

Ofcom review of public service
television broadcasting

Phase 3 – Competition for quality

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Foreword

Ofcom embarked on its first statutory review of public service broadcasting just over twelve months ago. We are charged by the Communications Act with assessing the effectiveness of the designated public service broadcasters (BBC, Channel 3, Channel 4, Five, S4C and Teletext), taken together, in delivering the public service purposes set out in the Act. We are also charged with reporting on how the quality of public service broadcasting can be maintained and strengthened in future. This, the third and last of our reports, draws together our findings and recommendations.

Since we began our work, there have been significant management changes at the BBC and Channel 4, the BBC Charter review is now well underway, and the merger of Carlton and Granada has been completed. Digital take-up has grown from 48% to 56% of households, while 21% of households have broadband connections and TV subscription revenues have overtaken advertising revenues for the first time.

The digital and broadband world will bring with it radical changes in the form and delivery of content, and the ways in which people choose to use the services available to them. Our aim has been to set out a new framework for public service broadcasting (PSB), designed for this future and sufficiently adaptable to respond to and reflect changing technologies, markets, and the needs of citizens and consumers.

The starting point for our work was an assessment of what we as a society want from our television. At present, the public think television has immense influence, and therefore television broadcasters should have a special responsibility to deliver more than just what consumers want. Based on extensive research and consultation, we developed a set of purposes and characteristics which we think will help more effectively to define PSB in future and complement the statutory definition. We concluded that there would be under-provision of certain types of programming in a purely commercial world and that there remains a high level of public support for current levels of public funding of PSB - preferably across a range of channels.

We also said we would look at the options for intervention against this background - how best could we secure the type of television and audiovisual content that, as a society, we would like to see over the next few years, especially as we approach digital switchover?

We identified the risks to the current model - including a breakdown in the old regulatory compact which has delivered PSB on commercial TV channels for many years - and have set out a new framework in the final report, based on more explicit funding of PSB, and clarity of roles for each of the main broadcasters. This, we believe, will maintain and strengthen the quality of PSB in the fully digital world.

In this final report, we recap the work carried out in Phases 1 and 2 of our review, and include further thinking and detail on our key proposals, including PSB for the Nations and Regions, and the Public Service Publisher (PSP). We suggest some ideas for a new internal governance, regulatory and accountability framework to support the new system. We make some proposals for PSB in Scotland, Wales and Northern Ireland, which are published here for consultation and will be the subject of a separate report later in 2005.

We also set out proposals for the transitional period between now and the completion of switchover. We strongly believe that action needs to be taken now to establish a clear and settled framework within which the key PSB providers can be sure of their future roles, and can focus on where they can each add most value. In particular, our proposals are designed to secure the provision of regional news and current affairs on ITV1. We will introduce immediate changes to ITV's non-news regional programming obligations, with a further change at the point at which digital switchover actually begins. This clear, two-stage process will provide certainty in the market, avoid continuing and distracting arguments about the appropriate level of PSB provision each year, and enable ITV1 to concentrate on what it does best - high quality news and original production from around the UK.

On this issue, we have listened to many representations, including the views of Ofcom's Content Board, where the balance of opinion was in favour of a postponement of the first changes from 2005 to 2006. The Ofcom Board, after careful consideration, on balance, decided that it is preferable to move immediately, to create a settled and sustainable new framework.

The overarching theme of this final report is **competition for quality**. To us, this means three concrete things: a competitive marketplace, plurality of PSB commissioning and production, and enough flexibility in the system for provision (and providers) of PSB to change over time, as the needs and preferences of citizens change.

First, we believe that a competitive broadcasting marketplace is a good starting point in the quest to ensure that citizens and consumers are able to benefit from a wide range of high quality programming and other content. For the first time, digital TV and broadband offer the prospect of a market that can work more effectively than the traditional analogue system to deliver viewers what they want to watch and are prepared to pay for. There is scope for many new channels to enter the market – last year, Ofcom issued 162 new licences for television channels – for new media to be used, and for payment mechanisms to allow direct relationships between viewers and broadcasters. All our research in this review has shown that consumers are increasingly media literate, prepared to seek out information about what they want to watch, and welcome the choice and convenience provided by multichannel TV.

Secondly, however, as a society, we clearly demand a wider range of high quality UK content than would be provided by the market - even in a more effectively competitive environment. We value trustworthy and independent news, programmes which increase our knowledge of the world, and content which reflects the different parts of the UK, and informs our cultural identity. Although commercial broadcasters will provide some of this content, intervention is needed to ensure that there is sufficient range, volume and quality of programming made in the UK and for UK audiences. The growth of digital television take-up does not alter this need.

But here again, competition for quality is the key. The BBC is at the heart of the UK PSB system, but PSB overall is likely to be most successfully provided if there is a range of different suppliers, with access to different sources of funding, and with different institutional models. Broadcasters and producers can then be set the challenge of identifying the best way of delivering public value. This plurality of provision not only ensures that there is a range of different views and perspectives available to viewers, but also that policy makers and regulators are provided with

information about the relative effectiveness of the different organisations delivering PSB. We can then make better decisions about funding and remits than would otherwise be the case.

Finally, competition for quality means that, over time, the preferred means of delivering PSB will change, as some providers prove themselves to be more effective than others, or as new media become more effective than conventional channels. A robust PSB system needs to be flexible enough to adapt to this sort of change. We have proposed a new Public Service Publisher, as a potentially dynamic and innovative new force in the system. By the time of Ofcom's next statutory review, the UK should be mid-way through the digital switchover process; and more than half of all households are forecast to have broadband at speeds which enable the delivery of rich audiovisual content. Today, the BBC has led the way in creating content for the broadband age. We believe that a Public Service Publisher would help provide greater plurality in the commissioning, and hence in the production, of UK-originated digital and broadband content.

The question of the governance of the BBC is at the heart of the Government's BBC Charter Review. Many respondents to our Phase 2 consultation suggested that any PSB framework which entirely ignored the question would be incomplete. In this report, therefore, we set out some core principles and criteria; any effective governance framework should support a well-run, strong, independent and properly funded BBC which operates consistently in the public interest. There needs to be greater clarity than now between the distinctive functions of internal governance, the accountability of publicly funded bodies in broadcasting, and of regulation for the broadcasting sector as a whole. We make some proposals for introducing greater clarity between governance and accountability on one hand and regulation on the other. As to distinctions between, and the effectiveness of, governance and accountability, we set out the pros and cons of different models as a contribution to the BBC Charter Review debate.

Overall, we have concluded that the forces of change in content and, therefore, PSB provision will have a significant impact more rapidly than is commonly understood. Our proposals are designed to recognise that change and, in some quarters, to encourage a reassessment of what is sustainable, how it should be funded, and from where it should be sourced.

The rest of this report sets out our final recommendations in detail. We would like to take this opportunity to thank all those who took part in the review and in the consultations. We have received much valuable insight and information from all those who contributed - either in writing, via e-mail, or at the many seminars held around the country. With this review, and the Government's review of the BBC Charter, we think there is a unique opportunity to identify and implement the steps needed to secure the quality of public service broadcasting for the next 10 years or more. Some of the next steps are in Ofcom's hands, others are for Government and Parliament to consider. We hope that the research, analysis and arguments in our three reports will help inform the next stage of that process.

David Currie, Stephen A Carter, Richard Hooper

Chapter 1

Executive summary

Context

1.1 Ofcom is required by the Communications Act to carry out a review of public service television broadcasting (PSB) at least once every five years. This, the first of these reviews, has had two key questions at its heart:

- How effectively, taken together, are the designated public service broadcasters (BBC, Channel 3, Channel 4, Five, S4C and Teletext – collectively referred to as the “PSBs”) meeting the purposes set out for them in the Communications Act?
- How can the quality of PSB be maintained and strengthened in future?

1.2 The review has been conducted in three phases:

- In Phase 1, we conducted a detailed programme of research and analysis to assess the performance of the designated PSBs. We concluded that, taken together, they were performing well in their delivery of impartial and independent news, and high quality UK originated programming, across a range of genres. We observed, though, that the system contained too many copycat and derivative programmes and formats, and that the public wanted to see more originality and innovation across their favourite channels. More ambitious content appeared increasingly to be pushed to the margins of the schedules. We also set out a rationale for the continued provision of PSB in the digital world, and proposed a new definition of PSB, focused on a set of purposes and characteristics, rather than genres or institutions.
- In Phase 2, we looked to the future, and, using detailed modelling work, established that the old PSB model will not be sustainable in the run up to switchover, and beyond. There will be a drain of funding from the system which - our research showed - would need to be replaced to secure effective PSB in this new world. Certain types of programming, including ambitious current affairs and factual programmes, programmes for the Nations and Regions, high-end drama and cutting edge comedy, would be at risk. We also showed that there is widespread public support for maintaining the current level of PSB funding and range of provision, across several providers.
- In this final report – Phase 3 – we draw together our earlier work, and the responses to our two previous reports, to set out in more detail our proposed framework for the future, and the steps needed now and over the next few years to put it in place. We need to prepare now for the fully digital world, as many of the building blocks will take time to design and implement, and the digital switchover process will start over the next few years. This review, alongside the Government’s BBC Charter Review, provides a unique opportunity to identify and take the necessary action to maintain and strengthen the quality of public service broadcasting for some years to come.

The end of the old model

- 1.3 For over 50 years, the PSB system in the UK has provided a wide range of high quality programming for citizens and consumers. Our research shows that the range of content provided remains, in the main, highly valued by the general public, as does the fact that it is widely available, free to air, and from a range of providers. The mix of institutions, funding, and regulation seems to have worked well.
- 1.4 But this established model is already breaking down. Commercial PSBs are increasingly affected by competition for advertising revenues, which in turn affects their ability to produce some elements of PSB output. In parallel, the scarcity value of their analogue spectrum - which has been allocated to them in return for meeting costly PSB obligations - is declining. At some stage, their existing licences will not be worth retaining, given the other transmission options available to them. Beyond switchover, we will no longer be able to ensure the delivery by commercial PSBs of the wide range of obligations - such as regional programming - we have secured in the past.
- 1.5 Channel 4, although facing different incentives as a not-for-profit broadcaster, faces similar competitive pressures to those affecting ITV1 and Five - its ability to deliver a wide range of PSB content will come under pressure too. Even the BBC, although it has access to public funds, may find that licence fee payers begin to question the level of funding they are prepared to support, when they have more choice in the market, and already voluntarily pay for many commercial broadcasting services.
- 1.6 We concluded that a new model would need to be put in place to address the challenges identified and to secure PSB for the future. This new model would require explicit public funding, and new providers alongside the existing main networks. We also concluded that new technologies and services could present means of increasing the effectiveness of PSB delivery in future. The majority of respondents to our Phase 2 consultation agreed with this diagnosis of the challenge. We now set out our proposed new approach.

A framework for the future

- 1.7 We believe that the future for television and audiovisual content in the UK is bright. As citizens and consumers we will have access to a much wider range of content and services than ever before, provided in more convenient ways and over new distribution systems. The capabilities offered by broadband provide the potential to transform and enhance the viewing experience, while personal video recorders and developments in electronic programme guides will provide viewers with much greater control over the television content they access and choose to watch. Alongside these changes, we have a unique opportunity to adapt and strengthen the provision of what we now call public service broadcasting, so that the range and quality of the content provided keeps pace with anticipated developments in technology and public needs. The rest of this report sets out how we think this future can be secured.

A more competitive market

- 1.8 Our starting point is the promotion of more choice and competition. In Phase 1 of our review, we explained that, as we approach switchover, the UK television market will work increasingly effectively to deliver what consumers want and are able to pay for. Long standing market failures, associated with spectrum scarcity, lack of direct payment mechanisms, and lack of consumer information, will be steadily reduced in significance.
- 1.9 We place a high priority on supporting these general developments:
- We will continue our programme of work to support the successful completion of the digital switchover process, and the roll-out of high bandwidth broadband services.
 - As set out in our 2005/6 Annual Plan, Ofcom will take forward a new initiative to review all aspects of competition in broadcasting markets, including a review of the content production sector.

A new definition of PSB

- 1.10 There are, however, some aspects of television which even a better functioning market would not provide, or would under-provide, which society as a whole values enormously, and which should be available to all. Given the power of television and its ability to reach and influence large numbers of people, public intervention to secure such content remains justified, even in a fully digital world.
- 1.11 We have set out a new definition of PSB, described in terms of purposes and characteristics, designed to remain relevant over time, even as new technologies and media emerge to supplement, or eventually replace, more conventional broadcast channels.

PSB Purposes

- To inform ourselves and others and to increase our understanding of the world through news, information and analysis of current events and ideas.
- To stimulate our interest in and knowledge of arts, science, history and other topics through content that is accessible and can encourage informal learning.
- To reflect and strengthen our cultural identity through original programming at UK, national and regional level, on occasion bringing audiences together for shared experiences.
- To make us aware of different cultures and alternative viewpoints, through programmes that reflect the lives of other people and other communities, both within the UK and elsewhere.

PSB Characteristics

- High quality – well funded and well produced.
- Original – new UK content, rather than repeats or acquisitions.
- Innovative – breaking new ideas or re-inventing exciting approaches, rather than copying old ones.
- Challenging – making viewers think.

- Engaging – remaining accessible and enjoyed by viewers.
- Widely available – if content is publicly funded, a large majority of citizens need to be given the chance to watch it.

1.12 A small number of respondents to our consultation voiced some concern that the PSB purposes and characteristics we have set out remain too broad. But we believe that the benefits of a relatively broad definition outweigh the possible drawbacks, and we set out, in this report, our proposals for how the assessment might be undertaken.

Scale of public intervention and sources of funding

1.13 Our research indicates that the present level and range of PSB provision retain public support. This allows audiences to reap the benefits this brings – high levels of original UK production in peak viewing hours and high viewing levels for PSB genres. There is public support, too, for retaining the current level of funding in the PSB system. This means that, as the implicit funding associated with today's model disappears, new sources of funding will need to be found to replace the shortfall.

1.14 We therefore propose that current levels of public funding for PSB should, as far as possible, be maintained for the period up to the completion of switchover. Beyond then, increasing market provision *may* allow for a gradual reduction in public support, and this should be periodically reviewed.

1.15 In Phase 2, we set out options for future sources of explicit funding of PSB, along with their strengths and weaknesses. Many respondents to our consultation favoured using the licence fee model, although there was support from different respondents for all of the options we advanced, including direct grant, an industry levy, and scope for realising potential spectrum value.

1.16 The decision about the best source of funding for maintaining PSB is a matter for Government. We therefore propose that:

- the case for additional direct funding for PSB to replace the decline in implicit funding should be examined carefully by Government. This should include consideration of tax funded support;
- the Government should examine in more detail the scope for an enhanced licence fee, and for use of the licence fee model to support direct funding of PSB across a range of suppliers at some stage in the future; and
- Ofcom's future reviews of PSB should examine the level of public funding of television, as well as its effectiveness and value for money.

The new PSB system

1.17 We propose a new model, which secures continued provision of PSB from a range of providers, with different remits, with access to different funding sources, and with different institutional approaches. Each element of the

new system has a vital role to play in ensuring that overall quality, range and choice are maintained:

- The BBC, funded by the licence fee model, should remain as the cornerstone of PSB, with a special responsibility to invest in distinctive content which strives always to meet public service purposes and characteristics.
- ITV1 should focus on its strengths of news and high production value origination from around the UK. We believe it is better for ITV1 to prepare for its future role as soon as possible, rather than to be asked to preserve in full a range of commitments designed originally for a very different analogue world.
- Channel 4 should remain as a not-for-profit, commercially funded broadcaster, with a specific remit for innovation.
- Five should be primarily market-led, with its PSB obligations focused on UK original production.
- There should be a new Public Service Publisher (PSP), publicly funded, charged with using new media to deliver distinctive and high quality content to citizens and consumers.
- Other commercial digital channels should be encouraged to develop further their investment in, and broadcast of, high quality UK content - they too can increasingly contribute to the overall PSB mix. Such channels might be accorded some form of PSB status. We will work over the next few months to assess the criteria for and practicalities of being awarded such status, and consider the benefits it might bring.

1.18 Content production is also an important source of plurality. A strong production sector, with a range and diversity of suppliers, can be a source of creative competition as well as economic growth. In Phase 2, we proposed a further review of the production sector for September 2005, by which time the new codes of practice could be given time to work, and the BBC would have set out new proposals for its use of in-house and independent producers.

1.19 The BBC has now issued its new proposals, which we have seen in outline form. We welcome the general direction set out by the BBC. We understand, however, that independent producers have raised some concerns about how the proposed approach will work in practice. More generally, respondents to our consultation suggested that our review of production issues should begin earlier than originally planned. We therefore propose to begin immediately the preparatory work for our planned end of year review, and will use this opportunity to undertake a more wide ranging review of the UK content production sector than originally intended.

The BBC

1.20 The BBC is clearly seen to be at the heart of PSB in the digital age, as it has been in the past. But concerns were expressed again in our Phase 2 consultation about the distinctiveness of the BBC's remit going forward, about the robustness of the licence fee as the BBC's main source of

income, and about the potentially adverse impact of some of the BBC's activities on the wider market.

1.21 We therefore reiterate our proposals that:

- the BBC should strive to ensure that all its programmes, not just its services, reflect the purposes and characteristics of PSB to some degree;
- the BBC should be properly funded, using the TV licence fee model for the duration of the next Charter - but that there should be a mid-point review of the BBC's performance and funding, and the BBC should also be asked to consider the case for subscription revenue as a means of funding any future expansion; and
- the BBC's review of its commercial activities, and the plans emerging from them, should be subject to detailed independent scrutiny as part of Charter Review along with the proposed level of the licence fee.

1.22 We welcome the BBC's broad agreement with many of our earlier proposals, and the response it has made to addressing many of the programming concerns identified in our Phase 1 research. We also support its proposed application of a new public value test, which it has committed to apply to both existing and new services, such as the proposal for highly localised television services.

1.23 We agree with those respondents who argued that the BBC's new services can sometimes have an adverse effect on the development of the sector as a whole, particularly where new and niche services are concerned. We therefore look forward to sharing ideas and approaches with the BBC on the implementation of the public value test, and on an agreed methodology for impact assessments.

The role of Channel 4

1.24 There is broad agreement that a not-for-profit, commercially funded Channel 4 is an important part of the PSB landscape, and should remain so up to switchover and beyond. In this context, Ofcom welcomes the renewed focus of Channel 4 on its core PSB remit. In the longer term, Channel 4 will face competitive pressures which may well reduce its capacity to deliver its PSB remit in full. Consultation responses indicated differences of opinion about the likely timing of any such difficulties.

1.25 We have carried out detailed analysis of Channel 4's funding projections, and have found that the performance of the core channel is very sensitive to small changes in key assumptions. A poorer than expected performance of total TV net advertising revenue (NAR) growth and other downside risks could see a funding shortfall approaching £100m per year by 2009, if not more. However, applying an equally plausible set of assumptions could remove the funding shortfall entirely. In our view, this demonstrates that it is too early to consider direct, ongoing public support for Channel 4.

1.26 We therefore propose that in the short to medium term, Channel 4 should develop further its proposals for self-help, including cost savings, and value creation through new commercial ventures and alliances. Consideration

should also be given by the Government to the options for funding the one-off exceptional costs associated with Channel 4's transitional digital roll-out.

1.27 In parallel, Ofcom will consider the case for regulatory assistance advanced by Channel 4. Channel 4 has suggested options including:

- conferring PSB status across a wider range of Channel 4 activities, with possible benefits in terms of EPG positioning and rights agreements;
- additional spectrum capacity for Channel 4; and
- exemption from spectrum pricing.

1.28 It is still possible, however, that Channel 4 will face longer term funding problems. We therefore propose to monitor its performance and finances, with a further full review of the situation in 2006-7. Alongside this, we will continue work with Channel 4 on the options for meeting its longer term structural challenges. The main options are: direct public funding, indirect support (for example, through access to spectrum), and a relationship with the proposed PSP.

1.29 The provision of public funding, whether direct or indirect, raises significant questions. Although access to public funding might protect Channel 4's PSB output against long-term commercial pressures, it would also carry with it risks. It might change Channel 4's culture and values and make Channel 4 less independent; it would require a complex regulatory framework; it might be difficult to assess whether such funding was being used effectively; and it raises state aid concerns. For these reasons, we continue to believe that this is not an easy solution to the challenges faced by Channel 4.

ITV and Five

1.30 ITV1 and Five have an important but evolving role to play as part of the overall UK broadcasting mix. For both networks, we expect their future focus to be the provision of high production value, original content across a range of genres, and competition for quality with the BBC and Channel 4. Our aim is to ensure that - unlike in many other countries - the lives of people from around the UK are fully reflected on our mainstream commercial television. We also expect ITV1 and Five to provide independent and impartial news to ensure a continued plurality of supply of news and current affairs available on the main networks.

1.31 ITV1 has a special additional responsibility for the provision of regional news, current affairs and other regional programming. We set out our proposals for these areas below. For both ITV1 and Five, though, we need to develop our future expectations of PSB provision in the context of a rapidly changing market - our proposals are designed to help both broadcasters to focus on those aspects of PSB provision which are highly valued by the public, and which they are both well-placed to deliver effectively in the new environment.

Reflecting life around the UK

1.32 One of the most challenging issues for the future is securing the effective provision of PSB in the Nations, regions and localities of the UK. For the commercial PSBs, this programming has a high cost of provision and is

most at risk as competition increases. Viewers tell us that their priorities are regional news and current affairs, delivered by more than one provider, although many viewers would like the news to be more locally relevant than that currently provided. Viewers also like to see their own nation or region reflected on network television. The distinctive circumstances of the devolved Nations mean that meeting the needs of audiences in those Nations requires both more, and a greater range of programming specifically for each nation than is the case in the English Regions.

Longer-term framework

1.33 As we approach switchover, there is a unique opportunity to reshape national, regional and local television in a way that genuinely meets viewer needs, and recognises the economic realities of the PSB system. We think the priorities are:

- an increasingly important role for the BBC in the provision of news and a range of other programming for both the Nations, and the English Regions.
- a role for ITV1 focused on regional news and high-quality original production for the main network from the Nations and Regions;
- increased levels of production outside London, for both the ITV network and the BBC;
- improved dispersal of out-of-London production, including to the Nations;
- establishing the scope for imaginative new forms of local television news, information and entertainment, delivered via digital television and broadband;
- delivery of indigenous language services through dedicated services; and,
- a potential role for the PSP in providing local, regional and national content.

1.34 Our specific proposals to achieve these goals are as follows:

- the BBC should be asked, as part of Charter Review, to develop new proposals for local and regional programming, which go beyond those set out in its *Building Public Value* document, and help provide more well-funded television programming for the English Regions to complement its ambitious plans for the Nations;
- Channel 3 licensees will be required to provide regional news and current affairs;
- we will increase ITV1's quotas for out-of-London production for the network to 50% (by value and volume), representing more than £40m additional spend per annum outside London in 2006 and beyond;
- we will work with ITV plc to secure improvements in the range of production centres around the UK represented on the ITV1 network, including introduction of a new production partnership fund, to help build capacity outside London;

- we will consult with the BBC on increasing its out-of-London production for the networks, as part of the follow-up to Charter Review. We recognise that the BBC has already taken valuable steps in this direction and believe it is reasonable to expect that within a few years it should be able to achieve a position similar to ITV1;
- we will work with the Government and other parties to explore the options for digital local television, including further analysis to assess spectrum availability, economic prospects and audience requirements for such services;
- we have set out a range of options for provision of enhanced indigenous language services:
 - in Wales, greater transparency in the relationship between the BBC and S4C and clearer commitments by the BBC, with consideration given in the longer term to the use of the PSP model for the provision of Welsh language services;
 - in Scotland, the prospect of a dedicated Gaelic service for Gaelic speakers, initially delivered by digital satellite, providing more content, and a richer range, than is currently provided on mainstream channels; and
 - in Northern Ireland, the full implementation of the proposals in the Belfast/Good Friday Agreement.

Managing the transition

- 1.35 On the path to full switchover, we need to manage the transition as far as non-news programming on ITV1 is concerned. We propose a two-stage approach, with an initial change to take immediate effect, and a further adjustment at the start of the regional switchover sequence (currently expected to be 2008). While we have linked the next change to the timing of switchover, it is important to note that the need for change arises from the inexorable decline of the historic analogue model. This is a function of rising digital television penetration, rather than switchover itself. Our approach is intended to promote a sustainable approach to non-news programming. Regional news and current affairs will remain obligations of the Channel 3 licensees. The proposals for the Nations are different to those for the English Regions, reflecting the different circumstances referred to above.

ITV1 non-news programming for Scotland, Wales and Northern Ireland

- 1.36 Non-news programming obligations in the Nations will be maintained at a higher level than in the English Regions. Specifically, we propose to set minimum requirements for each of the licensees in the Nations to broadcast at least four hours per week of non-news regional programming, until the first UK region switches over to digital. Licensees may well exceed these minimum requirements, as they have done in the past. Some, but not all, of the Scottish licensees' non-news content would be shared between them, meeting the Scottish audience's interest in an all-Scotland service for the first time on ITV1.
- 1.37 When the first UK region achieves digital switchover, we propose to reduce the minimum requirement for the licensees in the Nations for non-news

programming to three hours per week. Reductions will all be in out-of-peak hours.

- 1.38 In addition, we plan to review the ITV Networking Arrangements to ensure that the national licensees do not pay for network programming they do not broadcast (during their opt outs), and require the ITV Network Centre to take into account the higher level of opt-out in the three Nations when devising its network schedule.
- 1.39 These proposals for the Nations are put forward in this report for consultation before we reach our final decisions, which will be published later in 2005.

ITV1 non-news programming for the English Regions

- 1.40 For the English Regions, in our Phase 2 report, we proposed reducing ITV1's regional non-news programming obligation from three hours a week to 1.5 hours in 2005, with all of the reductions occurring in off-peak hours.
- 1.41 Although we heard many representations from those opposed to making this change now, after careful consideration we have found no compelling reason to alter our view. The programming concerned is of lower priority to viewers than other aspects of PSB, and it is therefore hard to sustain an argument for increased investment by ITV. This programming will become unsustainable as switchover approaches.
- 1.42 We believe that it is better to move to a more realistic and sustainable approach now, and to require ITV1 to commission increased levels of high-value network production from the regions, rather than to preserve low-budget regional programming which is not as highly valued by audiences.
- 1.43 We will, therefore, implement our proposals for non-news regional programming in the English Regions as soon as possible. The new level of 1.5 hours per week of non-news regional programming, including at least 45 minutes in peak and a further 0.5 hours in near-peak, will remain until the first UK region achieves digital switchover. When the first UK region switches over, we propose to reduce the requirement for non-news programming to 0.5 hours a week. Parliamentary coverage and current affairs will be part of this continuing obligation.
- 1.44 A substantial settlement of non-news regional programming sits alongside the initiatives set out above: the proposed new out-of-London quotas for ITV1 and the BBC and the wider dispersal of production. In total these initiatives represent an additional flow of ITV1 production funds out of London of around £17 million in 2005 and £40 million in 2006 and will deliver direct benefits to producers in the Nations and Regions of the UK.

The Public Service Publisher

- 1.45 Consumption of audiovisual content is changing as new distribution technologies become more widely used, and new types of content are developed. Conventional linear channels will be less effective in reaching some viewers in the future than they have been in the past, and new media can enhance the effectiveness and value of many types of content - from

on-demand news, music and sport, to interactive education and learning material.

- 1.46 We think it is important for the PSB system to anticipate and respond to these changes, and have proposed the creation of a new Public Service Publisher, which would be explicitly charged with developing services and content which take full advantage of new distribution technologies.
- 1.47 A PSP could bring a burst of innovative energy to the landscape. New entrants have tended to have a substantial and positive impact on UK broadcasting and PSB. We think a PSP could make the same sort of impact. The real creative advantage of a PSP is that, from its very inception, it could focus on content for a broadband world. Its content could be distributed on a range of different digital and on-demand platforms - as well as digital TV. At present, only the BBC provides such an extensive, varied and rich broadband content proposition designed specifically for the UK. The PSP could provide competition for quality in broadband interactive content, just as the more conventional PSBs have done in the broadcast TV sector in the past.

