



BBC Service Licences and the Public Value Test:

Response from the Satellite and Cable Broadcasters' Group to the Governors' public consultation

SUMMARY OF RECOMMENDATIONS

Public Value Test

- If the market impact test is independent, transparently consulted upon, and ensures that there will be no significant reduction in competition or any market foreclosure, the Trust should be able to make a clear decision without the elaborate and flawed procedure of the Public Value Test.

Market Impact Assessment

- An independent Market Impact Assessment must be conducted by Ofcom alone, and published in its entirety, before any expenditure on new services or substantial change to existing services is permitted.
- Ofcom should be required in its Market Impact Assessment to state its own view of whether the proposed service is a cost-effective contribution to UK public broadcasting.
- Informed by this independent Market Impact Assessment, the Governors or the Trust should make their final decision on the management's proposal, subject to an appeal to the Secretary of State for Culture, Media and Sport. In order to allow the possibility of appeal, the Governance Unit should publish the decision within 30 days of its having been made, and a further 60 days should be allowed for appeal before the BBC incurs any expenditure.
- We recommend that any assessment of a publicly funded BBC service begin with a determination of whether the proposal risks foreclosing a market or substantially lessening competition, consistent with the rules governing the use of State Aid and the recommendation of the Lords BBC Select Committee in their recent report (para 2.2.8).

Service licences

- We recommend that reviews of compliance with the conditions of service licences should be a key item on the agenda of every meeting of the Trust, whose secretariat should provide the requisite information and assessments.
- All services should be reviewed independently every 2 years, and the results published unedited by the BBC. Any BBC response to the results should be published separately.
- Service licences for BBC online should therefore reflect the different online services within the overall bbc.co.uk offering.

- Service licences must reflect distribution as well as content and should be introduced separately for any new BBC services launched into a new economic market, for example video-on-demand.
- While it is reasonable for existing services to be licensed for the duration of the next Charter and Agreement, this long licence term should not apply to any new services. New services should be licensed for a maximum term of 3 years, with a “renewal review” to be conducted after 2 years.

Sanctions for non-compliance

- The expectation of BBC management responsible for licensed services should be that in the event of non-compliance they will be removed from their responsibilities.
- Persistent failure to comply with licence conditions must result in closure of the service. In this event, Ofcom should be asked to invite public tenders for operation of the service under identical or similar licence conditions.

The Board of Governors and the Trust

- The Governance Unit should be instructed to prepare a number of different regulatory proposals for consultation. These proposals should be for the new Trust to consider and select – or reject – in due course.
- The Governance Unit and BBC management should be preparing for the new Trust, and for public consultation, a review of present and proposed licensed services, whose consideration would be the Trust’s first priority.

Assessing Value for Money in Public Broadcasting

- A simpler approach to the assessment of future BBC expenditure, and to the value citizens receive from the compulsory licence fee, would apply a four-part test to every BBC programme, initiative, expenditure or expansion. The test's 4 questions would be:
 1. *The public interest question:*
Is the proposed outcome in the public interest?
 2. *The public expenditure question*
If so, can it best be achieved by spending public money?
 3. *The resource question*
If so, can it best be achieved by the BBC?
 4. *The competition question*
If so, will any adverse effect on competition be justified?

INTRODUCTION

The Satellite and Cable Broadcasters' Group (SCBG) is the trade association for Britain's satellite and cable programme providers. Its members air more than 100 channels in the UK, and in addition broadcast many more services from the UK to continental Europe and beyond.¹ Most of these services are privately financed, although a small minority are publicly funded.

SCBG channels remain highly targeted, with audience shares ranging from less than 0.01% to 2% of digital viewers, but with a combined share approaching 20% of total UK television viewing. In addition to entertainment they provide specialist factual and educational services, as well as broadcasting to cultural and ethnic minorities in their own languages. They have developed innovative enhanced and interactive services and continue increasingly to attract audiences migrating away from traditional channels.

The impact that the BBC's services have on UK audiences, and therefore on advertising revenues and investment incentives in the commercial sector, means that the BBC's governance arrangements are of fundamental importance to SCBG members. We welcome the opportunity to contribute to the debate on this aspect of BBC governance, and appreciate the move towards greater transparency.

