legitimate ways of accessing high volumes of content.

The establishment of a collective content licensing regime – as suggested above – should help more providers offer legitimate content use at a variety of price points using different business models. It took the music industry about 10 years to react to widespread piracy by licensing and part owning a service like Spotify (which offers ad funded music and extra premium tiers for an unlimited music streaming service), the TV sector needs to encouraged to get to that point much more rapidly.

39 Music publishers already have such a system, and book publishers and writers are edging towards a similar position in the USA to take forward negotiations on so called Orphan works (where a work is in copyright but no one has the publishing rights). The European Commission has recent indicated that Europe should move towards more multi-territory licensing of copyright material on the internet through the creation of more collecting societies.

31. Create a consistent set of regulations governing all internet tracking behaviour – (i.e. by search engines, ISPs and ad networks)

Decisions on how long search engines can store individuals search histories, and under what circumstances ISPs can allow targeted advertising networks access their customers are being made on an ad hoc basis both within and across national markets. The UK needs a consistent and transparent policy in this area which gives advertisers greater effectiveness but protects individual privacy. This policy will need to be developed at a European and WTO level. Responsibility for taking forward any agreed approach then needs to be given to one lead body: either the OFT, Ofcom or even the Public Access Division suggested in this report.

32. Introduce a "Kitemark" scheme for internet content sites (especially those focused in children's content)

There needs to be a more co-ordinated approach to discoverability and consumer protection and to this end, a Kite Mark scheme should be introduced to give consumers reassurance on the quality and veracity of the content and information they are using.

While some internet thinkers might protest that the "wisdom of crowds" can provide its own constraints on misleading information and poor quality content, there may be a need for a more positive approach where consumers can be given guidance as to the best content on the web (which may not always be the most popular). In some areas of internet activity this is more of a Fair Trading Issue (the OFT has been investigating price comparison web sites) but in areas of news provision and audio visual content the establishment of some kind of kitemark system for consumers might add significant value at very low cost. The Public Access Division could take the lead on establishing a kite mark system.

Public Service Broadcasting (PSB) aims to provide programmes that are in the interests of the public and society as a whole. Consumers do not always act in their best interests, especially if they don't see a short-term benefit. They are more likely to buy fast food, cheap holidays and chocolate than invest in education, pensions and health. It is the same with TV. PSB also fills the gaps left by market-driven TV. Commercial channels focus more on popular entertainment, lifestyle and sports programmes that boost ratings and reap more in advertising revenue. Intervention is needed to ensure these broadcasters produce some programmes that have public value. PSB systems should also lead to large scale investment in indigenous UK creative output that promotes cultural identity. A strong output of British produced programmes can be exported, which is good for trade and protects us from being swamped by imported US programmes, which are readily available.

However the current UK broadcasting system, which was set up in the 1950s, is struggling to keep up with the extraordinary changes of the digital age. It is clear that the 20th century analogue institutions that were created are now worryingly out of date. We need a dramatic rethink if we are to continue to deliver public service broadcasting in an entirely new age. This report provides a radical but workable vision for the future of PSB. It makes recommendations that will refocus the BBC on quality rather than on ratings, protect PSB in the commercial sector without propping up institutions for the sake of it, safeguard content creation in the UK, and provide a more sensible approach to regulation.

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