The remit of the PSP

- 1.48 Several options for the PSP's remit have been suggested in response to our consultation. We have assessed each of these options against a range of criteria and believe the best solution may be a combination of different approaches. Two distinct elements have been most commonly proposed:
- A free-to-view premier content service providing high-quality, imaginative and innovative drama, comedy and factual content, designed to take full advantage of broadband capabilities. This proposition would help meet the public's interest in original and innovative content – and would address the risk that this sort of output might be under-provided in a fully digital world. The new PSP could be challenged to find new formats for traditional genres, designed specifically for interactive, on-demand consumption. Such a service could also be required to be non-metropolitan in outlook, commissioning content that reflects the whole of the UK, not just London. It could be based outside London and this in turn would help strengthen the creative production sector outside London.
 - Local and communities services. The public values local news, information and other content which is focused on their own particular locality – digital television and broadband provide new opportunities to serve such local needs more effectively. Broadband allows fragmented communities to be better served, by bringing together those with similar interests from across the UK. Broadband could also encourage, with appropriate support, the evolution of peer-to-peer services, prompting a more participative approach to media consumption.
- 1.49 In addition to the above, some have suggested that the PSP could play an important role in helping consumers and citizens navigate their way through the wide range of content available on all digital platforms – a trusted public service guide or navigator. It might also be well-placed to work with existing organisations, such as museums, galleries and educational institutions, to

provide access to a much wider range of publicly funded content, from non-broadcast sources, than is currently available. Given the wide range of interesting proposals for the PSP, we would encourage continued thinking and research on the options, in order to progress the proposition further.

- 1.50 It would be possible to deliver these sorts of services through one PSP operator – for example, with a consortium containing a premium content provider with access to regional production bases, and a network of local service providers. But it may be more effective to award two or more separate contracts for the individual elements, with different levels of funding (for example, the local and communities services might only require seed-corn funding).

How it might work

- 1.51 Ideally, plans should be in place so that the PSP is up and running before digital switchover is complete. Given the timetable for the primary legislation needed, this means that work to develop the idea, including research into the public response to alternative options, would need to begin in good time.
- 1.52 In Phase 2 we suggested that the PSP might require around £300m to invest in content and distribution that could have real reach and impact. Responses to our consultation suggested that this was a reasonable funding level to aim for, given the objectives of the proposal - the PSP, in this model, would not provide a conventional 24 hour broadcast channel, but could instead focus its investment on a more limited volume of high quality, well promoted and widely distributed material, likely to be available on-demand for an extended release window, or as a community-orientated service, as suggested above.
- 1.53 The PSP (or PSPs) would be established through the periodic award of a contract to the successful bidder(s). In order to win the contract, and gain access to public funding, prospective providers would put forward competing proposals for content, distribution and management. We believe this approach would create greater contestability, encourage new ideas and approaches, ensure value for money, and facilitate new entry into the industry. In principle, the tender process should be open to the widest possible range of potential bidders, including broadcasters, but also other media, telecoms, and production companies. The BBC would be excluded, as one of the aims is to maintain plurality in the supply of PSB.

Channel 4 and the PSP

- 1.54 Several responses to our consultation proposed that Channel 4 might have a close relationship with the PSP, especially as it might be able to provide an initial broadcast outlet and cross promotion for some of the PSP's content. We have considered three main options for the possible involvement of Channel 4 with the PSP:
- The tender process is open to anyone, except the BBC. This would allow the PSP to be allocated competitively to the best possible bidder, perhaps a consortium drawing from a range of different organisations and sectors. Channel 4 would be free to bid alongside all other parties.

- Channel 4 could be granted a substantial stake in the PSP, and would be required to bring in partners to operate the PSP. This would guarantee a role for Channel 4, and provide it with a base from which to achieve a new scale and breadth in PSB provision, particularly in new media.
 - The winner or short-listed bidders for the PSP could be obliged to reach an agreement with Channel 4 - for example, for access to Channel 4 airtime and promotion.
- 1.55 On balance, we consider that that the first two of these options should be considered in more detail – the first would generate much greater competition for new approaches and ideas; the second would create a route for Channel 4 to strengthen its PSB proposition. Both need further detailed analysis, including their possible impact on competition in the broadcasting market. The third option would, we believe, be difficult to implement and risks achieving neither of these benefits very effectively.

PSB regulation, accountability and governance

- 1.56 The final element of an effective, new model for PSB is the overall framework of regulation, accountability and governance. In Phase 2, we suggested that the separate roles of governance and regulation of the BBC needed to be clarified. Our consultation process has highlighted the importance of these issues, and has raised wider questions which relate to the PSB system as a whole, not just the BBC. Since then, the Burns panel (advising DCMS on Charter Review) has published its proposals for a new Public Service Broadcasting Commission.
- 1.57 We strongly support the Burns panel suggestion that a distinction should be made between management and compliance on the one hand, and regulation and accountability on the other. Our analysis in fact suggests that there are three aspects to securing successful governance and regulation:
- **External, cross-sector regulation** - applying to all participants in the market.
 - **Accountability** - effective oversight, on behalf of the public, of any use of public funding for the provision of PSB.
 - **Internal, or corporate governance** – management and compliance of the various organisations and institutions which make up the system.
- 1.58 Respondents to our consultation argued that the present system is flawed on several counts. The BBC Governors have up to now not been sufficiently independent of the BBC's executive, with the risk that both internal governance and effective oversight in the public interest are compromised. The BBC falls outside the cross-industry regulatory framework in some key areas, including Tier 1 obligations to ensure accuracy and impartiality. There are real concerns expressed about the impact of the BBC on the wider marketplace and the independence of BBC market impact assessments. It was argued that competition issues need to be treated in a consistent way across the whole of the sector.
- 1.59 Furthermore, there are governance issues which need addressing across the wider sector. Ofcom is currently required to carry out a mix of potentially

conflicting regulatory and governance duties – for example, in respect of the appointment of Channel 4 non-executive directors, the Board of the Gaelic Media Service, and the operation of the Community Radio Fund. The governance of S4C is carried out in a different way again.

1.60 We do not believe that the answer to these problems is for Ofcom to take on the governance and oversight of the BBC. This would further confuse an already complex and imperfect set of relationships.

1.61 Instead, we believe that the three distinct roles of internal governance, regulation, and accountability should be further clarified.

1.62 First, we think there are sensible steps which can be taken to secure better and more consistent *regulation* of a PSB system in which there are complex interrelationships, and which is increasingly fragile. We propose the following:

- The approach to competition issues should be the same across the sector – with the BBC subject to the same *ex ante* rules as commercial broadcasters. This would allow Ofcom to intervene promptly in the event of a possible threat to competition, and ensure a consistent approach across the market. The BBC would then become explicitly responsible for compliance, and Ofcom for regulation.
- Where the BBC is proposing new services, the Impact Assessments (which examine the effect of those new services on the market as a whole) should be carried out by Ofcom, rather than by advisers appointed by the BBC's Governors. The results of such assessments would be published and then used by those responsible for the accountability and oversight of the BBC in reaching a decision on the approval of a new service; (in any event, as proposed elsewhere, we look forward to working with the BBC to help develop a common approach to Impact Assessments).
- All Tier 2 quotas which currently remain with the BBC Governors should in future be regulated by Ofcom: at present Ofcom's powers in relation to Tier 2 quotas on the BBC are limited in some areas.

1.63 Second, options for managing the *internal governance* of the BBC and *accountability and effective oversight* of the use of public funding on behalf of the public should be further examined. There are two broad options:

- The first is the model currently proposed by the BBC, which recognises many of the problems identified with the old system, and goes some way towards establishing an improved approach.
- The second, proposed by the Burns panel, would be to create a new external body, a Public Service Broadcasting Commission, which would collect the licence fee, ensure the BBC spends its licence fee funds effectively, and delivers public value.

1.64 Adopting the BBC model would have the immediate advantage of allowing the BBC's own proposed changes time to work. But the Burns panel model may be better equipped for future changes. It could also help address remaining anomalies across the sector as a whole.

- 1.65 The proposed new Public Service Broadcasting Commission could, for example, be charged with overseeing the proposed PSP, or any other future recipient of public funding. It could also assume responsibility for the oversight and accountability functions now assigned to Ofcom, such as allocation of the Community Radio Fund.
- 1.66 We believe there are advantages and disadvantages to both approaches. In our view, the critical issue is to ensure that any model adopted sets out an effective approach to the different functions of internal governance, cross-sectoral regulation, and the oversight and accountability of direct public funding.

Next steps

- 1.67 The proposals set out in this report are intended to help maintain and strengthen the quality of public service television broadcasting as we move into the digital age. We now need to take forward their implementation:
- **At Ofcom:** we will now implement the proposed regulatory changes for ITV1 and other licensees; take forward further work on local television; monitor the position of Channel 4; consider the role of multichannel broadcasters in the PSB system; review the production sector; and undertake wider work on PSB assessment and competition in broadcasting.
 - **More widely:** this report also contains a number of recommendations for Government to take into account in BBC Charter Review and elsewhere – for instance, proposals on governance and regulation, and on possible next steps for the PSP.
 - **New consultation:** finally, this report sets out for the first time our proposals for PSB in the Nations. Therefore, this report opens a formal consultation on this set of proposals, and the questions for consultation are set out in Annex A of this report.
 - **Future PSB Review:** no more than five years after the current review, Ofcom will conduct a further review of public service television broadcasting, as required by statute. As in this review, Ofcom will consider how effectively the public service broadcasters have met the purposes of PSB. Similarly, we will make recommendations for maintaining and strengthening the quality of PSB, taking into account the costs of provision, and the sources of income available at that time.
- 1.68 Our aim is to secure a new system for the future, in tune with the evolving needs of citizens and consumers, as they take advantage of new technologies and media. It should be characterised by a competitive marketplace with a plurality of providers, using existing and new technologies, competition for commissioning and distribution of quality content, a vibrant and diverse production sector, sustainable funding, and value for money. It should serve and reflect all of the UK, not just London and the South East. It should allow the market to work as effectively as it can, while securing those aspects of provision that the market alone will not guarantee. The main report develops each theme in more detail.

Chapter 2

Securing PSB in the digital age

- 2.1 Public service broadcasting in the UK has been sustained over many years by a mutually reinforcing mix of institutions, funding and regulation. One of the central conclusions in our Phase 2 report was that this delicate balance will not survive the move to the fully digital age. The purpose of this – the first main chapter of our Phase 3 report – is to describe our vision for PSB in the digital age, taking into account the wide-ranging contributions to our Phase 2 consultation, and our subsequent further research and analysis.
- 2.2 It should be noted at the outset that this chapter does not consider all aspects of our proposed new model for PSB, since a number of specific issues are reviewed in more detail in standalone chapters: Chapter 3 discusses PSB in the Nations and Regions; the role of Channel 4 is considered in Chapter 4; Chapter 5 focuses on the Public Service Publisher; and Chapter 6 considers the need for a new model of governance and regulation for PSB in the UK.

A vision for the digital age

- 2.3 In our Phase 2 report, we noted that the television market is changing rapidly. The majority of UK households now have access to digital television, and penetration continues to accelerate. Competition in the television market is becoming fiercer, and consumer choice is increasing, handing more power from producers to consumers. These are welcome developments.
- 2.4 New digital technologies are likely to have a profound impact on the way we watch television:
- Within the next decade, the achievement of digital switchover will mean that everyone in the country has access to at least 30 TV services.
 - People are increasingly likely to want to watch TV at a time, place and pace of their own choosing.
 - Personal video recorders (PVRs) will become increasingly commonplace and high speed broadband internet (greater than 2 Megabits per second) will allow different on-demand services and interactivity.
 - Improving digital compression technology could provide the capacity to carry at least double the current number of channels in the future.
 - Wireless networking will distribute media throughout the household.
 - Mobile devices will increasingly be used for viewing television services.
 - Sophisticated flat LCD and plasma screens will enhance viewing, and High Definition TV will create new opportunities in the medium term.
 - Home multimedia servers will personalise content and allow efficient storage and access.

- Increasingly sophisticated electronic programme guides (EPGs) will add powerful new functionality to the consumption of television.
- Developments in payment mechanisms could create a range of different ways in which viewers pay for the television they watch.
- Further into the future, traditional television schedules could be displaced by fully on-demand services.

2.5 Future delivery of PSB content will need to face up to the challenges created by these new developments. Before discussing these challenges in more detail it is worth also considering the opportunities created.

2.6 Technological developments will present new opportunities for creating and distributing PSB content: audiences will be able to access on-demand libraries and archives of PSB programming; interactive features will enhance the provision of news and educational material; content could be made available on portable and mobile devices, as well as on the main household TV screen; effective and user-friendly navigation around different types of content will allow viewers to find PSB content more readily. These developments could strengthen the effectiveness of PSB content and reinforce the special role that it can play in our lives.

2.7 Nor will technological developments mean that traditional television broadcasting is no longer important – a point that was made by some respondents to the Phase 2 consultation. Linear broadcasting – albeit over digital rather than analogue platforms – will continue to be of significant importance for the foreseeable future. Therefore, while PSB needs to adapt to change, traditional linear broadcasting may still be needed in the near term, in order to help secure reach and impact.

2.8 Our vision is of an exciting and durable PSB system as the UK moves into the digital age. Following on from this PSB Review, Ofcom's continuing programme of work in 2005/6 will seek to make this vision a reality. We will, for instance, look in more detail at the changing role of EPGs, search engines, and personal video recorders, and how they will influence and shape PSB consumption in the future. Looking further ahead, Ofcom's next five-yearly PSB review will examine the role of PSB in a world in which every UK household has digital TV, and a large majority have high-speed broadband access at home.

The challenges confronting the analogue model

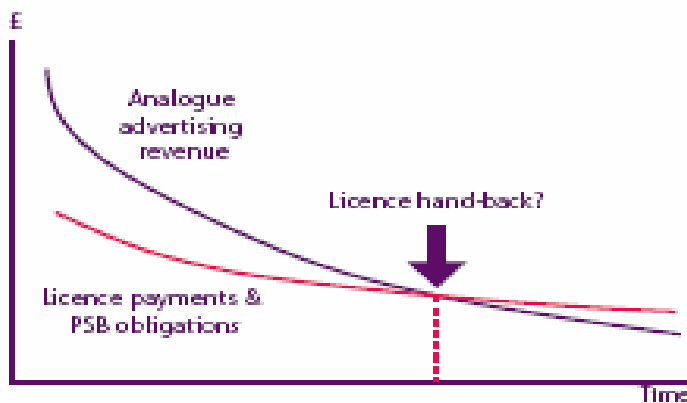
2.9 As we showed in our Phase 2 report, technological change could also pose a real risk to the implicit funding available to sustain PSB in the commercial sector.

2.10 Fragmentation of audiences and the growth of digital television act to reduce the audience share of the main terrestrial broadcasters. For instance, in 2004, and across all homes, multichannel services as a whole received a greater share of viewing than did any one of the main terrestrial channels. And in the latter half of 2004, more than half of all viewing in cable and satellite homes was to multichannel services. This has the potential to reduce the advertising revenue available to commercially-

funded public service broadcasters, relative to the total income in the broadcasting market as a whole.

- 2.11 This development creates challenges for the historical commercial PSB compact. Through this compact, commercial broadcasters such as ITV1 and Five have been willing to carry PSB obligations and pay the Government for their broadcasting licences – in return for which they have received privileged access to the analogue spectrum at less than the full scarcity value of the spectrum. The value of this privilege is the implicit PSB funding received by commercial broadcasters.
- 2.12 The nature of this compact is of significant importance for the future of PSB. Our Phase 2 report demonstrated that, regardless of the overall profitability of the commercial public service broadcasters, the increasing penetration of digital television will raise two key issues:
- As audience fragmentation continues, privileged access to the analogue spectrum reduces in value. The revenue from analogue advertising is no longer the only source, and possibly not the main source, of income for commercial broadcasters.
 - There are alternative routes for broadcasters to reach audiences. In the past, the main broadcasters could only reach audiences through analogue television – and so they had no choice but to take part in the PSB compact. But in the multichannel world, broadcasters can reach audiences through many routes: not only analogue but also digital terrestrial TV (DTT), digital satellite and cable platforms. Indeed, as technology develops further, content providers may at some stage no longer need television platforms to reach their audiences.
- 2.13 As a consequence, at a point at or before digital switchover, the compact between the commercial broadcaster and society will erode. As Figure 2.1 illustrates, the costs of retaining PSB status (the sum of licence payments and the costs of PSB obligations) will at some stage exceed the scarcity value of the analogue spectrum (the advertising revenue generated on the analogue platform).

Figure 2.1: Illustrative costs and benefits of PSB obligations for fully-commercial broadcasters

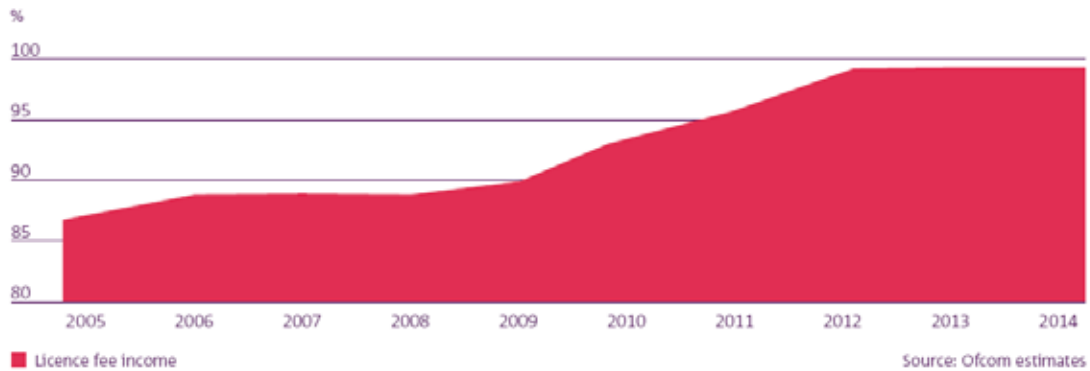


- 2.14 If this situation were to arise, then – regardless of their overall profitability – the commercial broadcasters will face a strong economic incentive to cease broadcasting on the analogue terrestrial platform, and rely on digital

television to reach viewers. Unlike analogue spectrum, digital capacity is available without the costs of PSB obligations.

- 2.15 Some respondents to the Phase 2 consultation expressed scepticism about whether the compact will really break over the next ten years. In Phase 3 of our work, we have therefore carried out further modelling to assess the significance of this risk. This analysis has established that the risks identified in the Phase 2 report are real.
- 2.16 Specifically, while much depends on the assumptions about the opportunity cost of the various elements of PSB, some conclusions are clear even with a fairly conservative set of assumptions. At a point shortly before digital switchover (likely to be one to two years before switchover), it could be in the interests of the Channel 3 licensees to give up their analogue broadcasting licences if their current PSB obligations remained in place. In addition, the regional phasing of the switchover process means that this would happen for different licensees at different times once switchover gets underway in 2008 or 2009.
- 2.17 After switchover, commercial broadcasters with PSB obligations would be entitled to appropriate prominence on EPGs, reserved capacity on the digital terrestrial platform, and must-carry rules. In addition, there might be some scope in the future for introducing spectrum pricing waivers for broadcasters with PSB obligations, subject to other strategic priorities. In our Phase 2 report, we noted that the aggregate value of these privileges is unlikely to exceed £25m per annum. Implicit funding of this order would not be sufficient to preserve PSB obligations on the current scale.
- 2.18 Channel 4 is in a different position, in that it does not have the option of handing back its broadcasting licence. It is, however, still affected by the same pressures described above. Channel 4 has been able to sustain PSB programming, since it gains substantial advertising revenue from its more commercially attractive programming. But Channel 4 faces greater competition as digital penetration rises. Therefore, in the medium to longer term, it is likely to suffer a decline in audiences and advertising revenues. While it cannot choose to abandon its PSB status, these pressures may affect its ability to fund PSB – and so cause it to place less emphasis on providing PSB programming.
- 2.19 The overall effect of this is that plurality of supply of PSB will be under threat if we do nothing – it will no longer be possible to hold the commercial public service broadcasters to the obligations they accept at present, and so the provision of PSB by commercially funded broadcasters may well decline.
- 2.20 As we noted in Phase 2, and as Figure 2.2 shows, the BBC could become a near-monopoly supplier of PSB if no action is taken. This would not be welcome development: a lack of competition in PSB programming risks leading to complacency, inefficient production, lack of innovation, lower quality programming, a narrowing of perspectives, and the loss of PSB programming for certain groups. Given the need to maintain and strengthen the quality of PSB, this outcome would not be in the society's interest, and nor would it be in the interests of the BBC.

Figure 2.2: Possible BBC share of PSB funding



2.21 We therefore conclude that it is necessary to act now to build a new model of PSB for the digital age – one which ensures a sustainable and plural system, and which protects the best qualities of PSB for all.

A framework for the future

2.22 At its heart, the new digital model of PSB needs to have the notion of **competition for quality**. To us, this means three concrete things:

- A more competitive marketplace.
- Plurality of PSB commissioning and production.
- Enough flexibility in the system for provision (and providers) of PSB to change over time, as the needs and preferences of citizens change.

2.23 This theme underpins the framework for a new PSB system for the digital age. Specifically, the new model of PSB will be one in which:

- PSB works with the competitive broadcasting marketplace;
- PSB is defined in terms of purposes and characteristics;
- the scale of public intervention is periodically reviewed;
- new sources of explicit funding will be needed; and,
- plurality of PSB provision is sustained – both through current providers, and through additional contributors to the PSB landscape.

2.24 We discuss each of these principles in more detail below.

A more competitive marketplace

2.25 Our starting point is a competitive broadcasting marketplace, which should encourage broadcasters to provide quality, innovation, range and choice as they seek viewers and advertisers. In our Phase 1 report, we explained that, as we approach switchover, the UK television market will work increasingly effectively to deliver what consumers want and are able to pay for. Long standing market failures – associated with the public good characteristics of broadcasting, spectrum scarcity, lack of direct payment mechanisms, and lack of consumer information – would be steadily reduced in significance.

- 2.26 Some respondents to our earlier reports expressed the view that we have been too optimistic about the extent to which consumer market failures will be addressed by the move to the fully digital age – arguing that an entirely free broadcasting market would not deliver desirable outcomes, both up to switchover and beyond. It was suggested, for instance, that a free market would result in a lower level of funding for UK-originated content, and so would result in an under-supply of programming typically thought to be at the heart of PSB – such as high quality news and factual programming, UK drama and comedy, arts and children’s content.
- 2.27 It was argued by some that, regardless of changes in conditional access and other technologies, television would remain a public good. Broadcasters would always be able to supply any programme to an additional viewer at no additional cost, so the efficient price of an individual TV programme should be zero. But we believe that this analysis is true only in a narrow technical sense. It ignores the fact that TV is not unique in being an industry with high fixed costs and low variable costs. Publishing, film, telecoms, airlines, software, music, pharmaceutical and even car manufacturing share many of the same characteristics without the same degree of subsidies and regulations.
- 2.28 More importantly, effective markets exist in these industries, and market failures have been mitigated. In publishing, for example, newspapers bundle individual stories together so the cost of any one article is indeed zero. In television, we believe that a combination of bundled subscription services, windowing, free-to air advertising channels and increasing capacity and ever-declining barriers to entry would gradually reduce consumer market failures and would allow broadcasting in a fully digital world to begin to resemble a reasonably effective market.
- 2.29 It was also argued by some that broadcasting markets tend to be characterised by high levels of concentration, which places effective competition at risk. This may well be the case – although rapid changes in technology are changing market boundaries and making it harder for incumbents to protect their market position. Even so, it is not clear that the PSB intervention is the answer to such competition concerns – rather, effective application of Ofcom’s competition powers should be the key response here.
- 2.30 In addition, and as emphasised by a number of respondents to the Phase 2 consultation, the pursuit of public purposes could be aided by greater competition in broadcasting markets. Some responses argued that purely commercial broadcasters (i.e. those without public service obligations) play an important role in delivering high quality, original content which meets public purposes – and so helps deliver more and more choice to viewers. It was also argued that the role of the multichannel sector will become even more important as digital penetration and reach continues to increase. Therefore, it was suggested, Ofcom needs to recognise this contribution when framing policy recommendations for the future of PSB.
- 2.31 Some respondents stressed that – if this contribution is not given adequate attention – then there is a significant risk that public funding will crowd out potential private investment in PSB content. The view was expressed that such crowding out is already taking place; and that this might increase if the scale and scope of the PSB intervention is determined without reference to

the role of the multichannel sector. We agree that this risk does exist, especially in emerging and niche markets – and so we believe that steps should be taken to ensure that broadcasting markets work better.

2.32 We also believe that the market may not always deliver socially desirable outcomes – and indeed we showed in our Phase 2 report that revenue fragmentation might reduce the commercial provision of high production-value programming in some of the genres mentioned above. We also noted that, in some cases, competition can lead in the short run to derivative and copycat programming. But we are not convinced that, in a fully digital world, these undesirable outcomes will necessarily be a direct result of consumer market failures – rather, we believe that this implies a situation in which a better-functioning market (i.e. one which provides *consumers* with what they demand) would not meet all of our needs as *citizens*. For this reason, we continue to believe that public intervention to deliver social purposes will still be needed, even with a fully-functioning broadcasting market. But we do not believe that continued consumer market failures are likely to be a major rationale for public intervention in a mature, fully digital world.

2.33 This debate, alongside our further analysis, leads us to conclude that a number of steps are needed to help the broadcasting market work as effectively as possible as we approach switchover:

- A high priority should be given to the successful completion of the digital switchover process, which will help create increased competition between broadcasters, and will increase choice for viewers.
- Progressive roll-out of high bandwidth broadband services should also be encouraged – Ofcom's Strategic Review of Telecommunications, carried out in parallel with this PSB Review, sets out proposals for securing competition and investment in UK broadband infrastructure.

2.34 In addition, we should encourage the further development of the commercial broadcasting sector, and its future contribution to PSB:

- Commercial broadcasters should have a fair opportunity to develop innovative new services – proposals for any significant expansion of services provided by the BBC should be subject to especially rigorous market impact analysis, since it is in these areas that public funding might have the most adverse impact on new commercial market developments. In the first instance, Ofcom will work with the BBC to construct a common and agreed methodology for such assessments.
- The potential benefits of competition must be realised. Ofcom will take forward a comprehensive programme of analysis during 2005, to assess potential barriers to competition in the UK broadcasting sector, and scope for reducing or removing those barriers.
- Finally, positive steps should be taken to recognise – and therefore incentivise – the contribution made by commercial multichannel broadcasters to public purposes. These steps are discussed in more detail later in this chapter.

A new definition of PSB

- 2.35 To support the new model, we have developed a new definition of PSB, described in terms of purposes and characteristics. This definition is designed to remain relevant over time, even as the trends noted earlier – for new technologies and media to emerge to replace more conventional broadcast channels – become of even greater importance.
- 2.36 Respondents to both previous Phases of the review have largely supported our proposed new PSB purposes and characteristics, set out in Box 2.1 below:

Box 2.1: A new definition of PSB

The **purposes** of PSB:

- to inform ourselves and others and to increase our understanding of the world through news, information and analysis of current events and ideas;
- to stimulate our interest in and knowledge of arts, science, history and other topics through content that is accessible and can encourage informal learning;
- to reflect and strengthen our cultural identity through original programming at UK, national and regional level, on occasion bringing audiences together for shared experiences; and
- to make us aware of different cultures and alternative viewpoints, through programmes that reflect the lives of other people and other communities, both within the UK and elsewhere.

The **characteristics** of PSB content:

- **high quality** – well funded and well produced;
- **original** – new UK content, rather than repeats or acquisitions;
- **innovative** – breaking new ideas or re-inventing exciting approaches, rather than copying old ones;
- **challenging** – making viewers think;
- **engaging** – remaining accessible and enjoyed by viewers; and
- **widely available** – if content is publicly funded, a large majority of citizens need to be given the chance to watch it.