The Legal and Economic Context

As a public institution financed by a mandatory tax on UK households the BBC has a legal obligation to comply with rules on public expenditure, including European rules on State Aids². We accept that its services should not be limited only to satisfying market failures. But it must not ignore the legal environment in which it operates, by seeking to expand and dominate in areas that are either well served by the market, or where there are strong prospects that the market will satisfy consumer demand without publicly-funded intervention. Ignoring these economic factors and legal constraints will undermine the BBC's ability to compensate for genuine market failure, as well as damaging further its relationships with other broadcasters. Self-regulation can work and can be effective, but only if all stakeholders trust the system of regulation and the regulators. In order to secure that trust, the BBC's regulators must demonstrate (as Ofcom does) their understanding of and commitment to the legal environment within which all UK broadcasting must function. The BBC is not an exception.

We believe that the assessment of present and proposed BBC services must take place within the legal and economic constraints to which the UK Government is obliged to adhere. Our comments below should be viewed in that context.

¹ See www.scbg.org.uk for more details.

² See <http://europa.eu.int/scadplus/leg/en/lvb/l26099.htm>

1. THE PUBLIC VALUE TEST

As a component of licences for existing services, and for measuring performance against licence criteria, the proposed Public Value Test is a helpful concept but is far too general and lacks independent input.

As a decision-making tool for the assessment of potential new services the Public Value Test is substantially flawed and should be replaced.

1.1 The Public Value Test procedure as proposed does not meet the important central objection of Lord Burns' advisory panel to the DCMS, which stated clearly in relation to it that "if such a test is defined solely by criteria set by the BBC, using data and measures defined by the BBC, it will lack conviction". For that reason alone, it should be regarded as incomplete until it includes elements of independent input.

1.2 Some members of the new Trust may feel, as we do, that the proposed components of the test, including Public Value Assessment, RQIV Performance Measurement Framework and Outcome-Related Key Performance Indicators are more likely to lead to obfuscation than to clarity. Spectrum Strategy Consultants, upon whose thinking the proposals appear largely to be based, describe this as a "structured, evidence-based framework" and urge its merits over the alternative of "fundamentally qualitative assessment". But despite their appearance of bureaucratic rigour the tests are so subjective, their parameters so wide and their content so reliant on the BBC's own measurements and data that few actions or proposals by BBC management could possibly fail them. A fundamentally qualitative assessment would be equally valid, and certainly less hedged about with jargon that citizens are unlikely to understand and whose validity is questioned by the broadcasting industry.

1.3 Allied to the Green Paper's six core public purposes, which include such vague propositions as "building digital Britain", and its instruction that the BBC "should provide a wide range of content across every genre and trying to reach the greatest possible range of audiences", it is hard to see what the BBC will not be able to include in its services on these Public Value Test grounds. This makes the Market Impact Assessment an absolutely critical part of the BBC's decision-making that should be given far more weight than is allowed in the Governors' proposals.

1.4 The Governors should not be criticised for seizing on the Green Paper's catch-all definitions of the BBC's role and remit. But, as a result, their impressive-sounding PVT and PVA and PMF and RKPI merely provide BBC management with a series of easy boxes to tick. What may appear to be hurdles are in fact a series of inviting escape routes by which every BBC activity can ensure effortless self-regulatory compliance. Does a management proposal offer high quality? If not, no matter - provided it is original. Is it not original? That is immaterial,

provided it is “challenging”. Is it not challenging, or original, or of high quality? No matter, as long as it is “engaging”. If none of these applies, then provided it is “innovative” all will be well. And should all of these tests still be failed, then a claim to helping drive digital take-up will suffice. Is there any BBC programme or activity that cannot be allowed under these rubrics?

1.5 In relation to new service proposals the Public Value Assessment (PVA) that is proposed as part of the Public Value Test is inadequate, since it relies so heavily on BBC management assumptions and BBC indices of public appreciation. A PVA is a submission by BBC management in support of whatever proposal it is making for further licence fee expenditure. (Although the paper talks throughout of “investment” by the BBC, “expenditure” is the appropriate term.) The PVA will give management an opportunity to indulge in speculation and possibly hyperbole on what the BBC describes as “the four generic drivers of public value”. These are:

Quality

Proposals described by management as of low or medium quality will presumably be rare. Since the proposed service has not started, no objective measurement can be made.