- 2.37 We also concluded in our earlier reports that PSB needs to retain reach and impact in order to justify continued public support. However, as we noted in our Phase 2 report, when we say that PSB needs to have reach and impact, we do not mean that *every* PSB programme needs to bring in a large audience every time. The reach and impact of some types of specialist programming can be much more significant than individual audience figures suggest. Where programmes can be shown to be achieving results in this way, they should remain an important part of PSB provision in future. Where they cannot, or where programmes do not contribute to PSB purposes and characteristics, there is little justification for public funding.
- 2.38 Some consultation responses argued that the purposes and characteristics of PSB should be revised to include specific reference to programming in

particular genres, or to content targeted at specific groups – such as education, religion, sport, music, and multicultural programming, or programming tailored to the needs of disabled people. But we remain of the view that the purposes and characteristics, as defined, do encompass all of these types of programming. For instance, in ensuring that programming is widely available, the public service broadcasters need to ensure that the needs of disabled people are appropriately catered for; and the fourth purpose of PSB (to make us aware of different cultures and alternative viewpoints) should mean that broadcasters produce programming that reflects the needs and interests of people from ethnic and other minority groups.

- 2.39 In addition, a small number of respondents voiced some concern that these PSB purposes and characteristics remain too broad and that, consequently, it will not be easy to assess performance against them. We agree that new forms of assessment are needed. However, we continue to believe that the benefits of a relatively broad definition outweigh the possible drawbacks; and we set out later in this report our proposals for how the performance assessment might be effected.

Maintaining the scale of public intervention

- 2.40 Our work has established that there is a strong case for continued public intervention for PSB. But how much PSB is it necessary to support? In Phase 2 of our review, we showed that there remains broad public support for current or even slightly increased levels of public funding for PSB. However, the decline of the analogue PSB compact will result in a significant part of the implicit funding for PSB being lost from the overall system. So, in order to maintain current levels of funding, action is needed to replace this implicit funding with new sources of explicit funding.
- 2.41 Some respondents argued that the contribution of the multichannel sector – as noted earlier – will mean that any decline in the provision of PSB by the main terrestrial broadcasters will be offset by increased provision by purely commercial operators. Others argued that our Phase 2 audience research did not provide precise indications of the extent of public funding that would be supported by the public, and so felt we had not presented enough evidence to support current levels of intervention. And a small number of respondents argued that public funding should be reduced straight away since the UK already spends more than most other countries on PSB (as our analysis in the Phase 2 report showed).
- 2.42 But most respondents to our consultation broadly agreed that the overall level of PSB provision is about right and should be maintained, at least for the next few years – although, beyond that, the scale of public intervention might be reduced as market provision increases or as the reach and impact of PSB declines.
- 2.43 We agree that it is difficult to present definitive and conclusive evidence on the appropriate scale of public intervention in the broadcasting market – and indeed we explicitly acknowledged this point in the Phase 2 report. But we note again the continuing importance of television as an influential medium, and the evidence – at this point in time – of public support for its continued subsidy. In addition, our Phase 2 report showed that the UK benefits from a high level of domestically originated output, and that UK viewers still watch

more output in broadly defined PSB genres than viewers in other countries. And we note the evidence from other markets that certain types of programmes are at risk in a fully commercial world. However, we also recognise the force of the argument that, over time, the need for public intervention *may* decrease, and that the scale and scope of public intervention should be kept under review.

2.44 Our overall conclusions, therefore, are that:

- Parliament has asked us to make recommendations to maintain and strengthen the quality of PSB. In light of this remit, and given the evidence discussed above, we see no case for a reduction in the level of the PSB intervention. Current levels of public funding for PSB – explicit and implicit – should as far as possible be maintained in the system for the period up to the completion of switchover.
- Beyond that, increasing market provision may allow for a gradual reduction in public support. Ofcom's future reviews of PSB should examine the level of public funding of television, as well as its effectiveness and value for money. As in this review, Ofcom will make recommendations for maintaining and strengthening the quality of PSB, taking into account the costs of provision, and the sources of income available at that time.
- Specifically, in order to inform future funding needs, Ofcom's next PSB Review should conduct further detailed analysis of market developments and the commercial provision of content which meets PSB purposes and characteristics. Future reviews of the BBC's Charter (including any mid-Charter review) should be informed by this work.

The need for new sources of explicit funding

2.45 The above conclusion means that new sources of explicit funding will be needed in order to maintain and strengthen public service television broadcasting in the future.

2.46 Our Phase 2 report noted that the explicit funding of providers of PSB other than the BBC was a matter for the Government. We proposed, however, that three main possibilities were available: direct funding through taxation or foregone spectrum receipts; a levy on the turnover of UK licensed broadcasters; or a higher (or enhanced) television licence fee, through which the BBC is properly-funded, and additional licence fee revenue is used to fund other providers of PSB.

2.47 In the responses to the Phase 2 report, only a few respondents thought that direct taxation should be used to fund PSB. Those who supported a direct government grant did so on the grounds that they saw it as a more transparent and sustainable source than other options. But it equally gave rise to credible concerns about political interference in the use of the funding, and concerns about the potential for year-on-year instability in the amount of available funding. There was some support for the use of spectrum proceeds – another form of tax revenue foregone – especially the anticipated value of the spectrum made available for alternative uses after switchover. But, even here, some of the concerns associated with direct

government funding still applied, and it was pointed out that the proceeds from spectrum release are highly uncertain.

- 2.48 There was little support for a levy on the turnover of all licensed broadcasters, or any similar tax on broadcasters' businesses. Some were in favour of this approach as a means of forcing all successful commercial broadcasters to underpin PSB provision. But many other respondents argued persuasively that an industry levy would have a negative impact on the quality of content available to viewers, both as citizens and consumers; and it would reduce the spend across the commercial sector on original UK production. It was also pointed out that commercial broadcasters might be able to avoid a levy by obtaining their licences from another member state of the European Union. Therefore, many felt that the use of a turnover tax would run counter to the goal of maintaining and strengthening the quality of PSB.
- 2.49 Many respondents to the Phase 2 consultation felt that the best mechanism for providing explicit PSB funding is through the television licence fee model. There were, however, several who disagreed with the notion of an enhanced licence fee – arguing instead (as noted earlier) that current levels of explicit funding should be sufficient. The BBC and some other respondents argued that a higher licence fee could damage the BBC's accountability with licence fee payers, and argued instead that other methods should be used to provide explicit funding for PSB.
- 2.50 We recognise that the use of licence fee income for providers other than the BBC would amount to a major change in the system of public service broadcasting. But our view is that an enhanced licence fee model should be considered further by Government. Using an element of the licence fee model to fund other providers of PSB should not damage the accountability of the BBC to licence fee payers, so long as its use, and those who receive funding from it, are effectively communicated to, and endorsed by, licence fee payers.
- 2.51 Funding through the licence fee would, however, have a distinct advantage since the licence fee could then become the principal source of explicit funding for public service broadcasting. Discussions on the level of the licence fee would then become a public debate concerning the total quantity of public funds used to deliver PSB rather than, as now, a narrower debate on the level of funding given to the BBC.
- 2.52 We recognise, however, that if the licence fee model were used to fund public service broadcasters other than the BBC, there is a need to ensure that the use of the licence fee does not amount to a top-slice which results in an under-funded BBC. As we stated in our Phase 2 report, it is important to ensure that the BBC is properly funded before the licence fee model is used to fund other providers of public service content.
- 2.53 Some respondents noted that if the current Charter Review process does not ensure scope for considering the wider use of the licence fee model, then this source of potential funding for PSB outside of the BBC will be closed off for a further 10 years.
- 2.54 Although we reiterate in this report that funding decisions are a matter for Government, we recommend the following:

- The case for new funding for PSB to replace the decline in implicit funding should be examined carefully by Government. This should include consideration of tax funded support.
- We also recommend that Government should examine in more detail the scope for an enhanced licence fee, and the use of the licence fee model to support direct funding of PSB across a range of suppliers at some stage in the future.

The importance of plurality of provision

- 2.55 We argued in both Phases 1 and 2 that plurality and competition between suppliers of PSB content is at the heart of a successful PSB system. As well as providing viewers with access to a range of different views and perspectives, plurality can help inform the process of regulation by providing valuable benchmark information about the performance of different providers.
- 2.56 Plurality can apply at different points in the broadcasting production and distribution chain. We suggested in Phase 2 that it is needed at three key levels:
- **Plurality of outlets:** so that viewers do not have to be reliant on a single provider in order to receive PSB.
 - **Plurality of commissioning:** so that a range of commissioners working for different organisations can bring their different perspectives to bear on the system).
 - **Plurality of production:** so that there are different creative organisations competing for commissions.
- 2.57 Respondents agreed that plurality in the supply of PSB is important, and will continue to be important in the fully digital world. In addition, there was strong support for the idea that plurality should be secured at all points in the broadcasting value chain. In addition, there was widespread agreement that a new system will be needed to secure plurality of PSB provision in a digital world.
- 2.58 In this new system, there will be a revised role for each of the main players and a role for a new Public Service Publisher (PSP), which could develop new ways of meeting PSB requirements and ensuring plurality of provision in the digital age. These revised roles are discussed in more detail later in this chapter, and in other parts of this report. Figure 2.3 provides a brief summary.

Figure 2.3: Key players in the plurality of PSB provision

BBC	The cornerstone of PSB, and fully-funded by a licence fee model
Channel 3	Focus on strengths of news, and original production from all parts of the UK
Channel 4	Remain as a not-for-profit, commercially-funded broadcaster
Five	Maintain its modest but important PSB contribution – primarily a market-led PSB
S4C	Key role in Welsh language public service broadcasting
Teletext	Remit for a range of high quality and diverse text material
New contributors to PSB	The Public Service Publisher; and a PSB contribution from multichannel services

- 2.59 Content production is also an important source of plurality. A strong production sector can be a source of creative competition as well as economic growth. Following the Independent Television Commission (ITC) review of the programme supply market in 2002, new codes of practice have been put in place for all existing public service broadcasters. In the Phase 2 report, we suggested that it would be sensible to wait for 12 months before conducting a further review of the production sector, during which time the new codes of practice could be given time to work. We also said that the BBC should demonstrate that it has clear plans to introduce a commissioning system, outside news programming, which has fair access for independent suppliers and which commands widespread confidence across the sector.
- 2.60 The BBC’s preliminary proposals announced in December contain the following key elements:
- Maintaining the existing statutory quota of 25% in television.
 - Reducing in-house capacity to around 60%.
 - Creating a “window of creative competition” for an additional 25% of television production.
 - Simplifying and streamline the commissioning process to make it fairer and more open to all producers in all genres.
- 2.61 We have seen these proposals in outline, and consider them to be a positive step towards improving the functioning of the television production sector.
- 2.62 However, we note that final proposals have still to be approved by the BBC Governors; and we understand from Pact that there are some concerns with these proposals, which remain to be resolved as further details are provided. As a result, Pact have told us that the proposals do not yet have

the confidence of the independent sector. In view of these concerns, we propose to begin immediately the preparatory work for our planned end of year review, and will use this opportunity to undertake a more wide ranging review of the UK content production sector than originally intended. As noted in the Phase 2 report, this review will include:

- the effectiveness of the existing quota;
- the transparency of the commissioning process;
- the extent to which the new codes of practice have helped the market to function more effectively;
- the appropriate definition of an independent producer, both at UK level and in the Nations and Regions; and
- the case for tougher action or for alternative solutions.

The players in the new system

2.63 Our aim has been to devise a new system which will deliver high quality PSB content for the future, using a range of funding sources, institutions, and approaches. The overall objective of the new system should be to deliver quality through effective competition between both commercial and publicly funded providers, with sufficient scope for the system to change and adapt as the market develops, and the needs of citizens and consumers change over time. The rest of this chapter provides our conclusions of the roles of the key players in the new system – it expands on Figure 2.3, but the roles of S4C and the PSP are discussed in subsequent chapters of this report.

The BBC

2.64 We very much welcome the BBC's response to our Phase 2 report. In particular, we note that there are many issues on which the BBC's response agrees with our analysis and recommendations – for instance, on the continued importance of PSB; on the need for plurality in the PSB system; a definition of PSB based on purposes and characteristics; and on the role of the BBC as the cornerstone of the PSB system.

2.65 Respondents to our Phase 2 consultation largely supported the recommendation that the BBC should, for the foreseeable future, remain at the heart of PSB in the UK, although as part of a wider system which encourages competition for quality. Indeed, some respondents noted that, given the increasing pressure on the analogue PSB model, the BBC's role may be even more important going forward. In addition, many respondents argued that the current structure of governance and regulation of the BBC is in need of review, and that this was directly relevant to the PSB system as a whole.

2.66 In addition, most respondents agreed that the BBC should continue to be funded by a licence fee model, and the BBC noted that its own research on willingness to pay suggested public support for a higher level of PSB funding than that suggested by the Ofcom research. A small minority of respondents adopted a different view – suggesting, for instance, that Ofcom should explore the scope for a subscription-funded BBC. The BBC and

some other respondents challenged this perspective, arguing that the use of a subscription model would bring about an undesirable shift in the BBC's role, the content it could provide, and its ability to ensure universal access to its services.

2.67 Our recommendations for the BBC are broadly unchanged from those in our Phase 2 report:

- An effective, strong, and independent BBC – properly funded by a licence fee model – should remain the cornerstone of PSB.
- A 10-year Charter – with a substantive mid-point review¹ to reflect the fact that the broadcasting market is changing rapidly, and to coincide with Ofcom's next PSB Review.
- The BBC should strive to ensure all its programmes reflect to some degree the purposes and characteristics of PSB, for example by having regard to the extent to which Hollywood films and other expensive acquired programming meet its own definitions of public value (discussed in more detail in Box 2.2 below).
- For the medium-term, we continue to believe that the BBC should be asked to review options for the use of subscription funding to supplement the licence fee, in advance of the proposed mid-point review of its Royal Charter.

2.68 Since Phase 2, the BBC has announced details of its internal review of commercial activities, resulting in a limited sale of parts of BBC Worldwide. We remain of the view that the BBC's (relatively limited) plans for the sale of its commercial activities should be subject to an independent assessment as part of Charter Review.

¹ It should be noted that, when we refer to a "mid-point" Charter Review, we do not necessarily mean that the review should take place literally half way through the next Charter (i.e. at the start of 2012), but that it should take place at an interim stage close to the mid-point. It may, for instance, be more appropriate for the review to take place at a slightly earlier stage (e.g. in 2011), to ensure that planning for a post-switchover world can take place in good time.

Box 2.2: Building public value

The BBC, in its *Building Public Value* document, said that all public organisations should “aim to deliver not only value for individuals, but also value for people as citizens. This is their public value – the difference they make to the quality of life in the UK.” The submission went on to say that the public value of a public service has three components: value to people as individuals, value to society as a whole – to people as citizens; and impact on the performance of the wider commercial market – its net economic value.

The BBC intends to apply a public value test to its activities to decide what it should and should not do. It acknowledges the difficulties involved in measuring public value and proposes the use of a number of proxy measures such as weekly reach, range of programmes, audience appreciation, audience size, as well as peer review.

As shown in the figure below, there is a great deal of similarity between the BBC’s conceptual approach and the one we set out in our Phase 1 report where we distinguished between the value of PSB to consumers and its value to citizens. Ofcom, therefore, welcomes the BBC’s proposed use of the public value concept.

Ofcom PSB purposes	BBC public purposes
<ul style="list-style-type: none"> • To inform ourselves and others 	<ul style="list-style-type: none"> • Democratic value: providing trusted and impartial news and information
<ul style="list-style-type: none"> • To stimulate our interest and knowledge 	<ul style="list-style-type: none"> • Educational value: build a society strong in knowledge and skills
<ul style="list-style-type: none"> • To reflect and strengthen our cultural identity 	<ul style="list-style-type: none"> • Cultural and creative value: enriching the UK’s cultural life
<ul style="list-style-type: none"> • To make us aware of different cultures and alternative viewpoints 	<ul style="list-style-type: none"> • Social and community value: connecting communities • Global value: supporting the UK’s global role

Source: Ofcom PSB Review; and BBC, *Building Public Value*

We also consider the BBC’s public value test to be a useful approach to assessing the broad benefits provided by the BBC’s services and support its proposed use in deciding the scope and scale of the BBC’s activities. In particular, we welcome the intention of the BBC to put “more rigour and evidence into the evaluation of public service broadcasting that has in the past tended to be almost wholly subjective.”

The value of the test will depend on two crucial issues, however. Firstly, how the test is applied and, secondly, who applies it. It will be important to ensure that the specific way in which the test is applied allows it to cope with the difficult issues at hand. Related to this question, is whether the test is applied by an external body or simply within the Corporation’s existing governance structure.

Ofcom is working with the BBC to share ideas and approaches to measuring both the value of PSB output and the market impact of BBC services. Chapter 6 of this report, meanwhile, considers the issue of BBC governance in more detail.

ITV1

2.69 In relation to ITV1, respondents to our consultation endorsed the idea that the channel’s strengths are in the areas of news and high quality UK originated content. In addition, while there was wide support for our conclusion that some of ITV1’s current PSB obligations are not sustainable

in the medium-term, some respondents questioned the extent to which ITV1 would actually scale back its provision of PSB content – arguing, for instance, that ITV1 would most likely continue to broadcast news, drama and other types of expensive programming. We agree that ITV1 will continue to show content in many of these genres, but that our underlying analysis of the decline of the analogue model remains valid – especially as regards programming with a high opportunity cost. As a result, regulatory quotas on ITV1 will be increasingly ineffective in those areas where high opportunity costs make programme obligations unsustainable.

2.70 There were more substantial differences amongst respondents on transitional issues. Some argued that most of ITV1's obligations should be removed immediately, in order to allow it to focus on its most important contributions to the UK PSB mix. Others suggested that changes could be phased in over time.

2.71 We turn to this issue, particularly as regards programmes for the Nations and Regions, in more detail in the next chapter, but our clear conclusion is that it is better for ITV1 to prepare for its new future role as soon as possible, rather than to be asked to preserve in full a range of commitments designed originally for a very different analogue world.

Channel 4

2.72 Respondents to our Phase 2 consultation agreed with us that Channel 4 is an important part of the PSB landscape, and should remain so up to switchover and beyond. There was general support for the idea that Channel 4 should be granted greater commercial freedom to pursue alliances and new ventures. However, at the same time, respondents tended to believe that greater commercial freedom should not allow Channel 4 to abandon or diminish its specific remit – particularly as a source of innovation, and the main provider of competition for quality with the BBC. We endorse this view.

2.73 But there were clear differences of opinion about the future commercial fortunes of the broadcaster. Channel 4 itself argued that a significant funding gap is imminent, and that this will need to be filled by a combination of self-help and public support – including regulatory change and direct public funding.

2.74 Some disagreed with the view that Channel 4 needs further assistance, suggesting that Channel 4 is in a strong financial condition; and that if financial problems were to arise, these could be resolved by self-help on the part of Channel 4 itself. For instance, respondents pointed out that Channel 4 had trebled its profits over the last financial year, that it continues to have significant potential for strong airtime sales, and that its strong brand will leave it well-placed to compete even in a fully-digital environment.

2.75 In addition, several respondents expressed concern about the possibility that Channel 4 might become a recipient of direct public funding. It was argued, for instance, that a mixed-funding model (whereby Channel 4 receives both public and advertising funding) could fundamentally alter the organisational culture and incentives of Channel 4, and could raise state aid concerns.

- 2.76 This debate has led us in this phase of the Review to carry out detailed modelling of Channel 4's funding projections; we report the results of our analysis, and our recommendations for the future of Channel 4, in Chapter 4 of this report.

Five

- 2.77 Our Phase 2 report noted that Five plays a modest but important role in contributing to PSB purposes, and that the channel's regulatory obligations are lower than those of the other public service broadcasters. Specifically, Five's contribution to PSB mainly takes the form of its commitment to original UK production and to news. We will expect the channel to invest more in original production in the run-up to switchover.
- 2.78 There was broad – but not complete – agreement to this approach in the responses to the Phase 2 consultation. Some respondents were of the view that the obligations on Five should be maintained for as long as possible. But some others felt that Five is well on the way to becoming a fully commercial broadcaster, and so all of its PSB obligations should be eliminated with immediate effect.
- 2.79 We do not believe we need to revise our view on the future role of Five in the broadcast landscape – Five should continue to make its modest but important contribution to PSB purposes, and should be primarily a market-orientated public service broadcaster. As noted earlier, this could test the extent to which the market can deliver a range of quality original UK programming. We note in this regard that Five – despite the lack of specific obligations to do so – has chosen to develop its programming in arts and documentary programmes. We welcome this development, which demonstrates that commercially-oriented broadcasters can and will voluntarily make contributions to the purposes of PSB.

Teletext

- 2.80 As part of the PSB Review, the Communications Act requires us to evaluate the performance and role of the 'public teletext provider', whose public service remit is defined by the Act as the provision of a range of high quality and diverse text material. The public teletext licence is currently held by Teletext Limited ('Teletext').
- 2.81 In the Phase 2 report, we set out our thinking and proposals on the role of the public teletext service in the transition to the digital age. Following our review of responses to the Phase 2 consultation, we have not revised our view about the future of Teletext.
- 2.82 Prior to switchover, we will ensure that Teletext is given greater flexibility to meet its public service obligations. This may mean fewer specific page requirements. After switchover, we will seek to ensure that the digital public teletext service will have the same capacity available as now.

Other commercial channels

- 2.83 As noted earlier in this chapter, some commercial digital channels carry programming which has many of the attributes of public service broadcasting. Our aim is to encourage the market to provide more of such content over time - especially high quality UK originated programming. Like

Five, other channels will have a key part to play in creating a competitive climate in which it makes sense for commercial channels to upgrade their UK content. Growth in digital take-up, providing channels with access to a bigger market, will help this development – as will the standards set by the BBC and the other public service broadcasters.

2.84 Ofcom's main roles here are to ensure there is a competitive marketplace, that regulation does not create barriers to growth, and that public funding does not have a significant chilling effect on commercial investment. As mentioned earlier in this chapter, Ofcom has put in place a number of mechanisms to ensure that the broadcasting market works as effectively as possible in the run-up to switchover and is currently conducting a programme of work to ensure effective competition in broadcasting markets.

2.85 In addition, there is a case for recognising and incentivising the contribution of commercial multichannel broadcasters to public purposes. We therefore propose over the coming months to consider ways in which some of the benefits of PSB status – such as appropriate prominence on electronic programme guides – could be conferred on existing multichannel services if they are considered to make a significant contribution to PSB purposes and characteristics.

2.86 A PSB threshold would need to be established, both for existing commercial channels and for new channels established by the current public service broadcasters. For example, in order to be considered a significant part of the PSB landscape, a channel might need to meet at least the following requirements:

- Demonstrate that its content makes a real contribution to the PSB purposes and characteristics set out earlier.
- Play a significant role in high-quality, original UK production. Therefore, channels predominantly reliant on archive content or acquired programming would not be considered to be public service broadcasters.
- A commitment to maintaining a contribution to PSB purposes and characteristics over a significant period of time.
- A willingness to be subject to closer regulatory oversight.
- Given that the majority of UK households do not at present have access to subscription television services, a PSB channel would need to be available on a free-to-view basis, and on all digital platforms.

2.87 Our work over the coming months will look in more detail at the criteria that could be used to define any such PSB threshold. We will also review the practicalities and legal basis² for granting some of the benefits of PSB status to commercial channels. If appropriate, we will consult on any proposals in this area.

² Primary legislation would be needed in order to designate a channel as a public service broadcaster, but some of the benefits of PSB status could be conferred through an order from the Secretary of State.

Summary: a new model for PSB

- 2.88 This chapter has summarised our proposals for laying the foundation for a new model of PSB – a plural system which will promote competition for quality from a wide group of institutions. The existing public service broadcasters will have important roles – the BBC and Channel 4 as not-for-profit institutions, ITV1 playing to its PSB strengths, and Five as a predominantly market-led PSB.
- 2.89 But it is a system designed to be flexible enough to change over time. There is scope for a greater contribution from other institutions: including the commercial multichannel sector, and – as we discuss in Chapter 5 – a Public Service Publisher for the digital and broadband world.
- 2.90 We now turn to specific conclusions concerning PSB in the Nations and Regions, the role of Channel 4, the PSP, and the overall system of governance, accountability and regulation of PSB in the UK³.

³ Many of the decisions described in this document will affect the regulatory environment for holders of digital replacement licences. A number of these licensees have requested Ofcom to undertake a review of the financial terms of their licences. Ofcom expects to complete these reviews by the end of June 2005. Ofcom expects to take into account the most up-to-date available information on the regulatory environment for the relevant licensees at the point when it determines the new financial terms. This is likely to include taking into account a number of matters discussed in this document.

Chapter 3

Reflecting and responding to life around the UK

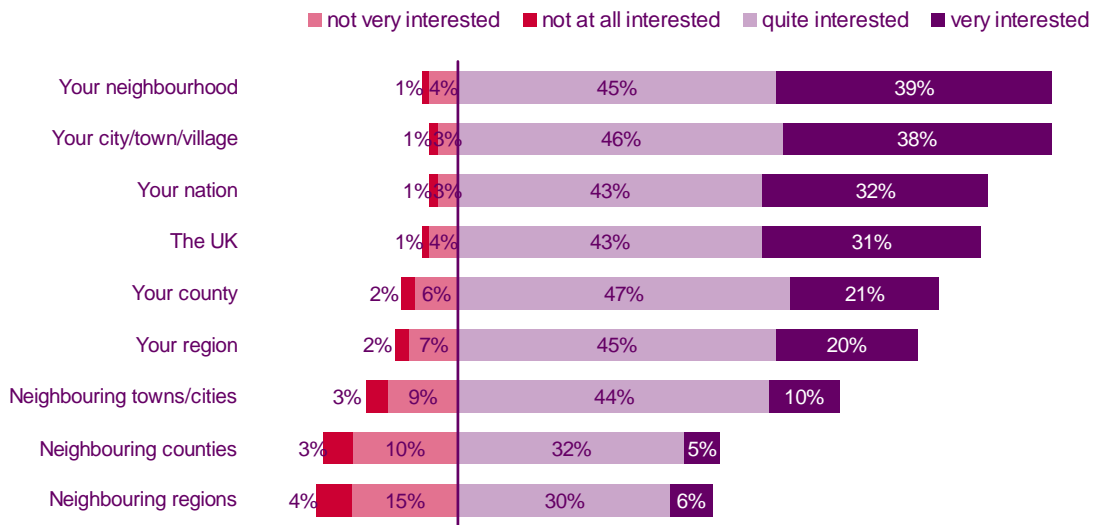
- 3.1 As we set out in our Phase 2 report, regional programming on commercial channels faces particular challenges. It is by far the ITV network's most expensive contribution to PSB. As switchover approaches, regional programming on the current scale will no longer be sustainable.
- 3.2 The time is right to establish a new model, one that preserves what is most important about the existing model of national and regional PSB, while adapting to the changing needs of citizens and consumers, and exploiting the opportunities for enhanced services created by new digital technologies.
- 3.3 Our starting point is the evidence, detailed in Phase 2 of this Review,⁴ that geographical communities and identities are still vitally important in the UK, despite growing social mobility and diversity. Our research – like other research before it – found that people have a mix of identities and attachments. Most people still live within a few miles of their place of birth. People tend to think of their 'region' as a relatively small area, defined in terms of their day-to-day lives and typically covering an area within 14 miles radius of their homes.⁵ As a result, many people's attachment is greatest to their own neighbourhood or to the settlement they live in (town, city or village).
- 3.4 Our research has confirmed that national identities are also strong. Devolution has created new political and social infrastructures in Scotland, Wales and Northern Ireland, and PSB must be flexible enough to adapt to the complex requirements of a devolved society.
- 3.5 We found that regional attachments, while present, are typically somewhat weaker than local and national identifications (Figure 3.1). Regional affiliations are strongest in the South West and North East of England.

⁴ Ofcom, *Reshaping television for the UK's nations, regions and localities*, 2004

⁵ The Future Foundation, *Redefining regions: exploring regional and local identity*, 2003

Figure 3.1: Importance of location

How interested are you in hearing about issues and what's going on in...?



Source: Ofcom/IPSOS UK – Phase 2 Research

- 3.6 Yet our research has found that people throughout the UK believe that regional broadcasting continues to have value. Regional news is the clear priority, in all the regions and Nations, although many viewers would like the news to be more locally relevant than at present. Non-news regional programming is less of a priority; viewers are aware of its limitations, although some programmes have strong and loyal audiences and achieve respectable audience shares.
- 3.7 Viewers also want to see their nation or region reflected on network television, and for television to serve as a window on the geographical diversity of the UK. In the devolved Nations, both programming for the Nations and UK-wide network representation serve social purposes as well as providing information and entertainment – viewers say such programmes show their nation is being taken seriously.
- 3.8 The following section describes our long-term framework for national, regional and local broadcasting, before we turn to the transitional arrangements that will take us from the current model to this new environment.

The long-term model

- 3.9 We believe that our proposed approach to local, regional and national broadcasting responds to the changing needs of the diverse communities of the UK. We believe it will deliver more value to audiences than the current mix of regional programming and network production. But we also believe that it will be financially viable, through to digital switchover and beyond. It has seven core elements:

- an increasingly important role for the BBC in the provision of news and a range of other programming for both the Nations and the English Regions;
- a role for ITV1 focused on regional news and high-quality original production for the main network from the Nations and Regions;
- increased levels of production outside London, for both the ITV network and the BBC;
- improved dispersal of out-of-London production, including to the Nations;
- establishing the scope for imaginative new forms of local television news, information and entertainment, delivered via digital television and broadband;
- delivery of indigenous language services through dedicated services; and
- a potential role for the PSP in providing local, regional and national content.

3.10 The remainder of this section covers our strategy in each of these areas, with the exception of the role of the PSP, which is discussed later.

An enhanced role for the BBC

3.11 Historically, ITV1 was the main provider of regional television in the UK, thanks to its origins as a federal system of regionally-based licensees. In recent years the BBC has increased its provision, particularly in the Nations, while ITV1's has fallen back. Nonetheless, even in 2003, ITV1 broadcast more hours of regional programming than the BBC.

3.12 In the future, our analysis suggests that this will no longer be the case. The BBC will need to take the lead.

3.13 Our starting point for a new regional settlement, therefore, is an enhanced role for the BBC. The Corporation recognises this in its *Building Public Value* document, and has set out some ambitious plans. Its key proposals are:

- strengthened core services in Scotland, Wales and Northern Ireland, including continued commitment to the UK's indigenous languages and coverage of devolved institutions;
- 'ultra-local' television news services for 50-60 cities and counties across the UK, initially delivered by broadband, and potentially later on digital television;
- creation of more opportunities for citizen participation and involvement in local communities.

3.14 The BBC has, however, so far stopped short of proposals to increase its non-news TV output for the English Regions. The BBC should not offer a direct replacement of programming no longer available on ITV1. Nonetheless, Ofcom considers that, following the completion of Charter

Review, the BBC should be asked to develop new proposals of its own, which go beyond the use of local new media, and help provide more well-funded television programming for the English Regions in addition to its ongoing activity in the Nations.

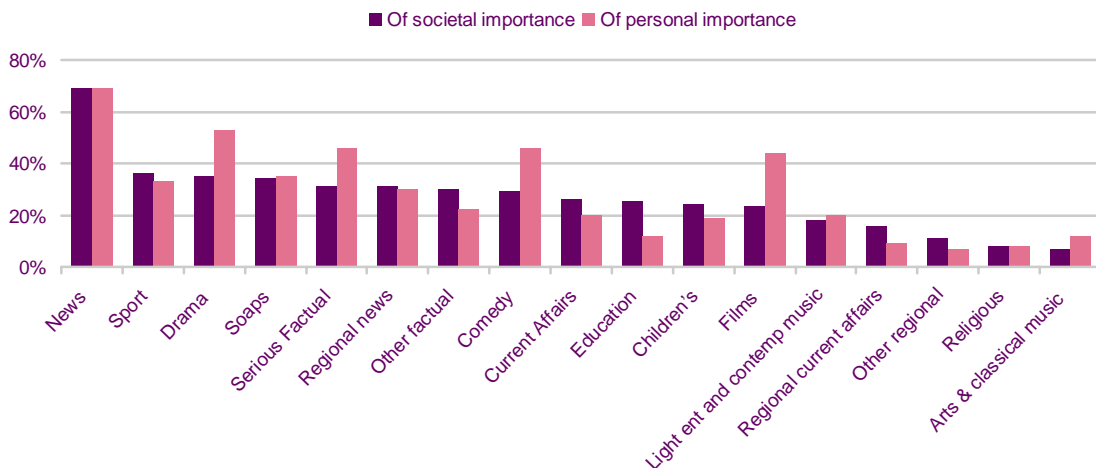
- 3.15 For example, initiatives such as the ten-minute regional inserts in *British Isles: A Natural History* represent new ways of reflecting regional diversity without requiring the wholesale dedication of regular slots to regional programmes. Similarly, occasional event programmes responding to particular regional or local developments on an ad hoc basis can achieve impact without imposing excessive cost or disruption to the schedule.

A sustainable role for ITV1

- 3.16 Chapter 2 summarises our analysis that demonstrates that PSB at current levels will not be sustainable as digital switchover approaches. Against this background, we believe ITV1 should focus on viewers' priorities – provision of plurality in the delivery of regional news and regional production for the network – thereby continuing to make a major contribution to PSB, while reducing costs in those areas that are less valued by viewers, including regional non-news. As Figure 3.2 shows, regional news is often seen as more important than any other kind of regional programming.

Figure 3.2: Personal and social importance of a range of TV genres (regional genres highlighted)

Which are the top five types of programmes whose presence on the main terrestrial TV channels you consider to be valuable to you personally/important for the good of society as a whole?



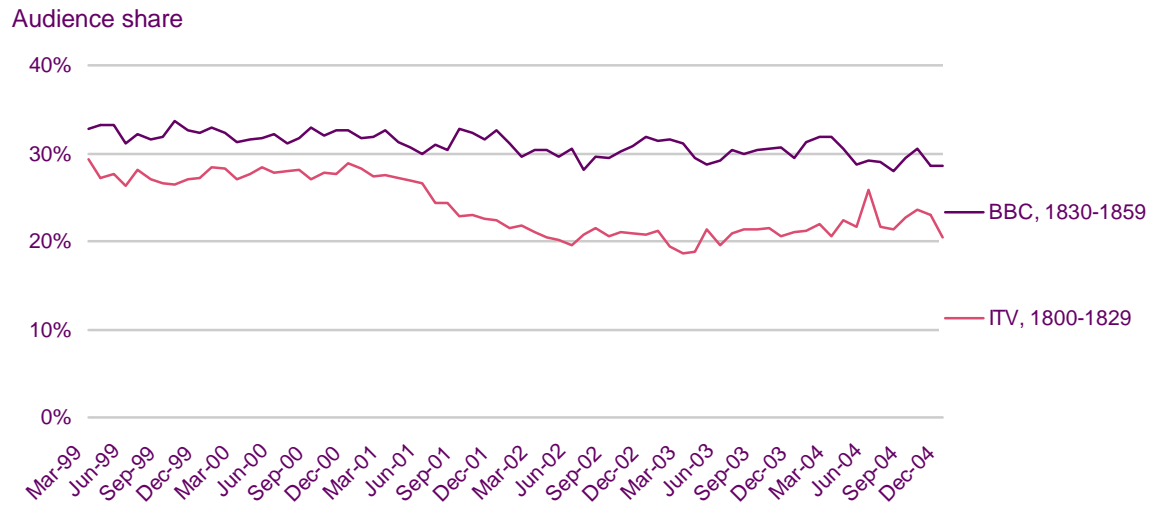
Source: Ofcom/IPSOS UK – Phase 1 Research

Regional news

- 3.17 Viewers tell us that provision of regional news and current affairs by the BBC alone is not enough – audiences value the alternative perspectives and plurality of voice offered by the commercial licensees. This message has

come through consistently in all the research we have carried out, in both the English Regions and most recently in the Nations, and it is reflected in viewing figures. Although audiences for ITV1’s flagship early evening regional news bulletin fell in the 1990s and early 2000s, it continued to attract around 20% share across the country as a whole, and considerably higher in some regions. More recently audiences have started to pick up, partly due to stronger inheritance from preceding programmes, and, by the end of 2004, audience share for ITV1’s flagship regional bulletin across the UK was two points higher than in the same period in 2003 (Figure 3.3).

Figure 3.3: Audience share for BBC ONE and ITV1 regional news, 1999-2004



Source: BARB

3.18 Regional news is included in all of the Channel 3 licences. Current affairs is also included as an obligation in these licences. The most significant and most valued aspect of ITV regional licensees’ output is, therefore, a specified licence condition. We will continue to monitor a range of measures (including audience opinion and investment) to ensure that the service to viewers provided by ITV1’s regional news is maintained and where possible enhanced.

Regional and national production for the networks

3.19 Most network production still comes from companies and organisations based in London, although all five main channels have some level of out-of-London production quota. In 2003, 33% of network originations across the five main channels combined came from outside the M25, accounting for 37% of total spending.

3.20 Viewers tell us that they value representation of their region on network TV, a finding confirmed by our most recent research in the Nations (although audiences in the Nations are also concerned about misrepresentation, and some feel that their local accent or culture is often portrayed in an atypical or awkward way on network TV).

- 3.21 As an immediate step, we will increase ITV1's quota for network production outside London to 50% of total originated hours and 50% of spend, from 2005. This represents a significant increase in spend outside London over 2004. ITV plc expects only 47% of its spend to be outside London in 2004, with the result that we estimate it will need to move £17 million of production out of London in 2005 to meet the new target.
- 3.22 In addition, we have been consulting with the broadcasters to introduce new, more inclusive definitions of production to which the out-of-London quota applies. These new definitions will take effect from 1 January 2006. Using these definitions, ITV expects only 43% of its spend to be outside London in 2004. We therefore estimate that these new definitions will result in more than £40 million of production moving outside London in 2006 in order for ITV1 to meet its new quota.
- 3.23 The BBC also has an important role to play in reflecting the Nations and Regions of the UK on its networks. In the early 1990s, the BBC set itself a target to increase the proportion of network programming made outside London from a fifth to broadly a third. In 2003, 31% of its produced hours were made outside London, accounting for 33% of its network production spend. The Governors' Review of Services for 2003-04 stated their particular concern that not enough material from the BBC Nations is shown on network television.⁶
- 3.24 We propose to consult with the BBC about increasing its out-of-London production quota, as part of the follow-up to Charter Review. We believe it is reasonable to expect the BBC over time to achieve a similar position to ITV1 – 50% of network production made outside London, measured by both volume and spend, across BBC One, BBC Two and its digital services.
- 3.25 We expect that the changes announced by the BBC in December 2004, which proposed a significant move of production and commissioning responsibility to Manchester, would represent a significant contribution towards this increase. However, further steps may be worth considering, in particular increasing the BBC's representation of the Nations and Regions in its network drama, entertainment and factual output. The BBC might also be able to complete the Manchester relocation programme faster than currently envisaged to help meet this proposed target.

The dispersal of network production

- 3.26 In addition to seeking increases in ITV1's and the BBC's network spend outside London, we believe there is a need to improve the spread of production around the UK. In 2003, almost 70% of ITV1's out-of-London network spend was in the north of England; nearly a quarter of it was accounted for by Coronation Street and Emmerdale alone. The level of ITV1 network production in the devolved Nations has declined every year since 2000. By 2003, just 2% of total network programme spend went to the three Nations combined, and almost all of that was in Scotland.

⁶ BBC, *Annual Report and Accounts 2003/2004*, 2004

3.27 We seek improvements in the dispersal of production of ITV1 network programmes around the UK over the next few years, and will work with ITV plc to achieve this. We suggest that the first priority is to return network production in the Nations to the levels of the late 1990s, when we estimate that on average the three Nations combined accounted for around 8% of total ITV1 network spend and hours of output; the network should seek to include programming from all three Nations in this total. We will review progress in 2007, including the option of introducing quotas thereafter if ITV plc's own initiatives (such as the production partnership fund proposed below) do not secure improvement towards this target.

A new production partnership fund

3.28 ITV1 is therefore now required both to increase its out-of-London production for the network, and achieve a wider dispersal of that production.

3.29 As a means of supporting the objective of delivering these new requirements, ITV plc proposes to introduce a ring-fenced fund, available to producers outside London but excluding established ITV plc network production centres. This will help producers meet increased demand from the network, and assist in meeting the transitional challenges created by the changes in regional programming obligations.

3.30 The fund could be used to:

- commission programmes from new-to-network regional producers;
- make available one-off seed funding for independent producers to further develop a promising programme idea (for example to carry out research, find new talent or produce a non-broadcast pilot);
- provide longer term investment in independent production companies, for example, by funding a development researcher or providing financing to allow selected producers to develop new ideas in a particular genre or for a particular strand; and
- create mentoring opportunities and secondments, for example financing an experienced executive producer to oversee a project.

3.31 ITV has proposed a fund of £9 million, to be drawn down over the next three years only. ITV expects the majority of applications to the fund to come from the regional independent sector. The fund could also be accessed by producers within ITV plc, but, as noted, this provision would explicitly exclude the company's established network production centres.

3.32 ITV would operate the fund with full transparency for Ofcom, in order to ensure that the fund is spent appropriately and that in-house producers are not favoured over independents.

Local TV and new media

3.33 Our audience research in Phase 2 suggested that television coverage of news and issues within the viewers' locality was highly valued, and not provided with a sufficient local focus by existing regional services.

- 3.34 Digital switchover creates new possibilities for the development of local TV delivered to a high transmission standard. It will make spectrum available that is interleaved with the digital multiplexes, as well as up to 112MHz of cleared spectrum.
- 3.35 Ofcom has made clear that in relation to the cleared spectrum it does not expect to bring forward any proposals until after the Regional Radio Conference in 2006. In relation to the interleaved spectrum, Ofcom has ruled out its use for a seventh nationwide multiplex⁷ since it would have achieved limited coverage and affected coverage of other multiplexes. The interleaved spectrum may however be usable for a range of other services, including local television, and programme making and special events. The growth of broadband networks also offers new opportunities for the development of high quality local content delivered over the internet.
- 3.36 Ofcom considers in the light of our audience research, and the Phase 2 consultation, that further work should be done on the potential for developing local digital television services. Many respondents to the Phase 2 consultation stressed the importance of local TV to the future PSB landscape (see Box 3.4). Several suggested that the PSP should have a role in financing and delivering more local, community-based services. Others argued that local TV services providing a wide range of news, information and entertainment would be viable on a commercial basis after switchover.

Box 3.4: Possible models for digital local TV

In the Phase 2 consultation, there was general support for our view that the prospect of innovative local services, delivered via digital TV and broadband, represents a new and potentially more attractive way of meeting viewers' needs for news and information about their local area than current regional provision. Different respondents proposed a range of different models for the future, although all of them stressed the importance of exploiting the interactive capabilities of broadband services alongside, or even instead of, digital TV channels.

Some proposals were commercially-focused: for example, City Broadcasting's proposal for a network of (initially) 12 city services, providing a mix of dedicated local news and information (provided on a commercial basis) and high-quality networked PSB content (possibly funded by the PSP, or by co-production); and the Institute of Local TV's proposal for a 'Scottish and Local Broadcaster' for Scotland, providing a mix of all-Scotland and more local programming, initially broadcasting in the airtime currently used by ITV1 for regional programmes, as a precursor to the development of dedicated digital local services.

Others were geared towards public and community provision: for example, Mersey Television is working with Liverpool City Council and the North West Development Agency to assess the feasibility of integrated digital television and broadband services for Liverpool and the wider north-west. These services would be available for use by all public sector stakeholders and would provide guaranteed, open and unfiltered access to broadcast and other platforms to a wider range of public service providers than can be accommodated by existing public service television. Several respondents stressed the value of this kind of provision in contributing to community regeneration and active citizenship, as well as the more traditional purposes and characteristics of PSB.

⁷ Ofcom statement: Digital Replacement Licences offered to Channels 3, 4, 5 and Public Teletext, November 2004

- 3.37 Both commercial and community models should be considered for future development. In addition, the potential for a mixed model that provides a mix of both commercially- and publicly-funded programming in a single service also deserves further exploration. The PSP could have a role in this kind of model, as described in Chapter 5 of this report.
- 3.38 As part of the follow-up to the PSB Review, Ofcom will carry out further research and analysis regarding the future prospects for local TV, including:
- evaluation of alternative uses for interleaved spectrum, and proposals regarding its possible use for local TV, taking into account the general policies on spectrum management set out in Ofcom's *Spectrum Framework Review*;
 - analysis of the commercial prospects for local TV services post-switchover, the likely development of community not-for-profit services, and the inter-relationships between commercial models, community services and the BBC's plans;
 - research into audience requirements of more local services, including content priorities, funding models and ownership issues;
 - work with Government to prepare an appropriate licensing regime that facilitates the development of viable commercial services and identifies the appropriate relationships between commercial and community services; and
 - further assessment of the possible role of the PSP in the provision of local services.
- 3.39 We will carry out this research over the next six months, to form the basis for further consultation in this area, and will work with Government to ensure common, collaborative policy on any future local TV licensing regime. In addition, we will seek to inform Charter Review with an analysis of the likely impact of the BBC's plans on the local commercial TV market, to complement the BBC's own public value test of these proposals.

Indigenous language services

- 3.40 In our Phase 2 report, we indicated our commitment to securing a sustainable future for Welsh and Gaelic services, and to assessing arrangements for broadcasting in the Irish language and Ulster Scots. We remain of the view that broadcasting in indigenous languages is an essential element of the UK PSB mix.
- 3.41 In our view, the future lies in enhanced provision on dedicated channels, exploiting the vastly expanded opportunities created by digital switchover, rather than limited provision through opt-outs on the main networks, which will become increasingly unsustainable. We believe that all relevant parties should begin planning now for the delivery of indigenous language broadcasting through dedicated channels, as opposed to on ITV1, to allow for any necessary legislative changes to be made.
- 3.42 We set out proposals for making progress towards this long-term goal in the consultation paper that concludes this report. The main options that we believe deserve further consideration are:

- In Wales, the creation of greater transparency in the relationship between the BBC and S4C and clearer commitments by the BBC, with consideration given in the longer term to the use of the PSP model for the provision of Welsh language services.
- In Scotland, the potential for a dedicated Gaelic service for Gaelic speakers, initially delivered by digital satellite, providing more content, and a richer range, than is currently provided on mainstream channels.
- In Northern Ireland, the extension of existing television services in Irish (TG4) for people with knowledge of the Irish language. Further consideration needs to be given by the relevant authorities to how an Irish language service can be delivered in the digital era. PSB providers also need to consider how the requirements of the Ulster Scots community might most appropriately be met.

Managing the transition to the new model

Our proposed approach in the transition period

- 3.43 The transition from the current framework of regional and national broadcasting to our new model requires careful management. In our view, there are three possible approaches to this, all of which were supported by different respondents to the Phase 2 consultation.
- 3.44 The first approach would be to move immediately to remove all PSB requirements from commercial operators, and to focus our energies and public funding on creating a completely new approach. We reject this approach – it allows no period of adjustment for audiences, broadcasters and producers, and it ignores the fact that a certain amount of PSB should continue to be viable for ITV1 well after switchover, albeit different from its current commitments.
- 3.45 The second option is the opposite: to hold onto commercial operators' existing PSB requirements for as long as possible, only giving ground at the last possible moment. We reject this approach too. We have an opportunity to reshape commercial PSB now, before the pressures become too great and constrain the options available to us. If we do not start to put in place a new model now, we may find that we have missed the chance.
- 3.46 Our preferred approach is therefore carefully to plan and manage the transition period, so that we maximise the use of available resources to help create a model that meets viewers' needs now and in the digital age.
- 3.47 With respect to regional programming, we have developed a two-phase approach, with one set of proposals taking immediate effect, and a further set at the start of digital switchover. We believe this is preferable to a more gradual, year-by-year transition, which would unnecessarily draw out the period of change, with its inevitable transitional challenges. While we have linked the further change to the timing of switchover, it is important to note that the need for change arises from the inexorable decline of the historic analogue system as a result of the rising penetration of digital television. These pressures would arise even in the absence of digital switchover.

The distinct needs of the devolved Nations

- 3.48 We believe that the needs of the devolved Nations of the UK are distinct from those of the English Regions, for several reasons. First, it is vital that broadcasting in the UK reflects the reality of our devolved social, cultural and political institutions. This partly relates to the continued need for dedicated regional news services delivered by a plurality of providers, to ensure local populations are well informed about news and current affairs in their nation. But it also affects audiences' requirements in other areas of programming. The distinct cultures, histories and interests of Scotland, Wales and Northern Ireland are unable to be fully reflected in UK-wide programming alone. They require a continued level of dedicated programming to ensure local audiences have adequate access to TV that reflects their own identities.
- 3.49 Secondly, and related to this, the TV regions in the Nations more closely map onto real cultural identities than the English Regions, which are largely driven by the practicalities of the 1950s television transmission map. Of course, there is huge diversity within each Nation, and some English Regions are less fragmented than others. But taken overall, our research has shown that these national identities are stronger than affiliations to the ITV regions in England.
- 3.50 Finally, audience research in this area provides a rich, if at times mixed, picture of opinions about programming. Within England, there is a broad south–north split in terms of affinity and interest with regional programming, partly driven by the transmission footprints outlined above. But taken as a whole, our and others' research indicates that viewers in the devolved Nations show greater interest in dedicated provision than those in England (see Box 3.5).

Box 3.5: The view in the Nations

Our latest audience research consisted of both qualitative and quantitative research in Scotland, Wales and Northern Ireland, to explore audiences' views on current provision for their nation and their priorities for the future. A full report of the findings of this research will be published on Ofcom's website in February 2005.

Results from both pieces of research show that viewers in Scotland, Wales and Northern Ireland hold many common views about the role and purpose of programming for their Nations, although there are some differences.⁸

Some of the key findings from this research are as follows:

- Viewers in the devolved Nations feel strongly about the need for television to reflect their particular national identities.
- Regional news is consistently, and overwhelmingly, seen as the most important element of dedicated programming for each nation.
- Viewers are concerned about the dominance of the major political and economic centres in regional news coverage and support more localised services.

⁸ There are of course also some differences in response due to the very different methodologies – one which provided viewers with in-depth information, and one which registered 'top-of-mind' responses. Nonetheless, findings are largely comparable.

- In other genres, viewers prioritise social affairs journalism – either as documentaries or current affairs programming. They find it useful as well as entertaining. In Scotland and in Northern Ireland viewers also value comedy, seeing their sense of humour as a key definer of national and local identity.
- Plural supply of news and current affairs programmes was seen to be vital in the qualitative research, to ensure competition between the broadcasters and to allow different views to be aired. Our survey also showed strong support for plural supply more generally, although this was less evident in the workshop discussions.
- Language provision is particularly important in Wales, but felt to be well covered by S4C. In Northern Ireland, younger viewers are more likely to see Irish language programming as important than other age groups. In Scotland, our survey showed strong levels of interest in Gaelic programming from Gaelic speakers, although it ranked low with non-speakers.
- Viewers value regular and largely peak-time scheduling for regional programmes, although some in the workshops were concerned that this might entail losing convenient access to network programmes.
- The majority prefer fewer, higher-quality programmes, which can compete with network offerings, to a greater volume of lower-budget output.
- A considerable majority of viewers in our quantitative survey think representation of their nation on network TV is ultimately more important than nation-specific provision.
- Participants in our workshops agreed that such UK-wide representation is vital, but they were concerned about misrepresentation or stereotyping in network portrayal, and stressed that network representation should be an addition to, not a substitute for, dedicated provision.

3.51 Our detailed proposals for the Nations are contained in the consultation paper annexed to this report. They are driven by four concerns:

- Audiences in the Nations have distinct needs that may be at risk if quotas on ITV1 are reduced in line with our proposals for the English Regions.
- Any increased differential between the Nations and the English Regions would impose significant additional costs and scheduling challenges on national licensees. These could be taken into account in the forthcoming review of financial terms for relevant licensees, and the review of ITV Networking Arrangements.
- Effective scheduling requires a certain amount of coordination, both between licensees and within the regulatory framework, and therefore each nation should have roughly similar requirements.
- Indigenous language broadcasting is best delivered via dedicated channels in each nation, and we and others should start to work towards this goal immediately.

3.52 Balancing these concerns, we propose to require each of the national licensees to broadcast at least four hours per week of non-news regional programming, until the first UK region switches over to digital.⁹ Some of the Scottish licensees' content would be shared between them, meeting the Scottish audience's interest in an all-Scotland service for the first time on ITV1.

⁹ At present the requirements for non-news regional programming are: 4 hours 4 minutes per week for Scottish TV; 1 hour 30 minutes for Grampian TV; 4 hours 30 minutes for ITV Wales; and 3 hours plus 1 hour 30 minutes of non-specified genre for UTV (this flexibility is retained in our proposals for UTV)

- 3.53 When the first UK region achieves digital switchover, we propose to reduce the national licensees' minimum requirement for non-news programming to three hours per week. These requirements would be taken into account in the forthcoming licence valuation process.
- 3.54 In addition, we plan to review the ITV Networking Arrangements to exempt the national licensees from paying for network programmes that they do not show in order to meet their regional quotas. We also propose to require the ITV Network Centre to take into account the higher level of opt-out in the three Nations when devising its network schedule.
- 3.55 The options and proposals for the Nations are set out in more detail in this report, at Annex A. They require a further period of consultation before they are finalised. The consultation will begin immediately, and last for a period of ten weeks. Annex A also sets out how to respond to this consultation.

Non-news programming in the English Regions

- 3.56 Our Phase 2 research found that non-news regional programming was not a high priority for viewers, who are aware of the funding constraints and challenging scheduling that characterises much regional output. They tend to prefer fewer, higher budget programmes and stress the importance of visibility of these programmes in the schedule. Regional programming in the English Regions imposes substantial costs on ITV plc, simply because of the need to make many programmes to fill a single half-hour slot.
- 3.57 In our Phase 2 report we therefore proposed reducing ITV1's regional non-news programming obligation from three hours a week to 1.5 hours in 2005, with all of the reductions occurring in off-peak hours.
- 3.58 There were many representations from those opposed to making the change now. We gave these representations careful consideration and examined the full range of arguments that was advanced. On the balance of evidence, we decided to move now, for three reasons.
- 3.59 First, we heard no arguments that were sufficiently strong to alter our view that overall, audiences in the English Regions attach lower priority to non-news regional programming than other elements of PSB.
- 3.60 Secondly, many objections were based on the argument that regional programming would be more highly valued if ITV put greater budgets, more attractive slots, and increased promotion behind it. This may or may not be true. But it is not within Ofcom's power to require this change in the licensees' strategy. And we should bear in mind that if regional programming could reach greater audiences as a result, and therefore become more commercially viable – as many respondents argued – there would be nothing to stop ITV plc from investing more in regional programming of its own accord for commercial reasons.
- 3.61 Finally, there was little challenge to our fundamental conclusion: that non-news regional programming will become increasingly unsustainable as digital switchover approaches. Given this reality, we continue to believe that the priority is to move to a more realistic and sustainable approach now. That will help us ensure that those elements of ITV1's regional service that

are most valued can be retained and enhanced: that is, regional news and current affairs and strong representation of the Nations and Regions in high-quality original network programming.