Reach

This also can be expressed only as an intention, since reach will not be known unless the service is permitted to start. BBC reach estimates are always optimistic, sometimes wildly so. An example of such entirely misplaced optimism is described fully in Professor Patrick Barwise’s study of BBC4, commissioned by the DCMS in 2004.

Impact

Confusingly, by “impact” the governors do not mean market impact. They mean, and say they mean, value to consumers and/or citizens. Under it, management will be asked to make further forecasts of how much people will appreciate or enjoy the proposed service. They will, naturally, be asked to say if it will be engaging or challenging. They will be asked if it creates value for consumers. The only support they will be able to offer for their opinions will come from the BBC’s own measurements and data.

Value for money

Here, the management will be asked about cost per hour, cost per viewer or listener hour (which will not be known), and about audience perceptions of value for money – based on the BBC’s own data. Since the BBC’s audience research in these areas never proposes alternative expenditures, it is invalid as an aid to decision making. It should also be noted that while cost per hour is a necessary starting point for radio or TV programme expenditure analysis, it has no relevance to activities such as publishing, websites, new distribution operations or any other of the multifarious activities on which BBC management and

governors are required to make judgments. All of these can have a high impact on the competitive market.

The Public Value Assessment is therefore an entirely subjective and speculative document, a brochure presenting the management's plans, and should be judged as such by the Trust. It is a valid part of the process for assessing new services, but there should be no pretence that it is an "evidence-based" procedure.

1.6 Instead, if the market impact test is independent, transparently consulted upon, and ensures that there will be no significant reduction in competition or any market foreclosure, the Trust should be able to make a clear decision without this elaborate procedure.

2. THE MARKET IMPACT ASSESSMENT

In the context of determining the consistency of decisions within European rules on the use of State Aid, we have both procedural and substantive concerns regarding the proposed approach to market impact assessment.

A Public Value Assessment and a Market Impact Assessment are completely different elements of the proposed decision-making process. While the first is entirely qualitative and speculative, the second is capable of accurate measurement. They should not be conflated.

An independent Market Impact Assessment must be conducted by Ofcom alone, and published in its entirety, before any expenditure on new services or substantial change to existing services is permitted. Unless this is an absolute and irrevocable requirement, the remainder of the media industry will have no confidence in the objectivity of decisions on new services or service changes.

2.1 The Governors' proposal that they or the Trust should decide whether or not to conduct full Market Impact Assessments is unacceptable. Neither the Governors nor the Governance Unit are qualified to "conduct a preliminary assessment of the market impact" of changes to existing services. The Trust's qualifications are unlikely to be any greater.

A full Market Impact Assessment must be required for every new service or substantial service change. Contrary to the BBC's proposals, assessments of market impact must be conducted entirely independently of the BBC. They should be carried out by Ofcom, as the government has proposed, or under Ofcom's auspices.

2.2 Only Ofcom can gather the necessary commercially confidential evidence in absolute security, since the BBC's competitors will not be prepared to share their

financial and strategic plans with the BBC Trust or management. Only Ofcom has the expertise to make well-founded judgments in the complex field of market impact studies. Only Ofcom is sufficiently disinterested to bring a purely regulatory approach to bear on each issue.

2.3 Ofcom should be required in its Market Impact Assessment to state its own view of whether the proposed service is a cost-effective contribution to UK public broadcasting.

2.4 Informed by this independent Market Impact Assessment, the Governors or the Trust should make their final decision on the management's proposal, subject to an appeal to the Secretary of State for Culture, Media and Sport, and ultimately to the European Commission under State Aid rules. In order to allow the possibility of appeal, the Governance Unit should publish the decision within 30 days of its having been made, and a further 60 days should be allowed for appeal before the BBC incurs any expenditure.

2.5 The proposed two criteria comprising Market Impact Assessment are *wider economic value* and *crowding out*. Neither is sufficiently defined in the document. Both are unacceptable in the form proposed.

The judgment of whether impact would be "broadly positive for the wider market" is not one that can safely be left to BBC governance under these criteria. Any such judgment must be made by Ofcom as part of its assessment. For example, the BBC's proposal that impact would be broadly positive "if users would find the service informative or non-users appreciate its provision to others" is too vague, subjective and self-serving a criterion. "Wider economic value", if such a thing exists, must be clearly measurable by economic rather than subjective criteria, and must be assessed independently.