- 3.62 We will, therefore, implement our proposals for off-peak non-news regional programming in the English Regions immediately. The new level of 1.5 hours per week of non-news regional programming, including 45 minutes in peak and a further half an hour near peak, will remain until the first UK region achieves digital switchover – on current plans, 2008 at the earliest.
- 3.63 Our analysis suggests, however, that even this level of programming will not be sustainable as switchover approaches. When the first UK region switches over, therefore, we propose to reduce the requirement for non-news programming to 0.5 hours per week. The 0.5 hours would include parliamentary coverage and current affairs. We believe that this two-stage approach maximises benefits to viewers in the transition period, while ensuring that other, more highly valued elements of ITV1's PSB contribution can be retained for a longer period. This is a new proposal, and is therefore included in the consultation paper at Annex A.
- 3.64 Many respondents to our consultation stressed the transitional challenge posed by the decline in commercial regional programming for the regional production community. We recognise this concern, and the potential threat it poses to our long-term goal of increased production for the networks from across the UK.
- 3.65 We believe that increased out-of-London production quotas for ITV1 and steps to improve the dispersal of production around the UK more than offset this risk.
- 3.66 Furthermore, the effects of these measures will be long-lasting and deep-rooted – not just a limited number of one-off commissions, but a significant boost to the development of a sustainable infrastructure that will enable both ITV1 and the BBC to commission high-quality, network productions from a wider range of production centres for years to come.

Chapter 4

The role of Channel 4

- 4.1 This chapter examines the outlook and options for Channel 4's ongoing contribution to the UK PSB landscape for the remainder of this decade and beyond. Our Phase 2 report and the Communications Act 2003 both anticipate a major role for Channel 4 as a broadcaster contributing to the continued success of the PSB system. The Communications Act clearly reaffirms Channel 4's PSB status and identifies its PSB remit as "the provision of a broad range of high quality and diverse programming" with a particular focus on:
- innovation and creativity in the form and content of programmes;
 - culturally diverse programming;
 - programming of educational nature and value; and
 - distinctive programming.
- 4.2 In our Phase 2 report, we further concluded that the Channel 4 Group should retain its current organisational status as a commercially funded, primarily not-for-profit institution in public ownership, with a sharp focus on its public purposes. In this context, Ofcom welcomes the renewed focus of Channel 4 on its core PSB remit.
- 4.3 We recognised, however, that moving into the digital age, Channel 4 is likely to face pressure on its ability to fund the same range of high-quality PSB programming. We encouraged Channel 4 in the years ahead to pursue further operational efficiencies and market based initiatives – alliances, joint ventures and partnerships with other organisations, new digital free-to-air channels – but we noted that those measures might not prove sufficient to protect the quality and range of Channel 4's PSB programming in the longer term.
- 4.4 The publication of the Phase 2 report generated considerable debate, much of it in the public domain, on the future role of Channel 4 as a public service broadcaster, as well as on its potential relationship to the Public Service Publisher.
- 4.5 Channel 4 itself announced an expected funding deficit that could approach £100m per annum by 2009¹⁰, and combined a commitment to self-help with a request for regulatory and financial support in order to protect its PSB remit. The forms of support requested by Channel 4 include indirect forms of regulatory support, public support for Channel 4's one-off digital switchover-related costs, and public funding to help Channel 4 bridge any remaining funding gap.

¹⁰ The expected deficit consists of anticipated losses and foregone operating profit, targeted at c. £30m.

4.6 This debate has led us in this phase of the Review to address two key questions:

- What action, if any, could be taken now in order to ensure Channel 4's ability to meet its PSB remit for the next three to five years?
- What longer term future do we see for Channel 4?

4.7 We provide some context for considering these questions by first reviewing Channel 4's current position and recent performance.

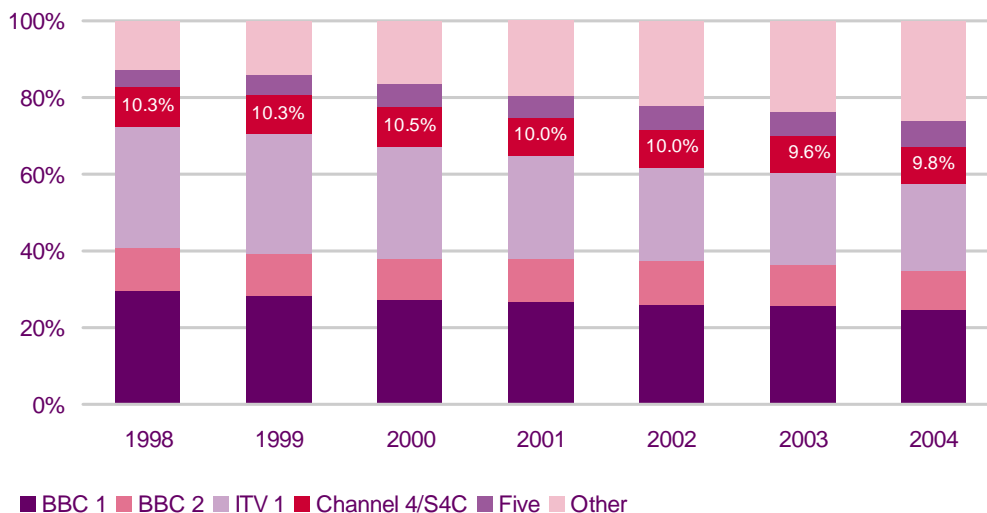
Channel 4's recent performance

4.8 As many respondents noted, the Channel 4 Group¹¹ is currently enjoying a good financial year, underpinned by an on-screen performance which has exceeded most industry expectations. This performance has been achieved during a time of significant internal change and despite continued pressure from increasing digital penetration.

On-screen performance

4.9 In terms of audience figures, the main Channel 4 channel has withstood the challenges of increased competition better than most other terrestrial channels since the launch of digital services in 1998 (with the exception of Five, which has benefited from increased reach in digital homes). The channel's overall share has held steady at close to 10%. Indeed, BARB figures show its overall audience share increased (although very slightly) from 9.6% in 2003 to 9.8% in 2004.

Figure 4.1: Channel audience share 1998-2004

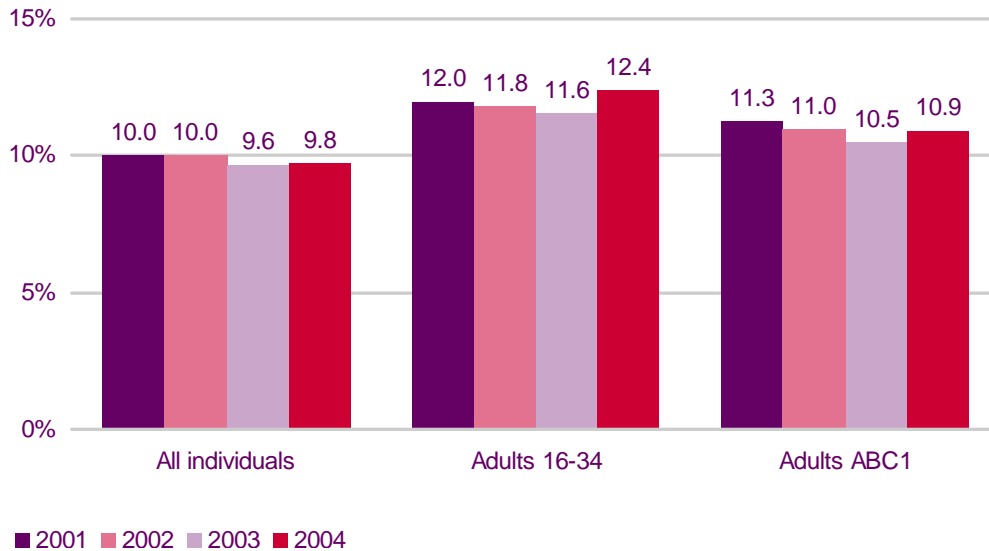


Source: BARB, all individuals

¹¹ At present, Channel 4 Group comprises Channel 4's main channel business and 4 Ventures, the holding company for all of Channel 4's other commercial ventures.

4.10 Among primary target groups, Channel 4 also continues to perform well. Its share of viewing amongst 16-34 year olds grew from 11.6% in 2003 to 12.4% in 2004, while that amongst ABC1 adults grew from 10.5% in 2003 to 10.9% the same period.

Figure 4.2: Channel 4/S4C audience share 2001-04

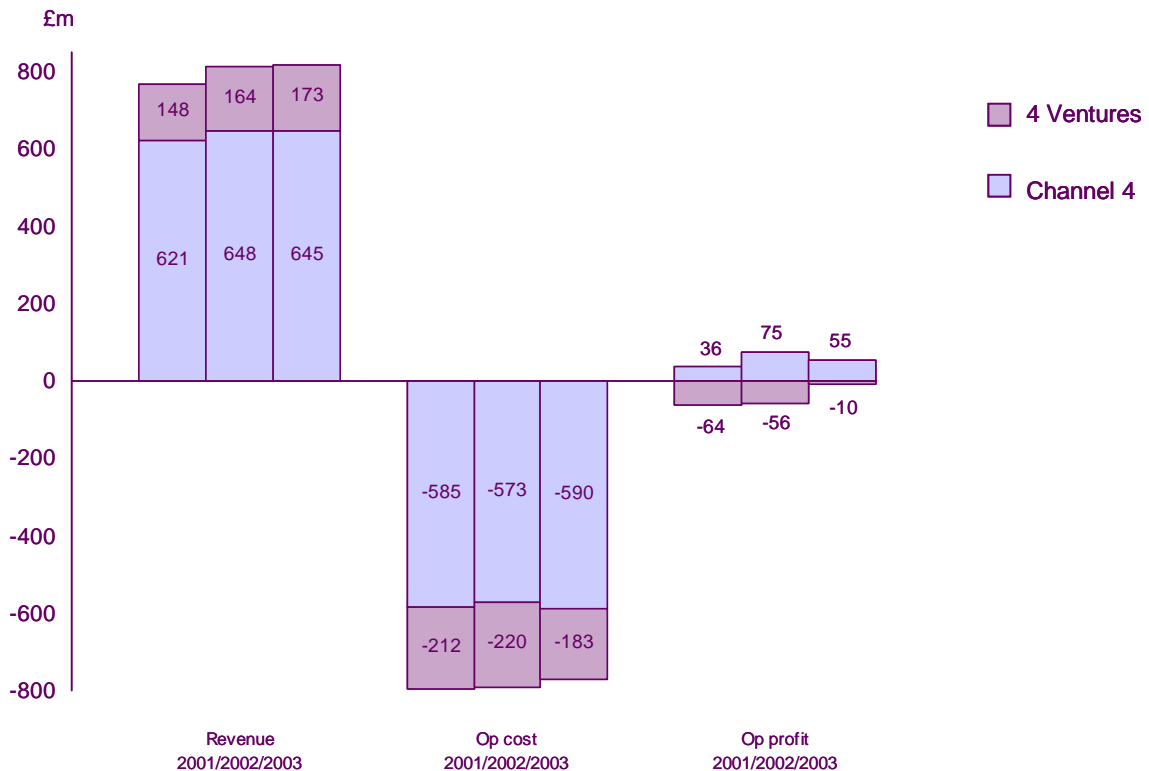


4.11 These on-screen results are the fruit of a successful programme strategy which has balanced the twin demands of the channel's PSB obligations with its commercial imperatives. In their response to our Phase 2 consultation, Channel 4 provided further evidence in support of its contention that its PSB delivery continues to increase rather than decrease.

Financial performance

4.12 At the start of the decade, Channel 4 was affected by the industry-wide advertising recession at the same time as its investments in new ventures were at peak levels. Since then, Channel 4's fortunes have improved substantially. At the Group level, operating losses of £28m in 2001 have been reversed and, in 2003, the Group achieved profits of £45m. This performance is a result of improvements both in the core channel and also at 4 Ventures.

4.13 Revenues for the Channel 4 main channel were £645m in 2003 compared to £621m in 2001. Combined with a programme of internal cost control, this meant that the channel returned a profit of £55m in 2003 and its operating margin improved from 6% in 2001 to 9% in 2003.

Figure 4.3: Channel 4 Group financial results 2001-2003

Source: Channel 4 annual reports

4.14 Following consolidation into a single company in 2001, 4 Ventures also achieved an improved financial performance as cash investment requirements eased and some of the more substantial ventures approached break-even. From 2001 to 2003, total revenues were up from £148m to £173m while at the same time costs were down from £212m to £183m. As a result, operating losses for 4 Ventures have been cut substantially to £10m in 2003.

4.15 These improvements in 4 Ventures are significant not just for the Group's overall financial performance, but also for the continued delivery of Channel 4's PSB remit. In future, positive operating results from the entities making up 4 Ventures are expected to make an increasingly important financial contribution to the Group as pressures on the core PSB channel mount. Channel 4's business model, however, is not without its challenges, which we discuss below.

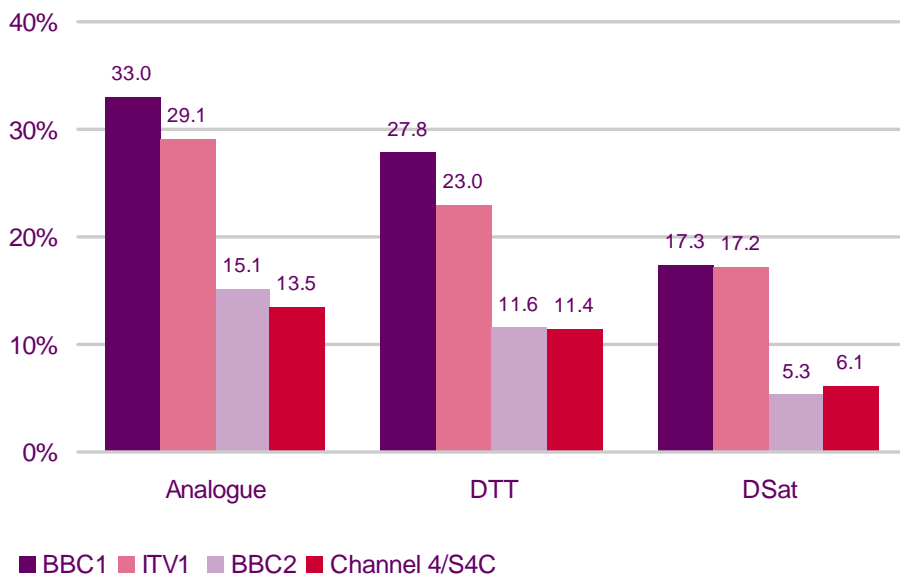
The challenges facing the Channel 4 Group

4.16 The improvements in Channel 4's position in recent years have helped establish a strong financial position, in the short-term at least. Channel 4 continues to benefit from a loyal, youthful and upmarket audience combined with one of the most powerful brands in the media sector. This section discusses the likely challenges facing Channel 4 in the run up to switchover and beyond. We discuss possible responses to these challenges later in this chapter.

Audience fragmentation

4.17 The biggest challenge facing Channel 4 results from the increasing penetration of digital platforms as digital switchover approaches, and the consequent fragmentation of audiences. While Channel 4 commands 13.5% of all viewing in analogue-only homes, its share is only 6.1% in digital satellite homes. The channel’s share in DTT homes, though still lower than in analogue-only homes, has been much less affected and stood at 11.4% in 2004¹². The lower viewing share in digital homes means that, other things being equal, Channel 4’s overall share of viewing is likely to be eroded as the penetration of digital platforms increases.

Figure 4.4: Audience shares in analogue and multichannel homes, 2004



Source: BARB, all individuals

Advertising revenues

4.18 As digital penetration increases, terrestrial commercial channels can expect their share of commercial impacts to be eroded as a result of audience fragmentation. This, in turn, may erode the advertising premium they are able to charge and, hence, their share of TV net advertising revenues (NAR). As around 90% of Channel 4’s core channel revenues come from advertising, any reduction in its share of NAR, other things being equal, will put pressure on operating margins and will constrain Channel 4’s ability to continue increasing on-screen investment in programming. Persistent relative underspend on programming could in turn further exacerbate difficulties in attracting audiences and thus risk a vicious circle of eroding viewing shares, commercial impacts and hence PSB programming quality and quantity.

4.19 Structural, economic and technological changes to the TV advertising market leading to a lower growth of TV NAR, such as particularly rapid take-

¹² There are probably two causes of this difference: first, the greater range of channels available on digital satellite compared with DTT; and secondly, the different demographic make-up of DTT homes.

up of PVRs, could result in further pressure on Channel 4's revenues. The effect of these changes is not possible to predict at this early stage of PVR adoption.

Programme cost

- 4.20 On the cost side, increased competition for premium acquisitions – particularly for US imports – and the consequent rise in programme cost inflation could affect Channel 4's overall financial position. Additional pressures on Channel 4's costs may also come from the consolidation in the independent production sector and as a result of the impact of the ITC's Programme Supply Review in 2002.
- 4.21 The BBC has recently announced plans to introduce a Window of Creative Competition (WOCC) for 25% of output open to both in-house and independent producers, in addition to its existing 25% statutory independent production quota. A potential short-term effect of WOCC could be to increase the cost of rights from independent producers for Channel 4.

Digital channels

- 4.22 Channel 4 has responded to the challenges posed by increasing multichannel penetration by launching a range of its own digital channels, including E4 and FilmFour. While Channel 4's new digital channels can expect to benefit from its strong brand and cross-promotion opportunities, they also face tough competition and the cost of key acquisitions – particularly from the US – is a significant concern.

New commercial alliances

- 4.23 More generally, in pursuing the largely commercial strategy of 4 Ventures, Channel 4 may be constrained by its publicly owned, not-for-profit status and its PSB remit. It may be difficult for the channel to find partnership structures that benefit both parties while protecting Channel 4's core remit. The possible merger with Five, widely mooted during the summer of 2004, was called off partly for that reason. In future, the channel will need to have a clear sense of purpose when pursuing its commercial ventures – whether they are to be purely commercial or tied to the fulfilment of its PSB remit.

Financial outlook and funding risks

Analysis of Channel 4's financial position

- 4.24 The challenges we described above could have the cumulative effect of undermining Channel 4's ability to deliver its PSB remit. As a commercially funded, not-for-profit public service broadcaster, Channel 4's underlying profitability is central to its ability to commission and schedule PSB programmes. If its profitability were to be threatened, Channel 4 could face a strong incentive to populate its schedule with more popular and commercially successful programmes, at the expense of the higher-risk PSB output. In particular, Channel 4 could face financial incentives to:

- push its PSB output to the margin of the schedule; and/or,
- commission shorter runs of important series which contribute towards the purposes and characteristics of PSB.

To assess Channel 4's ability to continue meeting its PSB remit into the digital age, Ofcom has undertaken detailed modelling of Channel 4's financial position in the years ahead and, in particular, between now and Ofcom's next five-yearly PSB review.

4.25 In their consultation response to the Phase 2 report, Channel 4 stated:

"Given Channel 4's target group profit of £30-40m, [forecasts] indicate a financial shortfall approaching £100m by 2009, which would grow further due to the impact of switchover in subsequent years."

4.26 Clearly, the view taken of Channel 4's future financial position has a significant impact on any conclusions about the need to provide the channel with various types of public and regulatory support, as well as the timescale in which the support might be needed. In the course of Phase 3, and, in particular, in response to the formal request for public funding, we carried out our own in-depth analysis of Channel 4's financial projections under a number of different scenarios. This analysis drew on the research conducted in Phase 2 and also benefited from collaboration with both the Government's Shareholder Executive and Channel 4 itself.

4.27 In assessing Channel 4's projections and building our own financial model for the Group, attention focused on a small number of key assumptions for the core channel, including:

- growth of TV NAR;
- Channel 4's share of TV NAR;
- Channel 4's overall share of commercial impacts;
- digital platform penetration growth; and
- growth of both programme budget and non-programming cost.

Additionally, we projected the performance of each of the main 4 Ventures businesses taking into account their current strategic position and possible future performance.

4.28 As with any future-based modelling exercise, it is impossible to make definitive predictions about the key underlying assumptions in the model. We, therefore, considered a wide range of potential outcomes for TV NAR, Channel 4's share of advertising and other key assumptions.

4.29 Our analysis revealed that the Group's projected performance is particularly sensitive to variations in a small number of assumptions, some of which (e.g. growth in TV NAR) are largely beyond Channel 4's control. We concluded that there is a range of plausible outcomes for Channel 4's performance over the next few years, some of which lead to a much faster deterioration in its financial position than others.

4.30 Some of the scenarios suggest that Channel 4's funding gap could in fact be larger than their own projected losses. On the other hand, even a moderately improved outcome for advertising growth and viewing share compared with those forecast by Channel 4 had a substantial effect in reducing Group losses. In fact, it is possible to close the funding gap

altogether by using a scenario based on a set of equally plausible assumptions about TV NAR and viewing performance.

Implications of financial modelling

- 4.31 Having undertaken careful analysis of Channel 4's financial projections, we believe that it is commercially sustainable for Channel 4 to continue to operate under the current funding model in the medium term:
- Having carefully compiled and assessed a range of scenarios, we are not convinced at this stage that Channel 4 Group's financial position will deteriorate so significantly before 2009 as to justify a radical change to the way it currently operates or is funded.
 - While we recognise that new digital platforms, such as the internet, are increasingly competing with TV for advertisers' funds, and that therefore, TV NAR faces structural risks to its growth, the probability is that TV NAR will continue to grow at a rate above inflation in the medium term at least.
 - Furthermore, we believe that Channel 4's unique culture of creating risky, innovative and original programming – such as *Wife Swap*, *Shameless* and *Peep Show* – is likely to enable it to continue capturing audiences. Its successful performance to date in multichannel homes, especially relative to other terrestrial broadcasters, has demonstrated that Channel 4 has so far maintained its popularity with younger audiences and those from a higher demographic group.
 - There is also a range of self-help measures which the channel can undertake to improve its financial position, including greater cost control – these are discussed in more detail below.
- 4.32 Notwithstanding our estimates, however, and in recognition of the fact that Channel 4's performance is sensitive to factors that are outside its own control – such as the growth of TV NAR – we recommend reviewing the channel's financial and on-screen performance again in 2006-07. This will enable us to respond to any developments the channel may face before our next PSB Review.

Securing Channel 4's future

- 4.33 Although our conclusion is that Channel 4 will remain commercially viable in the medium term, we do recognise the ongoing and fundamental risks to Channel 4's business model presented by the digital transition. In this section, we therefore consider the steps which could be taken to secure Channel 4's position as a public service broadcaster. First, we consider the steps which Channel 4 could undertake itself. We then consider a range of regulatory and other measures for the short-and medium-term, as well as the longer-term future of the Group.

Self-help measures

Core channel

- 4.34 Our analysis suggests that the core channel continues to be regarded as the home of innovative and challenging programming, and we believe it has an important role to play in the future delivery of PSB programming on UK

television. Channel 4 should ensure it continues to exploit the channel's strong brand, audience loyalty as well as the relationships with the independent producers to deliver its PSB remit as well as generate profits.

- 4.35 We also believe that Channel 4 should continue to pursue further operational efficiencies and reduction in non-programming costs, which could include further examination of staff, property and other overheads. An internal review of the group's commercial ventures is currently underway.

Channel portfolio and new media

- 4.36 In order to maintain its scale and viability in the digital world, it is sensible for Channel 4 to diversify its portfolio of digital channels. We therefore welcome Channel 4's plans to launch More 4 – as a free-to-air channel focused on ABC1 audiences aged 35 and over – and in particular, the plans for More 4 to make a significant contribution to delivering Channel 4's PSB remit.
- 4.37 Channel 4's brand and loyalty with profitable audiences mean that the Group should be reasonably well positioned to capitalise on commercial opportunities in new media. With *Big Brother*, Channel 4 has already successfully pioneered interactivity as a means of generating extra revenues. Channel 4 has also already started pursuing opportunities presented by the internet as a means of building its revenues and profile.
- 4.38 Additionally, Channel 4's 2003 annual report shows that it currently has a strong cash position of £80m – a surplus which is likely to have grown during the course of 2004. Our analysis suggests that its cash position is likely to be strengthened further over the coming few years. These cash reserves could be used for profitable investments in order to generate additional revenues in the future, or saved in a form of a 'reserve fund' to finance PSB programming investment on the core channel in the event of any unforeseen deterioration in performance.
- 4.39 We recognise that there is an issue about the timing of investment and returns. Channel and new media developments will continue to require investment in the short term to build businesses for the future. However, Channel 4's cash reserves, plus the projected profits from the core channel over the next few years, provide some comfort that this strategy is affordable.

Alliances / partnerships with other organisations

- 4.40 Channel 4 should continue to explore the scope for alliances and partnerships with other organisations, although its recent experience with Five highlights the difficulties of developing a partnership with a corporate structure which aligns Channel 4's not-for-profit status with a profit maximising culture. It may prove more straightforward for Channel 4 to examine collaborations which are essentially commercial in nature and do not raise issues about any conflict of interest with the PSB remit.
- 4.41 In our Phase 2 report, we raised the possibility of transferring commercial income-generating assets from the BBC to Channel 4 as a means of bolstering Channel 4's financial position. A number of issues related to this approach have been highlighted in the consultation responses. In the first instance, it would be difficult to identify the assets that could be transferred

to Channel 4 as the range of BBC assets with a meaningful fit with Channel 4's activities is relatively low. Secondly, the process of engineering such a transfer is likely to be extremely complex. In light of these responses, we have concluded that other ways of supporting Channel 4 would be preferable, if needed.

Potential regulatory support in the short and medium term

- 4.42 Although the likelihood is that Channel 4's position is secure for the next few years, we recognise that there are downside risks which could lead to a funding gap developing in the medium and long term.
- 4.43 To address these risks, Channel 4 has proposed a number of regulatory options which could be considered in the short to medium term and which could deliver some valuable financial comfort to the organisation in the period up to switchover. These include the following:
- extension of PSB status to a wider range of Channel 4 activities;
 - proposals for funding of some of the cost involved in DTT transmission rollout;
 - additional capacity on digital platforms, including DTT; and
 - exemption from spectrum charges.
- 4.44 In each area, there are different, and potentially difficult, issues to consider. For instance, many of these proposals could raise state aid issues which would need to be carefully examined.
- 4.45 We intend to carry out further work to assess each option. In particular, we will consider:
- the public value likely to be delivered;
 - whether the proposed measure is proportionate to the benefit generated;
 - the impact of any measure on the rest of the market, including its effect on competition; and
 - the consistency of the measure with Ofcom's range of statutory duties and responsibilities.
- 4.46 Improving the transparency and evaluation of funding – whether implicit or explicit – for public service broadcasters will be an important future theme.

Extension of PSB status

- 4.47 Since its foundation, Channel 4 has acquired a distinctive public service identity and we would like to see its contribution to PSB continuing in the years ahead. We hence welcome in principle Channel 4's ambition to extend its PSB role across new channels and media platforms – and, in particular, More 4 – in order to respond to the changing ways in which citizens and consumers access and view content in a digital environment. Indeed, we believe that a multi-platform approach is the optimal strategy for achieving reach and impact for PSB in a digital age. We note, however, that extending formal PSB status to new digital channels requires amendments

to the Communications Act, and hence would ultimately be a matter for Government.

- 4.48 Extending Channel 4's PSB role to include new channels and activities would also imply a significant change in the way the Group is viewed as a whole. At present, the activities making up 4 Ventures are regarded primarily as ways of generating funds for the core PSB channel: they do not fulfil a PSB purpose themselves.
- 4.49 Including some of Channel 4's other activities under its PSB status would mean we cease to categorise all of Channel 4's activities as binary opposites. Rather, as is the case with the BBC's publicly-funded activities for example, it would mean viewing Channel 4's various activities as part of a broader strategy to deliver its PSB remit with appropriate reach and impact.
- 4.50 In order to develop this approach, it would be necessary to set out clear principles governing which PSB benefits could be extended and under what conditions (e.g. appropriate prominence on EPG listings, and must-carry status). The activities that would qualify for the PSB benefits would need to be closely related to the purposes and characteristics of PSB, as we have defined them in the course of the PSB review. With regard to digital channels, this might include a requirement that they should broadcast free-to-air on all digital platforms and commission a significant amount of original productions. As we discussed in Chapter 2, the criteria for extending the PSB benefits could apply to any qualifying channel or broadcaster, not just to Channel 4. We will consider these proposals in detail over the coming months.
- 4.51 The new approach may require a clearer specification of Channel 4's PSB remit and an evaluation of how it should be monitored and assessed. We will consider these issues further, and discuss them with Channel 4 itself and with the Government as appropriate. Any proposal to designate More 4 or any other channel as a formal public service channel would require primary legislation and would be subject to full consultation. Some of the benefits of PSB status could, however, be conferred through an order from the Secretary of State.
- 4.52 In addition to extending PSB benefits, there would also be a need to consider the implications for the scope of the rights acquired in programmes commissioned from the independent producers – for example, how rights might be valued and used across a range of PSB channels. We intend to look at these issues in detail as part of the review of the UK content production sector that we discussed in Chapter 2.

Support for DTT transmission rollout

- 4.53 Channel 4 has proposed that it should receive support for the one-off costs in achieving digital roll-out. It argues that switchover from analogue to digital signal is an exceptional event with a clear public interest, and the costs involved can be clearly ring-fenced and kept separate from Channel 4's wider activities. Receipt of funding for such costs would not in principle seem to compromise Channel 4's editorial independence. We believe the proposal should be given further consideration by the Government.

Additional capacity on digital platforms

- 4.54 We encourage Channel 4's plans to develop an integrated portfolio of digital channels and new media services to enable it to maintain its reach and impact as well as develop the scale necessary to remain competitive in the digital world. With respect to distribution on digital platforms, Ofcom understands that technological enhancements are allowing additional carriage slots to be created on DTT multiplexes. These additional slots may present opportunities for Channel 4 to launch new services in the future, either within their current gifted capacity or on other multiplexes.

Exemption from spectrum charges

- 4.55 In 2004, Ofcom consulted on the options for extending spectrum pricing to TV broadcasting spectrum¹³. The consultation document suggested that spectrum pricing should not be extended to television broadcasting in the short-term but raised the possibility of doing so in the longer-term, after the expected date for switchover. Ofcom is currently considering responses to the consultation and will publish further work later in the year.

The longer-term future for Channel 4

- 4.56 The range of regulatory measures we have reviewed could provide some immediate help to Channel 4 and comfort about its position in the post-switchover world. They might not, however, be sufficient to address the fundamental long-term issue of Channel 4's funding and institutional model.
- 4.57 Post-switchover, Channel 4 will continue to face tough competition together with the other public service broadcasters. Interim regulatory support notwithstanding, the risk remains of a sustained financial deficit emerging, leading to a more fundamental structural problem for Channel 4. At that point, there would be three possible ways of supporting Channel 4 to enable it to meet its PSB remit:
1. Indirect financial support.
 2. Direct public funding.
 3. Collaboration with the PSP.

Indirect financial support

- 4.58 The most obvious forms of indirect support for Channel 4 could be in the form of exemption from spectrum pricing or a grant of additional spectrum capacity. This would be consistent with the approach that has been used to provide implicit funding for Channel 4's PSB remit hitherto, in the form of scarce analogue spectrum. Any proposals in relation to spectrum pricing or additional spectrum capacity would need to be considered against Ofcom's wider statutory duties.
- 4.59 Another possible form of indirect support would be to hypothecate revenues from future spectrum release for Channel 4 – this measure would be for the Government to decide upon. We note that it is not clear how secure and/or predictable such revenues would be. The provision of any form of indirect

¹³ Ofcom, Consultation on spectrum pricing, September 2004.

financial support may also be subject to many of the reservations set out below in relation to direct public funding, including potential state aid concerns.

Direct public funding

4.60 Channel 4 has functioned extremely successfully to date. Its position as a not-for-profit, commercially funded public service broadcaster has contributed to a plurality of PSB providers. Its culture of self-reliance avoids a dependence on the public purse and allows a more independent outlook. This independence gives Channel 4 more creative freedom, allowing it, for example, to show controversial programming, such as *Brass Eye* and *Anatomy for Beginners*. Its financing structure has also allowed the channel to evolve to adapt to changing market circumstances.

4.61 Providing Channel 4 with direct public funding would secure the channel's position as a PSB broadcaster but it would also carry a number of potential significant disadvantages which would need to be addressed further before such an approach could be supported.

- **Changing character** – Channel 4's reliance on commercial revenues, rather than public funding, gives it creative freedom to pursue risky programming and air controversial viewpoints – avenues which might be more difficult to pursue were it to be reliant upon public money.
- **Increased regulation and accountability** – In return for public funding, it would be necessary for Channel 4 to submit itself to greater regulation in order to justify the public money spent on it. It would also have to demonstrate greater accountability to the public and to Parliament. This may risk stifling its creative freedom and give rise to greater bureaucratic intervention.
- **State aid concerns** – Public funding could give rise to significant state aid issues.

4.62 For these reasons, we believe that direct funding would not be an easy solution to the funding risks faced by Channel 4.

Channel 4's involvement with the PSP

4.63 In our Phase 2 report, we set out a proposal to create a new PSB provider, the Public Service Publisher (PSP) in order to ensure continued plurality of provision of PSB.

4.64 Several respondents to our consultation noted that Channel 4 may have a valuable role to play in the establishment and operation of the PSP. Given the importance of Channel 4 to the PSB system as a whole, this issue warrants further consideration.

4.65 The involvement of Channel 4 with the PSP might help the PSP – allowing it to achieve greater reach and impact – but it might also help Channel 4 fulfil its PSB remit, thereby helping to maintain and strengthen the PSB system. Channel 4 could benefit from a link with the PSP in the following ways:

- sharing of management and other fixed costs with the PSP;
- access to content which it could co-produce with the PSP; and

- involvement in the PSP's wider activities which could help extend Channel 4's profile into new media and broadband.

4.66 Possible options for Channel 4's involvement with the PSP are discussed further in the next chapter. It should be noted, however, that any involvement of Channel 4 with, or contribution to, the PSP raises potential competition and state aid issues which would need careful examination.

Conclusions

- 4.67 We expect Channel 4 to continue to make a unique and important contribution to PSB in the run-up to switchover and beyond, and we welcome the renewed focus on this goal that has been shown by Channel 4 since the start of our review. We conclude from our analysis of Channel 4's financial projections that, although Channel 4 is likely to face increasing pressures on its profitability, it is commercially sustainable for Channel 4 to meet its PSB remit while continuing to operate under the same funding model, at least in the medium term. We also commit to reviewing the Group's position in 2006/07 in order to be able to respond to any challenges the channel may face before our next PSB review.
- 4.68 We recognise that the challenges brought about by increasing digital penetration may affect Channel 4's ability to produce the same range of high quality PSB programming in the future. We will, therefore, consider different options for regulatory support in the short and medium term which may offer some financial support for Channel 4.
- 4.69 We have identified three options for addressing Channel 4's potential structural issues in the longer-term and we intend to do further work on each option – our proposed next steps are set out in Box 4.1. Any possible indirect forms of financial support need to be considered in the light of Ofcom's wider statutory duties and be compliant with UK and EU law. We continue to believe that there are strong arguments against direct funding of Channel 4. Finally, there is the possibility that Channel 4 could continue to be a part of the PSB system through partnership with the PSP. This last option is discussed further in the next chapter.

Box 4.1: Next steps

2005

- Work further with Channel 4 to understand the scope for further self-help.
- Develop principles and criteria for the possible extension of PSB status and benefits beyond the current PSBs.
- Develop options for addressing Channel 4's longer-term structural problems.
- Consideration should be given to supporting Channel 4's one-off cost of DTT transmission roll-out before relevant transmission contracts are concluded.

2006

- Consider proposals for allocation of released spectrum.
- Consider proposals for the extension of pricing to broadcasting spectrum.

2006/07 and beyond

- Review Channel 4's financial and on-screen performance.

Chapter 5

The Public Service Publisher

Why we need the PSP

- 5.1 An important element of our new model for public service broadcasting is the Public Service Publisher (PSP). The PSP would be a new type of PSB provider – one designed for the digital world, rather than the analogue one. It will exploit the potential offered by broadband interactive services as well as ensuring the continued plurality of provision of PSB content in the digital world.
- 5.2 It would operate as a commissioning and publishing body which would commission creative content from independent producers and ensure that this content was effectively branded and made widely available across all important distribution systems. Its content would be fully interactive and available on-demand, thereby helping to expand broadband access and use. The contract to run the PSP would be awarded through a periodic competitive process to the consortium which had the best ideas for providing PSB content. And it would be based outside London in order to more fully reflect the UK and help the growth of regional production.
- 5.3 The PSP would have four key benefits for UK citizens and consumers:
- The PSP would provide PSB content designed for the digital and broadband world.
 - There would be an injection of creative energy into the PSB system.
 - The PSP would sustain the plurality of PSB provision.
 - It would underpin the provision of high-quality, distinctive and ambitious content.

A digital and broadband PSB provider

- 5.4 The PSP would not be a conventional, linear broadcaster. From its very inception, it would use all communications platforms in order to achieve reach and impact - from broadband to mobile platforms as well as digital TV. And, more importantly, it would provide fully converged content - linking together a wide selection of broadband and interactive content in innovative ways.

Providing plurality of content

- 5.5 As described in Chapter 2, the ability of commercial PSB channels to sustain their PSB output will come increasingly under threat. If we do nothing, therefore, the current range and choice of PSB content is likely to decline. Creating the PSP will help ensure that plurality in the supply of PSB content is maintained.
- 5.6 In particular, the PSP would help achieve plurality of supply in broadband content. The BBC is currently one of the few providers of high-quality, UK-originated broadband content on a significant scale. As more households acquire broadband, it becomes increasingly important to ensure that they

have a choice of high-quality, UK-originated broadband content available to them. The PSP would help offer this choice and would provide a new competitive spur to the BBC. The resulting competition for quality would raise the overall standard of content available to viewers.

Fresh creative energy in the PSB system

- 5.7 The launch of the PSP would bring a burst of innovative, creative energy to the communications landscape. New entrants – from ITV to Channel 4 to Sky – have always had a major positive impact on UK broadcasting. They have provided an outlet for creative talent - allowing new writers or new presenters to reach the screen. They have created new programme formats as well as significantly improving coverage of existing programme formats, for example, Sky's innovative coverage of sport. The PSP would inject new creative dynamism into the broadband and digital world as well as into the PSB system more generally.

Securing high-quality PSB content

- 5.8 The creation of the PSP will ensure that more PSB content is produced than would otherwise be the case. As we've established in our Phase 2 report, if nothing is done, the advent of the digital age will mean that the level of funding available to provide PSB falls, which in turn is likely to lead to a fall in the quantity and quality of PSB output. The establishment of the PSP could help secure the kind of PSB content which is most likely to disappear from our screens and which is most valued by citizens and consumers.
- 5.9 The competitive process proposed for the award of the PSP contract would also ensure that the best possible content ideas are made available to citizens and consumers. Bidders for the PSP contract will bring forward their own distinctive and innovative ideas for providing PSB content. The body which awards the PSP contract would then select the best available.
- 5.10 A competitive process also makes the PSB system more flexible over time. When the PSP contract is re-advertised, potential new entrants can put forward new ideas for content and distribution whilst the incumbent will have to rethink its PSB provision. This helps ensure that the overall PSB system is periodically rejuvenated.

Summary of consultation responses

General comments

- 5.11 We received widespread support in the Phase 2 consultation for our proposals on new ways to ensure the continued provision of PSB, although there were a range of views on the specifics of the PSP proposal.
- 5.12 Many welcomed the PSP as a source of innovation and as a way of ensuring public service provision on other digital platforms. Many respondents highlighted the potential role of the PSP in delivering benefits to local communities and marginalised groups and some argued strongly for a PSP based around new media.
- 5.13 Other respondents, particularly among the incumbent PSB broadcasters, were more sceptical about the proposal. Some of these incumbent broadcasters argued that it was unnecessary to create a new PSB service and that priority should instead be given to securing the position of existing

PSB broadcasters. There was also a view expressed by a number of respondents that the creation of the PSP could damage the existing public service broadcasters. There were also doubts that the PSP could achieve sufficient reach and impact. Some suggested that instead of the creation of a new institution we should either support existing PSB broadcasters or create a fund which could be used to finance PSB content across a range of different channels. The latter it was argued, would deliver more benefits in terms of PSB content than a periodic contest for a PSP contract.

- 5.14 On the issue of funding, some respondents doubted that public funds would be forthcoming, whilst others suggested that PSP should be paid for through a higher TV licence fee.

Comments on the PSP's content

- 5.15 The primary focus of consultation responses was the proposed remit for the PSP. Following publication of the Phase 2 report, we issued a hypothetical tender document¹⁴ which asked respondents to set out their own proposals on the content of the PSP. We also invited three consortia to present their proposals to a seminar which we organised and which was attended by many people from across the communications industry alongside representatives from bodies representing consumers (see Box 5.1).

Box 5.1: Seminar on the PSP

We invited three consortia to present their proposals to a seminar in December 2004 on the PSP. These proposals were then discussed by a panel of industry experts. The consortia's proposals are described below and their detailed presentations are available on the Ofcom website.

The consortium led by Human Capital, and which included BT and the Science Museum, proposed the use of the internet and a range of broadcast outlets to create much more value for the public from museums, art galleries, state education, the NHS and other recipients of public money. New technology, they argued, would allow public bodies to widen access to their services and create greater civic engagement.

The second consortium, led by David Docherty, involved BT, Telewest, Accenture, Reel Media, Thinner Media and talkback Thames. They suggested that the PSP should foster innovation, especially from under-represented audience communities in the UK. Their proposal involved a showcase channel on all four digital TV platforms, branded 'Six', but this would be supported by an extensive broadband internet site which would allow the decentralisation and democratisation of communication with people providing their own peer-to-peer content within their chosen 'tribes'.

The third consortium was led by Spectrum Strategy and involved a range of companies from across the communications sector: Cable and Wireless, Vodafone, Freemantle Media and the Discovery Channel. Their service, branded as 'Origin8', focused on developing original and innovative content in drama, comedy and factual programmes but it also included a network of local channels. They proposed to provide a broadcast service on all the main TV platforms, and also suggested the distribution of Origin8 kite-marked content on other TV channels. New media, including broadband, interactive TV and mobile platforms would also be used.

The seminar was not aimed at reaching a decision on the content remit of the PSP but it did successfully highlight the creative possibilities which could be achieved were the PSP to be launched.

¹⁴ Hypothetical tender document for a Public Service Publisher, November 2004, Ofcom

5.16 The proposals made during the hypothetical tender process and in response to our hypothetical tender document and consultation can be grouped into five broad areas shown in Table 5.1.

Table 5.1: Remits for the PSP suggested by respondents

Description of service	Content and distribution
A premier content service	<ul style="list-style-type: none"> • High-quality, innovative, original content, especially new comedy and drama, current affairs, factual, arts and documentary content. • Its aim would be to ensure the continued provision outside the BBC of the type of quality PSB content which might be most at risk in the digital age. • It would be effectively branded and promoted in order to secure reach and impact. • It would be available on a free-to-air basis. A limited amount of output would be released each week and would be made available through digital TV and broadband on-demand. It could, for example, be available for downloading for a period of one week after transmission (the BBC is considering allowing the viewing of its content in this way). • It might be supplemented by interactive/enhanced TV elements and internet content.
A Nations and Regions service	<ul style="list-style-type: none"> • News, current affairs, factual, drama and entertainment content for the Nations and the English Regions. • Would allow greater production in the Nations and Regions. • Could also provide support for indigenous language services. • Available through TV and broadband on-demand.
A local & communities service	<ul style="list-style-type: none"> • News and information for local communities as well as ethnic and other minorities. • It would have a much greater degree of local provision than currently provided by the BBC and Channel 3. • Could also provide a range of content for under-served ethnic, linguistic, and religious communities and other groups with shared interests. • Distributed through a network of small local TV stations coupled with broadband content for specific localities and communities. • Could make potentially imaginative use of new media and peer-to-peer involvement.

<p>Educational and public services content</p>	<ul style="list-style-type: none"> • Education service for both children and adults delivered largely online but with some TV support. • It could also take on Channel 4's schools responsibilities and complement the BBC's digital curriculum. • Other public services could also participate, e.g. there could be provision of background content, information, and interactive resources on museum exhibitions or public health issues. • It could be a means whereby public services used the power of communications technology to extend their reach to socially excluded groups. • This type of service need not be an entirely new service since many public services are already devoting resources to widening access using new technology, e.g. NHS Direct.
<p>Interactive new media</p>	<ul style="list-style-type: none"> • Would focus on internet-based interactive content which either works on a stand-alone basis or which enhances and extends the PSB value of broadcast programmes. • As well as creating its own content for new mobile and broadband services, it would be expected to work closely with existing broadcasters to enable them to provide enhanced online and interactive content around their broadcast programmes. • This would act as a PSB competitor to the BBC's online and interactive services.

5.17 Two, more general, proposals were put forward by respondents. Some respondents suggested that a key PSB objective in the future will not be to produce more content but to help users find their way around content produced by a wide range of commercial providers. It was also suggested that the PSP could be based around the concept of the creative commons whereby all non-commercial use of the PSP's content would be permitted. Boxes 5.2 and 5.3 summarise these ideas.

Box 5.2: A public service guide

As digital technologies take hold, the amount of content available through the internet and digital broadcasting has grown enormously. One of the problems facing consumers and citizens, however, is navigating their ways through this content, in particular finding PSB content. There may well be a potential role for a trusted public service guide or navigator to help people find high-quality content across a range of platforms. Such a service could act an all-platform guide to all of the available, high-quality content across all communications platforms, independent of any individual broadcaster or content provider. It could also potentially give access to a range of content from public bodies such as museums, galleries and educational institutions. This kind of service may require some public funding but could be provided separately to the PSP.

Box 5.3: Creative commons

During the Phase 2 consultation, it was suggested that the PSP could become a creative commons whereby all non-commercial use of the content is permitted. This would allow, for example, schools and universities to use the PSP's material to create more effective teaching materials.

Although the establishment of a creative commons would be valuable, it is not without its difficulties. For example, it might be impossible to prevent the commercial exploitation of the material. Also purchasing of the necessary content rights would be expensive or it may prove difficult to attract appealing content ideas from producers.

There is growing interest in the concept of the creative commons. In the UK, both the BBC and Channel 4 are considering making some of their content available for non-commercial use. In the US over 5 million creative commons licences have been issued offering access to written, video, audio, and educational content. Creative Commons (see www.creativecommons.org) is a non-profit organisation that offers a flexible copyright licence for creative work. It allows creative people to make their content available online while letting others know exactly what and what cannot be done with the work. Creative Commons is working with Programme in Comparative Media Law and Policy at Oxford University on adapting the Creative Commons licences to the UK.

Given the benefits of the creative commons approach in forming added value from PSB output, it warrants further work. As the idea of the PSP is developed further, therefore, the possibility of using the creative commons approach should be explored.

Proposals for further development

- 5.18 We have considered which of the proposals for the PSP's content set out in Table 5.1 are most likely to be of value to citizens and consumers. All of the proposed services meet the purposes and characteristics of PSB to some degree. Hence, in considering the value of the different services we have considered how they perform against a number of criteria:
- How effectively would the proposed service contribute to the overall system of public service broadcasting?
 - Do the proposals address significant emerging gaps in provision?
 - How would the proposals affect competition in the wider marketplace?
 - Would the proposed service achieve reach and impact?
 - Would the proposed service promote innovation in content and make full use of the possibilities arising from increasing use of new media, particularly broadband capability?
- 5.19 Our preliminary assessment suggests that the further development of the PSP proposals could be focused around two distinct, but complementary, remits. A premier content service would address the risk that certain types of content might be under-provided in a fully digital world and could also focus on developing new formats and approaches as the needs of the public change. A local and communities service, meanwhile, would address some clear gaps in current provision and would help expand the scope of PSB output.
- 5.20 Both of the services would be fully broadband-enabled by incorporating interactivity and using on-demand distribution, and the local and communities service would allow peer-to-peer exchanges using broadband. The two proposals are described in detail in Table 5.2.
- 5.21 It would certainly be possible to deliver these various services through one PSP operator – e.g. a consortium containing a premium content provider with access to regional production bases and a network of local television operators. But it may be more effective to award separate contracts for the individual elements with different levels of funding. Most of the funds available to the PSP could be used to provide the premier content service

whilst the local and communities service might only require seed-corn funding or could tap into other sources of funding.

Table 5.2: Two broad options for the PSP

	Remit	Key benefits
A premier content service designed for the digital and broadband world	<ul style="list-style-type: none"> • Provision of high-quality, imaginative and innovative drama, comedy and factual content designed for the digital and broadband world. • It would also offer a much greater degree of interactivity than existing conventional services. • Distributed free-to-air through broadband but could also use conventional broadcast distribution. • The service would be non-metropolitan in outlook and thereby reflect the whole of the UK. 	<ul style="list-style-type: none"> • Addresses concerns about higher risk original content. • Provides content specifically designed for broadband and thereby creates a competitive spur to the BBC and helps boost the broadband market. • Addresses the demand identified in our Phase 2 report for content set in different parts of the UK - without a metropolitan or London bias. • Helps strengthen the creative production sector outside London. • The use of on-demand distribution would allow a library of PSB content to become available for access at any time.
Local and communities services	<ul style="list-style-type: none"> • Local news and information coupled with a service which caters for the specific needs and interests of local areas and communities. • The service could be economically provided via new media, e.g. a website which allows local and community groups to share audiovisual and written content, or via new digital capacity for local TV. 	<ul style="list-style-type: none"> • Allows development of low cost, new media services which fill a current gap in PSB provision. • Consumer research indicates that people are most interested in receiving news and information about their neighbourhood and local area; their county or region are less engaging. • Would also cater for the demand for tailored services from ethnic, linguistic and other minorities who regard themselves as being underserved by the existing broadcasters.

Reach and impact

5.22 We consider that both of these kinds of service would achieve sufficient reach and impact:

- The premier service would be able to focus on marketing and promotion of a limited amount of high-quality content each week which would be available using on-demand. Not only will this be increasingly in tune with the way we access content in the future, but it will also allow public

funding to be used more effectively than if it had to sustain a 24-hour linear broadcast channel.

- Distribution through on-demand technologies would allow the PSP's content to be available over a prolonged period. This will mean that the PSP's content will have a longer life than if it was simply shown a few times on TV; thus the PSP's reach and impact would not be measured by audiences for a particular programme but by the total number of people who accessed its content over time. Other technological developments such as intelligent electronic guides to high-quality content (see Box 5.2) may also be able to allow citizens and consumers to find the PSP's content.
- An emphasis on encouraging interactivity and participation for distinct communities or localities can create a positive impact beyond just the number of viewers.
- The PSP's use of broadband will also make possible a form of marketing closed to existing broadcasters: viral marketing whereby consumers pass on links to the PSP's content between them.
- Finally, it should be remembered that high-quality original output is not inconsistent with achieving audiences of a significant size. The BBC, for example, has proven through programmes such as *Who Do You Think You Are?* and *Auschwitz: the Nazis and the Final Solution* that challenging and original PSB productions are able to attract substantial audiences.

5.23 The two services discussed above would also be complementary to the commercial PSB providers, in particular Channel 4. They would, therefore, be unlikely to take viewers from them in large numbers and would not, as some respondents to our Phase 2 consultation suggested, damage existing PSB broadcasters. Nor would the PSP be directly in competition for funds with the existing broadcasters. It is also important to note that, to the extent the PSP did provide a competitive spur to existing PSB providers, such competition for quality would be beneficial for citizens and consumers: where the PSP was better than existing providers, the latter would either have to improve their output or they would decline in importance.

5.24 Both services could be designed to minimise any distortion of the commercial market – in fact, to the extent that they help drive broadband take-up, they could have an overall positive effect on the prospects for new commercial services.

How the PSP would work in practice

Funding the PSP

5.25 In our Phase 2 report, we suggested that the PSP might require around £300m a year in order to invest in content and distribution which gave it significant reach and impact. Responses to our consultation suggested that this was a realistic level of funding given the fact that the PSP would not provide a conventional 24-hour broadcast channel but would instead focus its spending on a more limited volume of high-quality, well promoted and widely distributed material.

- 5.26 The PSP would be a not-for-profit service, but it would be entitled to cover its costs including management fees. If a PSP is operated by an existing commercial business, there would have to be measures in place to ring-fence the PSP operation to ensure that that public funding was used purely to provide the PSB service. The PSP would not be funded through advertising or subscription although it could have access to additional revenue streams such as co-production funding and ancillary revenues from secondary content sales.

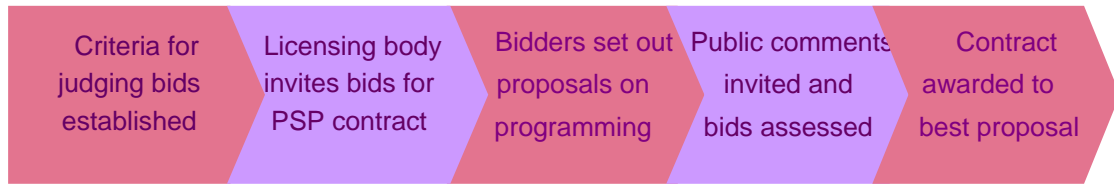
Box 5.4 Advantages of the PSP over a PSB fund

A few respondents to our consultation argued that rather than funding an entirely new PSB provider through the PSP we should create a fund which subsidised the provision of PSB output on a range of existing TV channels. In our Phase 2 report, we rejected this option on the grounds that it would be more costly than creating the PSP and would not provide compensating benefits in terms of better PSB provision. In the light of the responses, Ofcom has considered this issue again but we continue to take the view that the creation of the PSP would have a number of advantages over a PSB fund:

- The PSP would have the provision of PSB ingrained into its institutional values and structure – other broadcasters, concentrating on maximising audiences and revenues, would regard PSB as a means, not an end in itself.
- Providing funding on a programme-by-programme basis would mean that more programme ideas would have to be assessed which would require significant resources on the part of the funding body. There would thus be a duplication of many costs, in particular those associated with programme commissioning.
- This duplication could also have creative disadvantages: the need to receive approval from two organisations may make it less likely that innovative, risky content receives funding.
- A PSB fund would also make it difficult to establish the efficacy of providing PSB funding. In theory, the commissioning body could devise detailed and precise contracts for outcomes (e.g. quality of programming or reach and impact of PSB output) which the channel receiving funding would be required to achieve. In practice, however, it can be extremely difficult to draw up precise ways of specifying or measuring these outcomes on a programme-by-programme basis.
- Finally, it would be difficult to ensure that a public subsidy provided additional PSB output and was not simply used to transmit content which would have been broadcast in the absence of subsidy. By contrast, the performance of the PSP in providing PSB content with reach and impact would be assessed periodically across all of its output, rather than being judged on a programme-by-programme basis.

Choosing the PSP

- 5.27 The PSP would be licensed by an appropriate body. This body could be Ofcom but it may be preferable to establish a new body with special responsibilities for ensuring the PSP contract is effectively tendered and that public funds are properly used. Ofcom could then focus on its clearly defined regulatory responsibilities (this theme is developed further in the following chapter).
- 5.28 In broad terms, the process for awarding the contract for the PSP would be as set out in Figure 5.1.

Figure 5.1: Process for awarding the PSP contract

5.29 The licensing process would begin by the issuing of a tender document which set out the goals of the PSP award and the criteria by which bids would be judged. Lessons drawn from other tendering processes (see Box 5.5) indicate that the objectives should be defined in broad terms rather than being overly specific.

Box 5.5 Economic literature on tendering processes

Ofcom commissioned a review of the relevant academic literature¹⁵ from Robin Mason of Economics Department, University of Southampton. The main lessons drawn from this review can be grouped as follows:

- *Auctions v beauty contests.* The paper considered the advantages and disadvantages of auctions as opposed to beauty contests. It stated that auctions were more appropriate where there is little intrinsic variation between the different proposals on offer whereas beauty contests are more useful when, as in the case of the PSP, there is a greater role for subjective judgement.
- *Sufficient information.* Bidders for the PSP contract will need to give sufficient information, e.g. about the quality and cost of their proposed PSB programming, to allow proper judgements about the potential output to be reached. As well as allowing bids to be properly evaluated this also allows specification of the terms and conditions of the PSP's licence.
- *Encouraging participation.* A key issue for any tendering process is encouraging participation by as large and diverse a group of organisations as possible. In particular, it is important to keep the cost of preparing a proposal as low as possible and avoid asymmetries between potential bidders. The format for the bidding process will also need to encourage as many participants as possible.
- *Incumbency advantages.* It was pointed out that re-tendering of the PSP contract could lead the incumbent to have advantages which could potentially lead to inefficiency. The prospect of losing the contract could also cause the incumbent to under-invest in the latter stages of a contract term. Measures would need to be put in place to prevent such advantages (the kind of measures which might be employed are discussed further in Box 5.6).