2.6 Equally, the proposed BBC test of whether a service crowds out other services or potential investment has too many flaws for it to have any practical value. First, unless the test is restricted to "efficient investments" it has no economic meaning. As Dr Bill Bishop pointed out during a DCMS seminar on the issue of crowding-out, "*There's nothing wrong with crowding out if it crowds out things that don't need to be there. There's nothing wrong with chilling entry if it would have been inefficient entry*".³ But efficiency is an ex-post test and cannot be determined ex-ante. Determining whether a new or changed BBC service will crowd out *efficient* investment is not an assessment we believe that the Trust will be qualified to make. Commercial companies find it difficult to determine ex ante whether a planned investment will ultimately be efficient, which casts doubt on the ability of the Trust to make such a determination. The evidentiary requirements of such a test are so high that broadcasters will have difficulty in contributing robust evidence either way. Similarly, we do not believe that the

³ http://www.bbccharterreview.org.uk/pdf_documents/041008CSTranscriptFINAL.pdf

BBC would be able to provide proof that a proposed new service would not crowd out efficient entry.

2.7 The consultation offers no explanation of what level of crowding out would result in a proposal being rejected. Since any publicly funded intervention in a market will impact on commercial investment, crowding out will be a matter of degree. Without clarification on the degree of crowding out that will be deemed acceptable we cannot see how this test can be supported. It should be for the BBC, as the proponents, to provide evidence that the service would not crowd out efficient investment, and open it to challenge. The Governors/Trust must explain what that evidence should consist of.

2.8 An investment that could be efficient may be rendered inefficient solely by the BBC's decision to enter the market. By assuming that the BBC service has launched it can be easy to show the commercial investment in the market is inefficient, and therefore could be crowded out without a detrimental impact on economic welfare. The position of BBC governance as arbiter in such a case is not independent.

2.9 Given the lack of "case law" on the practical use of crowding out tests and the flaws that are inherent in such an approach we believe that its proposed centrality to the overall assessment of a proposed new service is inappropriate.

2.10 Instead, we recommend that any assessment of a publicly funded BBC service begin with a determination of whether the proposal risks foreclosing a market or substantially lessening competition, consistent with the rules governing the use of State Aid and the recommendation of the Lords BBC Select Committee in their recent report (para 2.2.8).

2.11 Given that a failure to comply with rules on the use of State Aid would result in a case being brought against the UK Government, rather than against the BBC, the DCMS should support entirely independent evidence and decision-making in relation to "crowding-out".

3. SERVICE LICENCES

SCBG welcomes the concept of licences for each BBC service and looks forward to the publication in 2006 of drafts for consultation. We think it important that licences adhere to the suggestions in section 3.1.2 of the consultation document, especially in relation to minimum levels of output categories and their position in schedules, and to prohibited activities. However, we have a number of comments about their proposed term, operation and content.

3.1 If the new Trust is to fulfil the regulatory function demanded of it, the approach to compliance must be one of constant and not occasional attention. The proposed annual performance assessments are insufficiently frequent, and should not be carried out by the BBC's own management. Nor are the proposed independent 5-year reviews adequate within a 10-year charter, since they afford too long a time for non-compliance with licences, and insufficient time for remedy.

3.2 In particular, it is our experience that the BBC may vary its scheduling, spend or output considerably at different times or seasons but still maintain that it has complied with its remit in aggregate over the year. In the children's market, for example, where the majority of commercial impacts are in peak and holiday time, the BBC's competitive scheduling during these periods has been a serious concern. It is our view that in order to ensure the BBC reflects both the spirit and the letter of its licence commitments, these variations must be checked.

3.3 Therefore we recommend that reviews of compliance with the conditions of service licences should be a key item on the agenda of every meeting of the Trust, whose secretariat – not BBC Management - should provide the requisite information and assessments. All services should be reviewed independently every 2 years, and the results published unedited by the BBC. Any BBC response to the results should be published separately and not, as has been the case, as a commentary within the review itself. (See, for example, www.bbcgovernors.co.uk/docs/reviews/VFM_White_City_webversion.pdf)

3.4 The use of the term “independent review” is misleading. The Governors' proposal is that reviews should be carried out by the Trust itself, based on data supplied by BBC management, before deciding whether any external advice was necessary. This is not an independent review. The Trust should be required to commission regular reviews that are wholly independent of BBC staff and management.