5.30 In putting forward their proposals, bidders for the PSP contract would set out their proposals on all the relevant issues including on programmes, funding, distribution, constitution, and governance and contractual arrangements. The licensing body would assess these proposals against its judging criteria. These criteria would be expected to include meeting the

¹⁵ The Tender Process for a Public Service Publisher, Robin Mason, December 2004

purposes and characteristics of PSB, extending the range and choice of PSB content, achieving reach and impact, and creating innovation in content and distribution. The licensing body would also invite comments from the public and conduct its own research on which proposal was most likely to be of value to consumers and citizens.

- 5.31 The precise details of the bidding process will need to be designed later if the PSP proposal is taken up, but economic literature suggests that it will be important to keep down the costs of bidding in order to ensure that there are as many bids as possible. At the same time, however, it will be necessary for the bidding process to extract sufficient information for a proper comparison between the different bids to be drawn (see Box 5.5).
- 5.32 Once the proposals had been assessed, the PSP contract would be given to the team judged best able to fulfil the purposes of the PSP. The length of the contract is one of the details which will need to be decided before the PSP comes into being, but Ofcom considers that a period of around 10 years would be appropriate. The contract would also be subject to a mid-term review which would assess whether it was fulfilling its promises. If a significant shortfall in PSB output were to become apparent, the contract could be terminated at the mid-term break-point.

Box 5.6 Lessons from other tendering processes

In developing the idea for the PSP, Ofcom has examined the lessons which can be learnt from other tendering processes and has conducted discussions with some of those involved. The other processes considered were the National Lottery, Teachers' TV, rail franchising, film franchises, and long-term support for charities/voluntary sector.

1. *Bids for the PSP contract should be judged on broad, rather than specific, objectives.* One important lesson which emerged from most of the examples considered was the importance of defining the right objectives for the operator of the PSP. Experience suggests that the objectives for the PSP should be defined in broad terms, rather than, for example, specifying in detail the types of output which would need to be provided. In the case of Teachers' TV, for example, the Department for Education and Science defined only the broad educational objectives of the channel; the winning operator had the flexibility to adopt whatever approach it considers appropriate to addressing these objectives. Other examples such as that of the film franchises indicated the possible problems in implementing a competitive tender process in the creative sector. For example, it can be difficult to judge the bids in terms of the quality of the programmes offered before the finalising of contracts with independent producers to supply those programmes. These kinds of problems can be overcome by placing more emphasis in the bidding process on the broad format and character of the service rather than on individual content.
2. *Effective financial incentives will need to be in place.* The experience of other tendering processes also indicates the importance of finding the right financial performance incentives – these may be less simple to construct for a not-for-profit PSP. Related to this is the need to maintain performance in the last few months of a contract that might be changing hands. If a supplier running the PSP were to lose the contract because of its poor performance in providing PSB, there would need to be mechanisms in place, e.g. through specific licence conditions or a post-dated bonus, to ensure that it carried on fulfilling its role before the new supplier was able to take control.
3. *Incumbency advantages will need to be controlled.* In some of the tender processes considered, firms which won the first licence period were adjudged to have significant advantages in subsequent periods, and mechanisms were therefore put in place to ensure there was sufficient competition to the incumbent. For example, the incumbent

operator of the National Lottery, Camelot, was required to install new lottery terminals if it won a second licence term. This removed the advantage created by the fact that the incumbent had already made a substantial investment which a new entrant would have to reproduce. This problem of incumbency is likely to be less of a problem in the case of the PSP since the sunk investments involved in broadcasting or content commissioning are significantly lower than they are in other industries. It would also be possible to allow the licensing body to retain the intellectual property rights over branding and content.

4. *Measures to ensure accounting transparency will need to be put in place.* The examples considered also indicated that it will be important to establish appropriate accounting transparency, particularly if the PSP is operated by another broadcaster. Mechanisms to ensure accounting separation could be put in place to ensure that there is no cross-subsidy to private firms.

Channel 4 and the PSP

- 5.33 Several responses to our consultation suggested that it would be valuable for Channel 4 to have a close relationship with the PSP. Channel 4, it was suggested, could provide a broadcast outlet for the PSP's content and could promote the PSP service. Any such involvement of Channel 4 with the PSP raises potential competition and state aid issues which would need to be examined carefully.
- 5.34 As a result of the consultation responses received, we have considered further the three main options for the possible involvement of Channel 4 with the PSP:
- Channel 4 would be free to bid alongside all other parties (apart from the BBC) in an open tender process. This would allow the PSP to be allocated competitively to the best possible bidder, perhaps a consortium comprised of a range of different organisations and sectors - new media, distribution, broadcasting, publishing and others.
 - Channel 4 could be granted a substantial stake in the PSP, and would be required to bring in partners to operate the PSP. This would guarantee a role for Channel 4, and provide it with a base from which to achieve a new scale and breadth in PSB provision.
 - The winner or short-listed bidders for the PSP could be obliged to reach an agreement with Channel 4 - for example, for access to Channel 4 airtime and promotion.
- 5.35 In considering these options, the benefits of stimulating greater competition for the PSP contract need to be balanced against the benefits of giving the PSP the advantage of a link to an established broadcaster and creating a means for Channel 4 to strengthen its provision of PSB.
- 5.36 On balance, we consider that that the first two of these options should be considered in more detail, but not the third: the first would generate much greater competition for new approaches and ideas; the second would create a route for Channel 4 to strengthen the scale and breadth of its PSB proposition and give the PSP the advantage of an established brand and broadcast outlet in achieving reach and impact. The third would, we believe, be difficult to implement and risks achieving neither of these benefits very effectively.

Next steps

- 5.37 Before the PSP can come into being, further work will need to be undertaken to develop the details of its operation, to address funding issues (including considering state aid issues) and to draw up a possible implementation plan. All this would need to happen ahead of enactment of the necessary legislation to establish the PSP. An immediate next step might involve audience research into the acceptability and perceived value of the various PSP options.

Chapter 6

PSB regulation, accountability and governance

Overall aims and challenges

- 6.1 As the final part of our proposals to maintain and strengthen the quality of PSB, we consider the framework for regulation, accountability and governance across the television broadcasting sector. We believe that a strong and transparent framework should:
- support high quality content across the PSB system;
 - ensure that the substantial amount of public funding made available to UK broadcasting is well spent;
 - underpin independence and impartiality in provision of news and current affairs;
 - secure effective and fair competition in the broadcasting market;
 - produce a common regulatory framework for all public service broadcasters; and
 - recognise the unique position and responsibilities of the BBC.
- 6.2 Above all, an effective framework must work for the broadcasting sector as a whole. The broadcasting sector is made up of some complex interrelationships - the actions of one player almost certainly impact on others. The use of public funding has the potential to affect significantly the investments made by commercial operators. The approach taken to the use of independent producers in one part of the sector affects relationships elsewhere. Editorial judgements made by one broadcaster, set the climate for judgements made elsewhere.
- 6.3 As convergence gathers pace, the regulatory regime for broadcasting will increasingly interlock with that for telecommunications and broadband. While *governance* mechanisms may vary between players, depending upon their individual circumstances, it is less and less possible or desirable to think about the *regulation* of individual participants in the sector in isolation from the environment in which they operate.
- 6.4 In our Phase 2 report, we suggested that clarifying the separate roles of governance and regulation of the BBC should be a central objective of the Charter Review process. We pointed to the proliferation of reviews of the BBC's activities and services in recent years as evidence that the current system is not working well.
- 6.5 In the responses we received to the Phase 2 consultation, we have identified some key themes:

- Significant support for our call for greater clarity in the roles of regulation, accountability and governance.
- Concern, especially from commercial broadcasters, that the BBC's impact on the wider market is insufficiently taken into account by the current system of BBC governance.
- Support for a common approach, as far as possible, to determining and enforcing editorial standards across all broadcast output, especially as regards news and information.

6.6 Not all agreed that these issues should be dealt with in the PSB Review, and certainly not all thought that Ofcom should be asked to take on a wider role which encompassed governance as well as regulation. But many did agree that there should be greater consistency in approach across the industry, and some argued strongly that these issues merit urgent consideration, now and as part of the Charter Review.

6.7 In parallel with our Review, the BBC has put forward and is introducing new proposals for addressing some of the problems associated with its current model of governance. The Burns panel, advising DCMS on the Charter Review, has also published its proposals for a new model of BBC governance, which involve the creation of a unitary BBC Board, a new Public Service Broadcasting Commission, and a cross-sector regulatory remit for Ofcom.¹⁶

6.8 Against this background, we think there would be a significant gap in our own work if we did not offer our own views for further debate, based on further analysis of the issues raised and the submissions we have received from a wide range of respondents.

The overall principles

6.9 The Burns panel proposals emphasise the importance of distinguishing between management and compliance on the one hand, and regulation and accountability on the other. We contributed our own views to the Burns panel, and strongly support this approach. Our analysis in fact suggests that there are three different aspects to governance and regulation, which any system should reflect:

- **External, cross-sector, regulation** - for example the rules, codes and regulations which would normally apply, in varying degrees, to all players in an industry - for example competition rules, environmental laws and - in this case - programme codes;
- **Accountability** - the arrangements which may need to be in place to secure, for example, effective use of public funds or to approve major public resource allocation decisions; and
- **Internal - or corporate - governance:** the arrangements which any large organisation should have established to ensure it is effectively managed and governed on behalf of its key stakeholders - including that

¹⁶ *Independent Panel's Final Advice to the Secretary of State*, available at: <http://www.bbccharterreview.org.uk>

it has access to high quality advice and expertise, and that it complies with all relevant laws and regulations.

- 6.10 There are different options for managing each of these aspects, and they can sometimes be collapsed into two rather than three separate categories. In the private sector, the third function - oversight of the organisation's performance - is entrusted to the directors, working on behalf of shareholders, within a corporate governance framework. In the public sector, the lack of a market-imposed discipline, and the importance of ensuring that public funding is used effectively, argue for an additional layer of oversight. It would, however, be unusual for all three functions to be carried out by the same body.
- 6.11 Some general trends regarding corporate governance and regulation are also relevant - as the Burns panel has pointed out. They include the following:
- Increasing demand for accountability and external scrutiny of public bodies, especially where public funding is involved.
 - Clearer definition of the roles and responsibilities of executive and non-executive directors, and in particular, the need for independent, non-executive chairmen in both public and private bodies.
 - Concerns about the adequacy of self regulation. Where key sectors require economic regulation, independent regulators have been established, separate from the companies they regulate, and accountable to Parliament.
- 6.12 These concerns are relevant to the sector as a whole, not just to the BBC. Ofcom is generally seen as being the sectoral regulator, and so it largely is. But it is also currently asked to carry out various responsibilities which are more akin to the accountability and oversight functions set out above. For example, Ofcom itself is currently responsible for:
- appointing Channel 4's chairman and non-executive directors;
 - appointing the Board of the Gaelic Media Service;
 - approving and reviewing the GMS budget; and
 - allocating the money contained within the Community Radio Fund.
- 6.13 Elsewhere in the system, there are separate governance arrangements for S4C.
- 6.14 There are hence good reasons now to make changes to the current system to ensure greater clarity of roles and responsibilities, and to improve governance and regulation across all the public service broadcasters, not just as it affects the BBC.

An improved approach to regulation

- 6.15 We do not believe that the answer is to ask Ofcom to take on governance or accountability responsibilities for the BBC. That would lead to a further confusion, rather than clarification, of the distinct functions.
- 6.16 Rather, an important first step towards addressing some of the concerns identified would be to take steps to remove inconsistencies in the approach to cross-sector regulation, as it applies to competition issues and to Tier 1, Tier 2 and Tier 3 content requirements for broadcasters.
- 6.17 Currently, there are broadly three types of content regulation in the broadcasting sector. As it relates to the regulation of the BBC, the picture is complicated and different regulators take the lead in different areas:
- **Ofcom takes the lead** – Ofcom is responsible for most Tier 1 and Tier 2 regulations for both the commercial sector, and for the BBC.
 - **BBC Governors take the lead** - In some areas, such as due accuracy and due impartiality, the BBC Governors retain responsibility for BBC matters, while Ofcom deals with the rest of the sector.
 - **Unclear who takes the lead** - For some Tier 2 quotas (e.g. for regional programming) Ofcom has more limited scope for action as far as the BBC is concerned, compared with its commercial licensees.

Box 6.1: Responsibility for content regulation (Tiers 1, 2, 3) and competition regulation

	Regulation by Ofcom			
	BBC	ITV	Channel 4	Five
Tier 1 – programme standards relating to harm, offence, privacy, accuracy, impartiality and fairness etc.	(✓)* powers in some areas	✓	✓	✓
Tier 2 – quotas and targets which must be met – e.g. independent production, original production, regional production	(✓)** powers, but limited in some areas	✓	✓	✓
Tier 3 – relates to the PSB remits of the main terrestrial channels – e.g. quality and diversity, statements of programme policy	X	✓	✓	✓
Competition regulation – ex ante and ex post powers	(✓) ex-post powers only	✓	✓	✓

* Ofcom is responsible for ensuring compliance with standards, for example relating to harm and offence, and fairness and privacy, but the BBC Governors are responsible for ensuring that relevant BBC programmes meet standards of due accuracy and impartiality.

** Ofcom is responsible for monitoring compliance with Tier 2 regulation (e.g. ensuring the BBC meets its independent production quota), although in some areas, our powers are limited to ensuring the BBC does not fall below current levels of provision.

6.18 Separately, on competition issues (as Box 6.1 shows), regulation is not consistent across the sector. For example, Ofcom has extensive ex ante competition powers for the commercial sector, but can only exercise ex post powers over the BBC.

6.19 The responses to our consultation suggest that this lack of consistency and clarity gives rise to some important concerns.

6.20 A key issue is the BBC's relationship with the rest of the sector, and the impact of its activities on competition in the wider broadcasting market, and on the commercial viability of other channels, service providers, and producers. The main issues are as follows:

- An inconsistent approach to the application of competition law - Ofcom has a much wider toolkit of powers that it can use with its commercial licensees than it has for the BBC. For example, Ofcom has to approve ITV's networking arrangements, as they relate to contracts with independent producers, but has little direct influence over any similar arrangements that might be proposed by BBC.
- Lack of confidence in the assessments made by the BBC Governors of the impact of any new BBC service on the market as whole, given their joint, but conflicting, roles as regulator and champion.
- Lack of predictability in the scope and scale of the BBC's activities in different parts of the market, with changes in the BBC's strategy for its services having potentially major implications for the viability of existing commercial operators.

6.21 There is scope to remove these anomalies and to ensure that regulation across all relevant areas is seen to be independent and enforced by a truly external body, able to draw on wide expertise of regulatory matters, case law and relevant comparative data. There are benefits, too, from a single regulator exercising its responsibility across the industry – applying a similar approach even if the detailed rules/codes vary from broadcaster to broadcaster.

6.22 We therefore have three firm recommendations:

- First, that the approach to competition issues should be the same across the sector – with the BBC subject to the same ex ante rules as are the commercial broadcasters. This would allow Ofcom to intervene promptly in the event of a possible threat to competition, and ensure a consistent approach across the market. The BBC would then become explicitly responsible for compliance, and Ofcom for regulation.
- Second, that where the BBC is proposing new services, the Impact Assessments (which examine the effect of those new services on the market as a whole) should be carried out by Ofcom, rather than by advisers appointed by the BBC's Governors. The results of such assessments would be published and then form part of the information

and analysis available to those responsible for the accountability and oversight of the BBC in reaching a decision on the approval of a new service (in any event, as proposed elsewhere, we look forward to working with the BBC to help develop a common approach to Impact Assessments).

- Third, that we believe that all Tier 2 quotas which currently remain with the BBC Governors should in future be regulated by Ofcom: at present Ofcom's powers to impose higher quotas on the BBC are limited in some areas.

6.23 We acknowledge that, if any of these recommendations were implemented, they would require appropriate changes to the BBC Charter and Agreement. In addition, making the BBC subject to the same ex ante competition rules as commercial broadcasters would probably require primary legislation.

The regulation of news and current affairs

6.24 A further area of concern is around the uneven application of editorial standards, which might result from the current split of responsibilities between Ofcom and the BBC Governors for the enforcement of standards in the areas of accuracy and impartiality.

6.25 There is a risk that a different approach to regulation of editorial standards between the BBC and commercial broadcasters risks implying to the public that there are two standards for news: a BBC gold standard, and the rest.

6.26 Arguably, it is in the public's interest to have:

- clarity and consistency in the approach that is taken to safeguarding editorial standards – in particular in reference to accuracy and impartiality; and
- a number of competing news services which all meet the high standards for impartial, accurate and high quality news that has been established in UK broadcasting.

6.27 A common regulatory approach would provide clarity and would enable the application of a consistent gold standard across the whole sector.

6.28 However, we recognise that in terms of the depth, breadth and quantity of its provision, the BBC has a unique status in providing news and current affairs in the UK and beyond. In this area in particular, the BBC has a role as the cornerstone of PSB as the UK's primary provider of publicly-funded news and information. It is critical to the public interest that the highest standards of editorial integrity are maintained and are placed at the heart of the overall approach to accountability and regulation of the BBC's output in this area. There is, therefore, an argument that the BBC should be regulated differently from the commercial news providers, reflecting the subtle distinctions described above.

Assessment of PSB delivery

- 6.29 As part of a more consistent cross-sector approach, Ofcom is developing further its plans for annual statistical reviews of the broadcasting and communications sector.¹⁷ We are also planning a new approach to assessing, each year, the effectiveness of PSBs in delivering the public purposes and characteristics set out earlier in this report. This assessment will include:
- an extensive audience tracking survey, to measure perceptions of overall delivery and the performance of each channel;
 - detailed analysis of Barb and output data, as already presented in Phase 1 of this Review;
 - expert review each year of selected genres or specific aspects of output, with wide public consultation; and
 - value for money of the various services delivered across the sector.
- 6.30 We hope to share this information with broadcasters and the BBC Governors, to provide a common basis for understanding the performance of different channels in delivering PSB, and the value they are delivering from year to year.

The effective oversight of the use of public funds

- 6.31 A separate but equally important issue is the need to secure effective and transparent oversight of public funding for PSB, and the extent to which it is delivering agreed PSB objectives. Is the BBC offering the right mix of services? Are its services providing distinctive content, with real public value? If there are other recipients of public funding, are they investing those funds wisely?
- 6.32 Here, there are two broad options: retain responsibilities for oversight with the BBC's Governors, as proposed by the BBC's new model, or establish a new external body to exercise these responsibilities, separate from the BBC, as proposed by the Burns panel. There are advantages and disadvantages associated with each model.

Oversight by the BBC Governors

- 6.33 The BBC has proposed a new system of governance, with greater separation between the BBC's Governors and management, and a clearer independent role for the Governors.
- 6.34 Its main features are as follows:
- The Governors will remain the custodians of the public interest, and will – as now – help develop the overall strategy for the BBC, and how the licence fee is spent.
 - There will, however, be clearer separation of the roles of Governors and management, embodied in physical separation.

¹⁷ *The Communications Market*, published annually from 2004

- Efforts will be made to recruit Governors with more relevant expertise, and the Governors will have their own independent staff, not reliant on the BBC as a whole for reward and career advancement, and will have the resources to seek independent advice on a range of matters.
- There will be a system of service licences, which will specify the remit for each service (e.g. BBC One, Radio 3) and what it must deliver - performance will be regularly reviewed against these licences.
- There will be a new approach to the annual report, which will be less of an advertisement for the BBC and more of an independent review of successes and failures.
- A new measure of public value will be adopted, which will be applied to all the BBC's services - existing and new. Before approving new services, the Governors will commission an independent assessment of the extent to which the service adds net public value.

How effective will this new approach be?

- 6.35 The system, in more or less this form, is seen by some to have worked reasonably well for many years, and is perceived to be an instrumental part of sustaining an independent and strong BBC, able to withstand political interference. The Governors, it is argued, benefit from being close enough to the Corporation to understand the key issues and challenges, and to take action via influence and persuasion, as well as more formal direction. Indeed, it may be difficult to specify precisely the nature of the service and programming which we would like the BBC, as a creative organisation, to deliver – the Governors, it is argued, can achieve results effectively even in the absence of precisely specified service contracts. If, as a modification to the BBC's proposed approach, regulation of common broadcasting standards and competition is more clearly the responsibility of Ofcom, the Governors would be able to focus even more effectively on their distinct governance duties.
- 6.36 However, the disadvantages of this approach are those which inevitably come with the perceived advantages. The case for the in-house model is based on exactly the same characteristics which others see as its fundamental flaw. There will be the scope for a continuing lack of clarity between the Governors' role in providing oversight on behalf of the general public and defending the strategic decisions they make jointly with management. The external perception will remain that the BBC's Governors cannot take a truly independent view when assessing whether or not to approve new services, nor can they easily exercise effective sanctions if the Corporation does not deliver agreed levels of performance.
- 6.37 A potential further disadvantage is that the need to demonstrate that the Governors remain separate from management may prevent the BBC from having access to the advice and expertise that would be available to most similar organisations via a unitary Board with appropriate non-executive directors. The BBC is a large and complex organisation. It encompasses international and commercial operations as well as UK public service activities. As such, it might benefit from a main Board which reflects best practice corporate governance processes and structures, including a mix of executive and non-executive members, a chairman and chief executive,

and formal processes to ensure that the corporation is working in the best interests of its key stakeholders – including the public.

- 6.38 Finally, this approach is less capable of adapting over time to the changing needs of the sector and PSB provision. For example, it may be difficult to adapt the model to allow a revised Board of Governors to exercise future oversight of Channel 4 (should it at some stage require public funding), or any other recipient.

Oversight by a new external body

- 6.39 Alternatively, as proposed by the Burns panel, a new body – a Public Service Broadcasting Commission – could be established to act as the custodian of the public interest in the use of such funding, and to provide effective external oversight of the BBC's delivery of PSB objective:

- The new body could be responsible for agreeing the BBC's overall strategy and plans, and its broad funding needs.
- It could be responsible for regular reviews of the BBC's performance against agreed remit and targets, for reviewing value for money and for reporting to Parliament each year on its conclusions and recommendations.
- It could be the body responsible for approving or otherwise BBC new services, and for assessing the extent to which existing services were meeting the terms of service licences, drawing on Ofcom's Impact Assessments.
- It could review and provide periodic advice to Government on the level of the licence fee and on the BBC's Charter and Agreement – although final decisions on both could be reserved for Government and Parliament, not the new body.

- 6.40 A new external body would have a number of advantages:

- It would be truly independent of the BBC.
- It would, if properly resourced, be able to bring professional expertise to bear on the key issues.
- It would enable the BBC to establish a unitary Board with non executive directors.
- It could relieve the DCMS of its current duty to approve and review new services.

- 6.41 There are potential disadvantages to this approach, too:

- There are inherent risks in setting up a completely new body – for instance, it could be difficult to develop a workable solution that can be readily implemented.
- Arguably, an external body would have less information than would an internal body about the BBC.

- Its responsibilities would be exercised more formally and procedurally, which might make it less effective than an internal body with more direct and informal contact with the executive.
- As an external body would be less closely associated with the BBC, it could be less willing to stand up for the BBC's political independence.

6.42 A further potential risk is that the new body could add a further layer of bureaucracy to the system. Although, if properly set up, it could lead to a streamlining of governance (by bringing together several diverse strands) and a reduction in the costs of governing the BBC:

- It could replace much of the work currently carried out by DCMS and by independent reviewers of the BBC's services.
- It would replace much of the oversight exercised by the current Governors.
- By locating the responsibilities in one independent cross-sector body, it could also take on the governance functions currently carried out by Ofcom (as discussed earlier in this chapter).
- It would allow Ofcom's work to be more focused on regulation of competition, economic, spectrum and pan- broadcaster issues.
- It could reach an arrangement to draw on Ofcom's research expertise and resource, to avoid duplication of activity in this area.

Governance of public service broadcasting

6.43 One advantage of the Burns proposal is that it could be extended to include wider governance responsibilities for the whole sector, and is more suited to accommodating change over time, as the PSB system evolves.

6.44 For example, such a new body would be ideally placed to take on responsibility for those functions of accountability and oversight which currently reside with Ofcom.

6.45 At some future stage, the proposed body could be responsible for collecting and disbursing the licence fee, and for co-ordinating and distributing other sources of public funding for PSB. It would be well placed to make informed judgements, based on comparative data, about where public funding would be used most effectively. For example, every five years, it could advise on how much funding (from the licence fee and other sources) the BBC should receive, and how much should be available for other PSB providers. Finally, as the Burns panel noted, it could introduce an element of contestability into the use of public funds for broadcasting.

Next steps

6.46 We have suggested that a new approach to governance and regulation should be informed by three clear and internally consistent elements: internal governance, external regulation, and the accountability and oversight of the use of public funding.

- 6.47 As a priority, we think that measures should be introduced to address inconsistencies in the current approach to cross-sector regulation - which would deliver a common framework for all broadcasters, and help clarify the role of the BBC Governors.
- 6.48 Ofcom can also contribute to a better understanding of the effectiveness of PSB provision across the sector, via its annual and five yearly reviews, supported by a new approach to assessment.
- 6.49 We have described two broad models for dealing with the important issues of internal governance and oversight of public funding. The first, in-house model builds on the BBC's current proposals, and ensures that the advantages (but also possibly some of the disadvantages) of the long established approach are retained. The second - a new body or public broadcasting commission - suggests a fully independent approach to oversight of the BBC, deals with some outstanding anomalies, and is better equipped to adapt to future changes in PSB funding and provision; but it risks setting up a new layer of oversight unless accompanied by reductions elsewhere, and would require careful examination in relation to its practical application.
- 6.50 We look forward to further debate on these options in the context of the Charter Review, but would encourage consideration of any proposals in terms of the wider industry context, not just their implications for the BBC.

Chapter 7

Next steps

7.1 The purpose of this final section is to summarise the key next steps that arise from the final Phase of our first PSB Review. A number of steps are to be taken forward by Ofcom, including consulting on our proposals in the Nations. Other issues arising from this report are issues for Government to consider - in the Charter Review process and elsewhere.

To be taken forward by Ofcom

Overall framework for PSB

- We will take forward a comprehensive programme of analysis during 2005, to assess potential barriers to competition in the UK television sector, and scope for reducing or removing those barriers.
- We will also undertake a wide ranging review of the UK content production sector.
- We will consider ways in which some of the benefits of PSB status – such as appropriate prominence on EPGs – could be conferred on existing multichannel services if they are considered to make a significant contribution to PSB purposes and characteristics.
- We will consider the changing role of EPGs, search engines, and personal video recorders, and how they will influence and shape PSB consumption in the future.
- We will work with the BBC to share ideas and approaches to measuring both the value of PSB output and the market impact of BBC services.
- We will work with broadcasters to develop a new assessment system for PSB.

PSB in the Nations and Regions

- We will continue to require Channel 3 licensees to provide regional news and current affairs and will monitor a range of measures (including audience opinion and investment) to ensure that the service to viewers provided by ITV1's regional news is maintained and where possible enhanced.
- We will require ITV1 to increase the level of provision of network programming from outside London to 50%, with dispersal of that production around the UK. We will work with ITV plc to develop the details of a production partnership fund to build production capacity outside London.
- We will consult with the BBC about increasing its out-of-London production quota to 50% of network production measured by both volume and spend, across BBC One, BBC Two and its digital services
- We will amend the relevant licences to reduce ITV1's non-news regional programming obligations in the English Regions to 1.5 hours per week,

including 45 mins per week in peak and 30 mins near peak, immediately.