3.5 There is no reference the time period for which compliance with Service Licence budgets or proposal to grant bbc.co.uk a single licence will not result in adequate regulation of what is in reality a range of different BBC services, and not a single entity. Nor does it reflect the range of online content sites provided by the market. Service licences for BBC online should therefore reflect the different online services within the overall bbc.co.uk offering.

3.6 Furthermore, service licences must reflect distribution as well as content and should be introduced separately for any new BBC services launched into a new economic market, for example video-on-demand.

3.7 While it is reasonable for existing services to be licensed for the duration of the next Charter and Agreement, this long licence term should not apply to any new services. New services should be licensed for a maximum term of 3 years,

with a “renewal review” to be conducted after 2 years. This will give an opportunity to test whether the Impact Assessment against which the licences were granted has proved accurate in practice and, if not, to take appropriate steps. These would include the possibility of non-renewal.

4. SANCTIONS FOR NON-COMPLIANCE

We believe the proposals in the paper in relation to sanctions for non-compliance are exceptionally weak. We agree that financial penalties are inappropriate, but the proposed alternatives are unlikely to have any practical effect in keeping services to their licence conditions. There are two sanctions that would have such an effect.

4.1 The expectation of BBC management responsible for licensed services should be that in the event of non-compliance they will be removed from their responsibilities. We think that this is what may be meant by “requiring the Director General to identify where there are management issues and take steps to deal with them”. But this is too vague and, as proposed, too much of a last resort. Just as Chairmen and Directors General must pay the price for any justified criticism of the BBC as a whole, executives must be held responsible for service failures in their area of operation. They are public servants.

4.2 Persistent failure to comply with licence conditions must result in closure of the service. In this event, Ofcom should be asked to invite public tenders for operation of the service under identical or similar licence conditions. The tender should be awarded to any public or private broadcaster (or combination thereof) that can satisfy Ofcom of their ability to operate the service cost-effectively.

4.3 Without these sanctions, licensed services can operate as serial offenders with impunity from any effective action by the Trust.

5. THE BOARD OF GOVERNORS AND THE TRUST

We believe it is inappropriate for the present Board of Governors to prescribe a single *modus operandi* for the new Trust in its most important areas of decision-making. Although the Chairman’s foreword describes the Governors as being merely “keen to play a part in laying groundwork” for the new body, the effect of these proposals is far more than that. We believe it important that the new Trust should not be seen as simply a continuation of the present Board of Governors under a new name.

5.1 The proposals suggest that the existing Board of Governors is determined to set in train procedures that its successor body will be unable to overturn - the more so since the Trust will be chaired by the present Chairman. The proposals

represent a single template, with no alternative, for a decision structure that arises directly from the present Governors' assumptions, relationships with management and wishes for the future. Indeed, the present Governors propose to initiate these new procedures before the Trust is appointed. This should be unacceptable to any member of the new Trust.

5.2 Instead, the new Trust and its Chairman should be making a clean break from the past. Nothing else will meet the requirements of the Green Paper, nor be an adequate response to the substantial criticisms of BBC governance during the consultations leading up to it. Therefore if the Governors are "keen to lay groundwork" for their successors they should be instructing the Governance Unit to prepare a number of different proposals for consultation. These proposals should be for the new Trust to consider and select – or reject – in due course.

5.3 The proposals in their present form have the effect of cementing the present range of BBC channels and services into an irrevocable structure that the new Trust will inherit. The present Governors appear to envisage the licensing of all these existing services as a process of rubber-stamping by the Trust of licences drafted and approved by its predecessors. Once this mechanical process of approval had been carried out, the new Trust would then be allowed to pass judgment on management's proposals for further expansion and expenditure.

This is to emasculate the new Trust before it starts. Its proper function must be to review BBC services as a whole, including any proposals for further expansion, and to licence those that fit within its conception of the BBC's responsibilities – which may well include the responsibility to keep the annual Licence Fee as low as reasonably possible. The present Governors assume that the licence fee should increase constantly in order allow frequent new activities with no commensurate reduction in existing services. The Trust may take a different view.

5.4 The Governance Unit and BBC management should therefore be preparing for the new Trust, and for public consultation, a review of present and proposed licensed services, whose consideration would be the Trust's first priority. Licensing of approved and affordable services would follow, but only after the application of Market Impact Assessments and Public Value tests (if such tests can be rendered credible) to each service and its content.

6. ASSESSING VALUE FOR MONEY IN PUBLIC BROADCASTING

We have argued that a properly conducted Market Impact Assessment is the principal independent, objective indicator that should be used by Governors or Trust in deciding whether to permit new BBC expenditures. However, we would go further and suggest that any assessment of new service proposals must consider how they can be most cost-effectively

provided. Without this approach, a fundamental question of public policy will go unanswered.

This is because future regulation of the BBC should rest not only on the objectively measured need to spend money from the public purse, bearing in mind the effect of doing so upon the UK competitive marketplace, but also the need for it to be spent *by the BBC*.

6.1 A simpler approach to the assessment of future BBC expenditure, and to the value citizens receive from the compulsory licence fee, would apply a four-part test to every BBC programme, initiative, expenditure or expansion. The test's 4 questions would be:

1. *The public interest question:*
Is the proposed outcome in the public interest?
2. *The public expenditure question*
If so, can it best be achieved by spending public money?
3. *The resource question*
If so, can it best be achieved by the BBC?
4. *The competition question*
If so, will any adverse effect on competition be justified?

6.2 In our view, the Trust and management should be obliged under the Charter to apply these tests to all BBC present and contemplated expenditures. Under its present form of management and regulation the BBC is unlikely to give a negative answer to any of them. But under the proposed new governance system they should be asked and answered, openly and transparently.

It is important that the regulators of the BBC should recognise the accuracy of the portrait painted recently by Simon Jenkins in *The Independent*, in which he wrote of “the BBC’s claim that British public service broadcasting needs one overarching co-ordinating genius, one monopoly supplier, namely itself”. The Government’s intention to maintain and increase plurality in the provision of public broadcasting will not be achieved unless the Governors and Trust see the possibilities of cost-effective public broadcasting in a market of public-private partnerships.

None of the four questions above relates to whether the BBC is *capable* of achieving a proposed outcome - be it a programme, a website, a channel or any other initiative. The BBC has immense capabilities, but it must be limited to only those activities that are in the public interest. Defining those tasks in terms more precise than those in the Green Paper, and ensuring that the BBC adheres to them, must be essential features of the new Charter and the new Service Licences.

Under the BBC's self-invented value-for-money criteria, such fundamental questions will not be asked. The perceived need for popular programmes eclipses such judgments. So "Level of Investment" and "Cost Per Viewer Hour" can be used to justify the public value of a service that the BBC does not in fact need to finance with public money, or to provide.

6.3 To give one example of where public funding may be desirable, but not through the BBC, we can consider the question of programmes and services for specific ethnic or cultural groups. Although many are already provided by the multi-channel sector on a commercial basis, the introduction of new such services may well deserve public funding. But the present arrangements, where the BBC chooses what services it would like to provide and then receives additional licence fee money for doing so, lacks objectivity in selecting the service and does not guarantee the most cost-effective or appropriate result. It is a paradox, for example, that the only publicly funded black music radio station in the UK is operated by the self-confessedly white, middle-class and London-centric BBC.

The process of its creation involved a successful appeal to the DCMS from the BBC for funds to provide such a station. But if the criteria suggested above had been applied, it would be obvious that public funds would have been better used by putting the station out to tender for operation in and by a black community, probably outside London. Options of this kind should be considered by the Trust and made transparent in their decision process.

6.4 Similarly, the fact that the BBC can operate a range of widely appreciated websites does not mean that it should be spending public money on any internet venture that happens to occur to its management. The same questions apply. The dozens of current BBC websites dealing with such subjects as teenage love horoscopes or gay speed dating may or may not be considered appropriate uses of public money, but in future the test criteria should be applied to such content and ventures.

6.5 The questions we propose demand a more searching and critical approach to purposes and costs than the BBC and DCMS have yet been prepared to consider. They also require recognition (as Ofcom has already established) of the potential for cost-effective public services in the multi-channel sector. Ultimately, however, these tests will tie the BBC's output more closely to what the public will be willing to finance in the fully digital age that is nearly upon us. In doing so they will help to preserve the core values of the BBC and maintain for it a crucial, though changed, role in the UK broadcasting ecology.