- We will consult on our proposal to reduce non-news programming requirements in the English Regions further, to 0.5 hours per week, when the first UK region achieves digital switchover
- Following consultation, we will finalise our plans for non-news programming for Scotland, Wales and Northern Ireland.
- We will carry out further research and analysis regarding the future prospects for local TV. We will work with Government to ensure a common, collaborative policy on any future digital local TV licensing regime.
- We will seek to inform the Charter Review process with an analysis of the likely impact of the BBC's plans on the local commercial TV market, to complement the BBC's own public value test of these proposals

The role of Channel 4

- We will work further with Channel 4 to understand the broadcaster's scope for self-help.
- We will consider, on their own merits, a range of near term issues that may affect Channel 4's position, for example the status of More 4.
- We will continue to monitor the performance and financial position of Channel 4 and review it again in detail in 2006-7.
- In parallel, we will continue work, with Channel 4, on developing options for meeting its longer term structural challenges.
- Relevant to Channel 4, but also to many other users of spectrum, we will consider how the spectrum released by switchover might be used; and we will consider proposals for the extension of pricing to television broadcasting spectrum.

Recommendations for Government and others

- The Charter Review process should examine in more detail the scope for an enhanced licence fee, and the use of the licence fee model to support direct funding of PSB across a range of suppliers at some stage in the future.
- The Government should develop proposals for the PSP in more detail, address funding issues, and draw up a possible implementation plan.
- The BBC should be asked, as part of Charter Review, to develop new proposals for local and regional programming, which go beyond those set out in its *Building Public Value* document, and help provide more well-funded television programming for the English Regions to complement its ambitious plans for the Nations.
- The BBC should consider further steps to increase its out-of-London production, beyond its existing proposal. In particular, it should consider increasing representation of the Nations and Regions in its network drama, entertainment and factual output, and may also be able to

complete the Manchester relocation programme faster than currently envisaged.

- All relevant parties should begin planning now for the delivery of indigenous language broadcasting through dedicated channels.
- The Charter Review process should consider further the structure of internal governance and external oversight for the BBC, and aim to introduce greater clarity between the different functions of regulation, accountability and internal governance.

Annex A

Proposals for the Nations and Regions: a consultation paper

The distinct needs of the devolved Nations

- A.1 As we set out in chapter 3, we believe that the needs of the devolved Nations of the UK are distinct from those of the English Regions, for a number of reasons:
- The need for broadcasting in the UK to reflect the reality of our devolved social, cultural and political institutions, both via regional news services, but also through other kinds of dedicated programming to ensure national audiences have adequate access to TV that reflects their own culture and heritage;
 - The strength of national identities, and the fact that the TV regions in the Nations more closely map onto real areas of shared identity than the English Regions, which are largely driven by the practicalities of the 1950s transmission map;
 - Audiences' views, which, although varied and not always internally consistent, suggest that overall, viewers in the devolved Nations are more interested in dedicated provision than those in England.
- A.2 The remainder of this paper sets out a series of proposals for regional programming on ITV1 in the Nations, and some options for the future of indigenous language broadcasting.

Proposals for the Nations

News for national audiences

- A.3 As we noted in Chapter 3, news provision for the Nations on ITV1 will be maintained. Any changes to news services in this period need to demonstrate that they would constitute an enhancement, not a deterioration, in the quality of the service provided to viewers.
- A.4 For example, Scottish Media Group (SMG), the operator of Scottish TV and Grampian TV, has suggested that Scottish TV should be permitted to lose its requirement to broadcast a half-hour lunchtime regional news bulletin – an obligation that no other licensee has, including the other Scottish licensees, and a legacy of the 1990 licence application process. This bulletin is currently broadcast at 1400 on weekdays, between the 1230 news (which includes a regional opt-out) and a 15-minute bulletin at 1500.
- A.5 SMG's research suggests that this slot is not highly valued by viewers. It tells us that it is increasingly difficult to find space for this half-hour slot in the network schedule, and that it takes resources away from the flagship 1800 bulletin, which is more highly valued. We carried out our own analysis of viewing figures which found that in November 2004 the average audience for the 1400 bulletin was only 75,000 viewers (11% share), compared to

415,000 viewers (24% share) for the 1800 bulletin.

- A.6 If we were to agree to SMG's proposal, we would expect it to compensate for the reduction in total regional news hours by improving its news service in other areas. SMG has suggested two ways in which this might be achieved.
- A.7 First, it has offered to explore the possibility of micro-regional news services using split transmission technology, to provide separate opt-outs for Glasgow and Edinburgh within the existing STV regional news service, and for the north and south of the Grampian region. This would help meet the need, identified by our research in Scotland, for more local coverage than can currently be provided by the regional news services.
- A.8 Secondly, SMG has proposed to commission ITN to develop a tailored Scottish version of the 2230 UK and international news bulletin. This service would feature largely the same material as elsewhere in the UK, because our research showed that Scottish viewers are as interested in UK-wide news as those elsewhere, and it would not be appropriate to develop a narrow or parochial alternative. However this proposal would create the potential to re-edit or omit stories of less specific relevance to Scotland. Several respondents to our consultation criticised the limited capacity of UK-wide news to reflect and be fully relevant to a devolved society; Westminster policy initiatives on health and education, for example, are often irrelevant to Scottish, Welsh and Northern Irish audiences, and yet this cannot be reflected in a single UK-wide bulletin.
- A.9 We welcome these contributions to the debate and seek others' views, particularly whether such proposals would still ensure that Channel 3 news is capable of competing effectively with other nationwide news services, as required under the Communications Act. We would also be interested in others' views about the merits of similar national versions of the 2230 news for Wales and Northern Ireland.

Non-news programming on ITV1

- A.10 Given the challenges of scheduling regional programming within the constraints of a network schedule, a certain amount of coordination is required, both between licensees and within the regulatory framework. As far as possible, therefore, we propose to establish similar requirements (in terms of hours) in each nation. In doing so, we recognise the additional needs of audiences in the Nations compared to the English Regions, but also seek to ameliorate the scheduling and financial challenges faced by national licensees.
- A.11 In Scotland, to help secure financial sustainability, we propose to require Scottish TV and Grampian TV to broadcast four hours per week of non-news regional programming until the first UK region switches over to digital. One hour of this would be unique to each licensee, and could not be co-produced with the other SMG-owned licensee – thereby helping to preserve the distinctly regional element of the service. The licensees would be able to share the other three hours' content, which could be produced by either of them or by independents in Scotland. These three hours of common content would include an hour of Gaelic programming, funded by the licensees and

separate from their continued requirement to broadcast GMS-funded Gaelic.

- A.12 This would replace Scottish TV and Grampian TV's current quotas for regional non-news, and the agreement reached with the ITC that each would broadcast the other's Gaelic programmes in addition to meeting this quota.
- A.13 We also propose to explore with the licensees the possibility of ITV1 Border's Scottish service showing the two hours per week of English language common content simultaneously with the Scottish licensees, and for this to be provided at no cost to ITV1 Border by SMG.
- A.14 These changes would meet the Scottish audience's demands for an all-Scotland service for the first time, while still retaining regional provision to enable reflection of differences between the three licence areas in Scotland.
- A.15 In total, these proposals represent a substantial increase in on-screen licence requirements in Scotland. They maintain Scottish TV's licence requirements for non-news at current levels, increase Grampian's from 1.5 hours to 4 hours per week, and increase the requirements on Border's Scottish transmission from 1 hour 8 minutes to 3 hours per week. This increased obligation would be made possible by allowing STV and Grampian to share up to three hours of their content, thereby reducing production costs but also increasing the amount of Scottish programming for Scottish viewers in Grampian and Border.
- A.16 We also propose to establish ITV Wales' non-news regional output at 4 hours per week, and UTV's at 2.5 hours per week plus 1.5 hours per week of non-specified genre¹⁸ until the first UK region switches over. This represents a marginal reduction in the current requirement of 4.5 hours per week, with the reduction coming from off-peak hours.
- A.17 When the first UK region achieves digital switchover, we propose to reduce the requirement for non-news programming for Scotland and Wales to 3 hours per week and for Northern Ireland to 2 hours per week, plus one hour per week of non-specified genre. Requirements for Gaelic programming on ITV1 in the Scottish and Grampian regions would be reviewed, subject to prevailing statutory obligations.
- A.18 These proposals increase the differential between the English Regions' requirements and those of the national licensees – on average, from 1.5 hours per week to 2.5 hours. This both imposes additional costs on the national licensees, and creates significant scheduling difficulties – it is already difficult for the national licensees to find viable and attractive slots for their regional opt-out programming in an increasingly competitive network schedule.
- A.19 We recognise the need to relieve the scheduling pressures on national licensees, and to reduce the cost of opting out of the network schedule to meet their regional programme licence requirements. In the current review of

¹⁸ In Northern Ireland, UTV is currently able to dedicate 1.5 hours of its regional quota to a genre of its own choosing, giving it the flexibility to allocate that time to news or non-news as it sees fit to most effectively meet its audiences' needs. Our proposals would retain this flexibility.

the ITV Networking Arrangements we therefore propose to amend the arrangements to:

- introduce a 'no-play, no-pay' clause for network programmes for national licensees, which enables national licensees to opt out of the network schedule in order to meet their regional programming requirements without having to pay for the network programme that they have opted out of; and
- require the ITV Network Centre to take into account the higher level of regional programmes in the three Nations when devising its network schedule.

A.20 We would expect to take account of these decisions in reviews of the financial terms for relevant licensees, and the current review of ITV Networking Arrangements.

Broadcasting in indigenous languages

A.21 Indigenous language broadcasting is an integral part of national television services, with both new opportunities and significant challenges opening up as a result of the expansion of digital choice. Chapter 3 of this report sets out our strategy for indigenous language broadcasting. The boxes on this and the following pages set out the issues we believe need to be addressed soon to ensure viewers will benefit from maintained and enhanced services in a digital environment.

Future options for S4C

A.22 In Wales, S4C has made a huge contribution to embedding the Welsh language and culture throughout Wales, and in the Welsh-speaking community outside Wales. However, its existing model will face major funding pressure after digital switchover, as the channel will lose Channel 4 programming and associated advertising revenue. Already S4C is under increasing pressure from declining audiences due to the high level of digital take-up in Wales, particularly amongst younger viewers. Our analysis shows that S4C's financial position, under a steady state model, will deteriorate significantly compared to other PSBs between now and 2012, due to the constraints on its major funding source (a government grant) and declining advertising revenue.

A.23 We therefore suggest that work should start now on clarifying the future purpose and institutional strategy of the Welsh language service. We believe there are broadly three options:

- Status quo, with revised arrangements for working with the BBC. S4C's relationship with the BBC has not been systematically reviewed for some time and this should be addressed as part of Charter Review. The first step would be to introduce greater transparency into the relationship, including explicit and documented service agreements, a clear ongoing financial commitment from the BBC (as opposed to simply an hours-based promise) and greater editorial control for S4C. Eventually, the share of the licence fee used to fund Welsh output could be transferred to S4C, enabling it to contract out elements of its service

to other providers if it believes it could deliver an enhanced or more cost-effective service by doing so.

We believe that the BBC-S4C working arrangements should be reviewed and that these recommendations represent a good starting point.

- Incorporate S4C entirely into the BBC. Some commentators have suggested this model, in which the S4C brand and service would be retained but responsibility and funding for their delivery would pass to the BBC. Advocates of this approach point out that it might enable cost savings and a more effective integrated cross-media service.

Nonetheless, we do not believe this is an attractive option. There would be a significant negative impact on plurality in Wales. And an important aspect of S4C's success is its independence and single-minded focus on serving the Welsh-speaking audience; there is a risk that the BBC's corporate priorities would not always coincide with those of the Welsh language television service if this were brought entirely under its control.

- A Welsh language PSP for Wales. We believe that in the longer term, consideration should be given to the use of the PSP model for the provision of Welsh language services. The franchise for operating the service, including but not restricted to the current S4C service, would be awarded on a contestable basis for, say, 10 years. Bidders would be able to propose solutions using a full range of distribution channels as well as traditional broadcast technologies. This could help bring new ideas into the debate about the delivery of Welsh language broadcasting as well as identify new funding opportunities, while a formal licensing and review process would help ensure that the service continued to operate efficiently and offered value for money.

Delivering a Gaelic digital channel

A.24 In Scotland, digital brings with it the prospect of a dedicated Gaelic service, providing more content, and a much richer range, than is currently provided on mainstream channels. The Scottish Channel 3 licensees are currently required to broadcast one hour of their own Gaelic programming per week (half an hour from each licensee), plus programmes supplied by GMS (currently around one hour per week, including 30 minutes in peak), for the estimated 90,000 people who can speak, read, write or understand Gaelic in Scotland. This requirement will become unsustainable as switchover approaches.

A.25 Regional opt-out slots are increasingly in demand and there is a view that in the long term these slots could be better used by SMG for English language programmes for the Scottish audience than for Gaelic programming. SMG has proposed to provide support for setting up a digital Gaelic channel, initially delivered by satellite, in return for reductions in its Gaelic obligations. Specifically, SMG proposes to work with the Gaelic Media Service (GMS) to develop a Gaelic service within its schedule (on Tuesday evenings) as a staging post to the new channel, with a separate brand, promotion and continuity.

A.26 We welcome the general direction of these proposals and propose to work further with SMG and GMS to explore the options for a Gaelic digital channel while ensuring that viewers of Gaelic programming have access to a suitable service on analogue television throughout the transition. We believe that in return for SMG's support to set up a digital channel, it would be appropriate to move its requirement to broadcast GMS-funded in peak to near-peak slots, although we recognise this may require changes to primary legislation. Once the Gaelic channel has been in operation for some time, we propose that SMG's Gaelic obligations should be removed. It should be noted that this, however, is ultimately a matter for Government, not Ofcom, since it would require changes to the 1990 Broadcasting Act.

Meeting the needs of the Irish-speaking and Ulster Scots communities in Northern Ireland

A.27 We had constructive dialogue with representatives of both Irish language and Ulster Scots interest groups during the PSB Review. We also received several responses from Irish language groups to our Phase 2 consultation calling for an increase in Irish language broadcasting in Northern Ireland.

A.28 There are an estimated 170,000 people with some knowledge of Irish in Northern Ireland, albeit normally as a second language rather than their native tongue. Compared to the amount of Gaelic programming in Scotland and Welsh programming in Wales, the UK broadcasters provide very little Irish language content and there is no statutory requirement on them to do so.

A.29 Historically, the BBC has spent less per head on serving its Irish-speaking audience than on the Gaelic and Welsh-speaking populations. We welcome its introduction of a regular factual strand in the Irish language, SRL, and would expect Charter Review to result in sufficient funding for BBC Northern Ireland to be able to continue and expand this commitment.

A.30 However, as we stated above, we believe the long-term future of indigenous language broadcasting lies in the delivery of dedicated services. In this context the rollout of TG4, the Irish language service in the Republic of Ireland, into Northern Ireland should be encouraged and extended as proposed in the Belfast/Good Friday Agreement. As a result of this Agreement, TG4 will be broadcast from the Divis transmitter during 2005, which should increase coverage to 65-70% of the Northern Ireland population. In addition the new Irish Language Television and Film Production Fund will provide £12 million of funding over the next five years for new productions, which could be broadcast on BBC Northern Ireland and/or TG4, or indeed on other channels available to viewers in Northern Ireland.

A.31 Consideration should be given now by the relevant parties as to whether and how it would be possible for TG4 to continue to be broadcast in Northern Ireland after switchover.

A.32 The needs of the Ulster Scots community are a little different. Recent research by the BBC found that the priorities of the Ulster Scots audience

were for programmes reflecting its culture, music and history, rather than for material which focused only on its linguistic heritage.

- A.33 Both the BBC and UTV have broadcast successful programmes addressing these needs and we would encourage them to seek further opportunities to provide programming that appropriately reflects the identity and diverse interests of the Ulster Scots community.
- A.34 We propose to review progress in all these areas at the next PSB Review in 2009.

Proposals for the English Regions

- A.35 We set out in Chapter 3 our reasons for reducing non-news programming obligations in the English regions from three hours per week to 1.5 hours per week immediately. We also reported the findings of our further analysis, that even this level of programming will not be sustainable as switchover approaches.
- A.36 When the first UK region switches over, therefore, we propose to reduce the requirement for non-news programming in all English regions to 0.5 hours per week. The 0.5 hours would include parliamentary coverage and current affairs. We believe that this two-stage approach maximises benefits to viewers in the transition period, while ensuring that other, more highly valued elements of ITV1's PSB contribution can be retained to switchover and beyond.
- A.37 This is a further step to that proposed in Phase 2 of the PSB Review which we now publish for consultation.

Consulting on our proposals

- A.38 This consultation seeks views on our proposals for programming on ITV1 in the Nations and Regions, as set out in this consultation paper. This consultation also covers the options we set out for indigenous language services in the Nations.
- A.39 The consultation will begin immediately, and last for a period of ten weeks. The findings of this consultation, and our final decisions regarding regional programming requirements on ITV1 in Scotland, Wales and Northern Ireland and the transition path in the English Regions will be published shortly after the consultation closes.
- A.40 We are seeking views from all organisations and individuals with an interest in the future of public service broadcasting in the devolved Nations, including:
- viewers;
 - television broadcasters, channels and platforms;
 - production companies;
 - other media organisations, including statutory bodies;
 - political representatives;

- government departments;
- organisations in sectors with related interests (film, the arts, language, culture and heritage);
- consumer groups;
- anyone with a commercial or employment interest in the broadcasting industry (e.g. trade unions, trade associations)
- anyone concerned about the importance of television to society, the economy and citizens.

A.41 Electronic copies of this document are available on Ofcom's website: www.ofcom.org.uk.

How to respond to this consultation

- A.42 Ofcom invites written views and comments on the issues raised in this document, to be submitted by 5pm on **19 April 2005**.
- A.43 Ofcom prefers to receive responses as email attachments, in Microsoft Word format, as this helps us to process the responses quickly and efficiently. We would also be grateful if you could assist us by completing a response cover sheet (attached as Annex D), among other things to indicate whether or not there are confidentiality issues. The cover sheet can be downloaded from the 'Consultations' section of our website.
- A.44 Please send your response to: mark.bunting@ofcom.org.uk, marked 'PSB Review Proposals for the Nations – consultation response'.
- A.45 Responses can alternatively be posted or faxed to:

Mark Bunting
Ofcom
Riverside House
2a Southwark Bridge Road
London SE1 9HA

Fax: 020 7981 3333

- A.46 Please note that we do not need a hard copy in addition to an electronic version. We do not routinely acknowledge receipt of responses.
- A.47 It would be helpful if your response could include direct answers to the questions listed below. Ofcom would also be interested to receive comments on any other aspects of issues raised in this document. It would be helpful if you outline why you hold your views, and how Ofcom's proposals would impact on you.

Questions for consultation

1. Do you agree with our proposals for non-news programming for viewers in each of Scotland, Wales and Northern Ireland?

Until the first UK region switches to digital:

- a. in Scotland, for Scottish TV and Grampian TV to be required to broadcast four hours per week of non-news regional programming, including one hour unique to each region – Scottish and Grampian – with a further three hours of shared content across the two regions, including one hour of Gaelic programming;
- b. ITV1 Border's Scottish service to show two hours of Scottish/Grampian shared programming simultaneously with the Scottish licensees, and for this to be provided at no cost to ITV1 Border by the Scottish licensees; and
- c. four hours per week of non-news programming for ITV Wales and 2.5 hours of non-news per week, plus 1.5 hours that can be news or non-news, for UTV.

Once the first UK region achieves digital switchover:

- d. a reduction in the requirement for non-news programming for Scotland and Wales to three hours per week and for Northern Ireland to two hours per week, plus one hour per week which can be either news or non-news;
- e. a reduction in the requirement for non-news programming for the English regions to 0.5 hours per week,

2. Do you agree with our proposed amendments to the ITV Networking Arrangements:

- a. the introduction of a 'no-play, no-pay' clause for network programmes for national licensees, which enables national licensees to opt out of the network schedule in order to meet their regional programming requirements without having to pay for the network programme that they have opted out of; and
- b. a requirement on the ITV Network Centre to take into account the higher level of regional programmes in the three Nations when devising its network schedule.

3. Do you favour or oppose SMG's proposal that it should lose its requirement to broadcast a news bulletin at 1400, instead developing sub-regional opt-outs within its regional news service and a tailored Scottish version of the 2230 national and international news bulletin? If the latter is possible under the Communications Act 2003, do you think that similar tailored versions should be available in Wales and Northern Ireland?

4. Have we set out the right options for the future of indigenous language broadcasting in Scotland, Wales and Northern Ireland? What are the pros and cons of our proposals?

Further information

- A.48 If you have any questions about the issues raised in this consultation, or need advice on the appropriate form of response, please contact Mark Bunting on mark.bunting@ofcom.org.uk or 020 7981 3488. The PSB Review is the overall responsibility of Ed Richards, Senior Partner at Ofcom, who can also be contacted in relation to the issues raised in this consultation document.
- A.49 Please note that you can register to receive automatic notifications of when Ofcom documents are published, at www.ofcom.org.uk.

Confidentiality

- A.50 Ofcom thinks it is important for everyone interested in an issue to see the views expressed by consultation respondents. We will therefore usually publish all responses on our website, www.ofcom.org.uk. We will do this on receipt of responses, unless respondents request otherwise on their response cover sheet.
- A.51 All comments will be treated as non-confidential unless respondents specify that part or all of the response is confidential and should not be disclosed. Please place any confidential parts of a response in a separate annex, so that non-confidential parts may be published along with the respondent's identity.
- A.52 Ofcom reserves its power to disclose any information it receives where this is required to carry out its functions. Ofcom will exercise due regard to the confidentiality of information supplied.
- A.53 Please also note that copyright and all other intellectual property in responses will be assumed to be licensed to Ofcom to use, in order to meet all its legal requirements. Ofcom's approach on intellectual property rights is explained further on its website, at: www.ofcom.org.uk/about_ofcom/gov_accountability/disclaimer.

Ofcom's consultation processes

- A.54 Ofcom is keen to make responding to consultations easy, and has published some consultation principles (listed in Annex C) which it seeks to follow, including on the length of consultations.
- A.55 If you have any comments or suggestions on how Ofcom conducts its consultations, please call our consultation helpdesk on 020 7981 3003 or email us at consult@ofcom.org.uk. We would particularly welcome thoughts on how Ofcom could more effectively seek the views of those groups or individuals, such as small businesses or particular types of residential consumers, whose views are less likely to be obtained in a formal consultation.
- A.56 If you would like to discuss these issues, or Ofcom's consultation processes more generally, you can alternatively contact Philip Rutnam, Partner, Competition and Strategic Resources, who is Ofcom's consultation champion:

Philip Rutnam
Partner, Competition and Strategic Resources
Ofcom
Riverside House
2a Southwark Bridge Road
London SE1 9HA

Email: philip.rutnam@ofcom.org.uk

Telephone: 020 7981 3585

Annex B

Impact assessment

B.1 Impact assessments (IAs) provide a valuable way of assessing different options for regulation and showing why the preferred option was chosen. They form part of best practice policy-making and are commonly used by other regulators. This is reflected in section 7 of the Act, which means that generally we have to carry out IAs where our proposals would be likely to have a significant effect on businesses or the general public, or when there is a major change in Ofcom's activities. In accordance with section 7 of the Act, in producing the IA in this document Ofcom has had regard to such general guidance as it considers appropriate, including related Cabinet Office guidance.

Phase 2 impact assessment

- B.2 In our Phase 2 report we published an impact assessment of the proposals contained within the report. This considered three key questions:
- Whether or not to intervene in the market to ensure the provision of PSB content?
 - If intervention was deemed necessary, whether PSB content should be provided by a plurality of different providers?
 - If plurality was considered important, what is the best option for securing this?
- B.3 In response to the first question, we concluded that the benefits from intervening were likely to exceed the costs. In particular, intervention allowed the UK to benefit from a high level of PSB content (both overall and in comparison with other countries), which is highly valued by viewers, whilst it did not appear to generate a significant negative impact upon non-PSB TV services.
- B.4 On the second question, we concluded that the benefits of securing plurality of PSB provision outweighed the costs. Although intervention to secure plurality had some costs (such as creating some duplication of PSB programming), the benefits in terms of stimulating competition for quality were deemed to outweigh these costs. In particular, we said that lack of competition in providing PSB content was likely to lead to complacency, inefficient production, lack of innovation, lower quality programming, a narrowing of perspectives and the loss of PSB programming for certain groups.
- B.5 Finally, we concluded that competition between prospective PSB providers for long-term funding was preferable to two other options for securing plurality: a fully contestable PSB fund and direct payments to existing PSB institutions, such as Channel 4.

- B.6 Respondents to our consultation did not comment on the substance of the RIA specifically,¹⁹ although their more general comments did discuss the three issues mentioned above in some depth.
- B.7 Having considered respondents' comments we have decided that the conclusions of the IA published in the Phase 2 report remain correct. The underlying reasons for these conclusions are set out in earlier chapters of this report, especially Chapter 2.

Proposals for the Nations and Regions

- B.8 We have prepared a further IA for the specific proposals we are consulting on in this report, as defined by section 7 of the Communications Act 2003. You should send any comments on this IA to us by the closing date for this consultation. We will consider all comments before deciding whether to implement our proposals.

Policy objective

- B.9 The Communications Act requires Ofcom to review the effectiveness of public service television broadcasting, and to report on how it can be maintained and strengthened. This report includes a set of proposals for the Nations and Regions. We seek views as to the extent to which these proposals would contribute to these requirements.
- B.10 We have defined public service broadcasting in terms of its purposes and characteristics. Following responses to our Phase 1 and Phase 2 consultation documents, we have defined these purposes as follows:
- **To inform ourselves and others and to increase our understanding of the world** through news, information and analysis of current events and ideas;
 - **To stimulate our interest in and knowledge of arts, science, history and other topics** through content that is accessible and can encourage informal learning;
 - **To reflect and strengthen our cultural identity** through original programming at UK, national and regional level, on occasion bringing audiences together for shared experiences; and
 - **To make us aware of different cultures and alternative viewpoints**, through programmes that reflect the lives of other people and other communities, both within the UK and elsewhere.
- B.11 We believe that PSB programmes should also have distinctive characteristics. We have defined these as follows:
- **High quality** –well-funded and well-produced;
 - **Original** – new UK content, rather than repeats or acquisitions;

¹⁹ One respondent pointed out a typographical error in paragraph B.14 of the Phase 2 Regulatory Impact Assessment

- **Innovative** – breaking new ideas or re-inventing exciting approaches, rather than copying old ones;
- **Challenging** – making viewers think;
- **Engaging** – remaining accessible and attractive to viewers; and
- **Widely available** – if content is publicly funded, a large majority of citizens need to be given the chance to watch it.

- B.12 Our audience research has shown that viewers in the Nations still value non-news programmes made for their nation, and that the circumstances in the Nations are different from those in the English Regions.
- B.13 Our policy objective is therefore to secure these purposes and characteristics of PSB.

Risk assessment

- B.14 The requirement for a review of PSB in the Nations and Regions is closely aligned to the broader need for a comprehensive review of PSB, outlined in the Phase 2 RIA. The review is necessary because the rapidly changing broadcasting environment is creating new challenges for the provision of public service television broadcasting. The contribution of the Channel 3 licensees in the Nations and Regions will become increasingly unsustainable. If we do not move to a more sustainable approach now, we risk significant uncertainty in the transition period, with significant disadvantages and costs for licensees, audiences and production companies.

Our approach to the review of policy options for the Nations and Regions

- B.15 This section sets out the main policy options we have considered in the light of the policy objective and risk assessment described above. In essence, we need to strike a balance between the value to the public of the programming provided, and the costs of provision (imposed directly on broadcasters and, to some extent, on tax payers, via reduced payments to the Treasury by ITV). We have assessed the proposed model for the Nations and Regions as a whole, rather than by looking individually at the proposals on a case-by-case basis. This reflects the remit and approach of the PSB Review, which was required to assess and make proposals for the framework of PSB taken as a whole. The specific proposals issued for consultation are detailed in Annex A of this report.
- B.16 Looking at the framework of PSB in the Nations and Regions, we believe there are three main options. These reflect the options outlined for the transition of PSB on Channel 3 as a whole (see Chapter 3).

No intervention

- B.17 First, we could make no changes to the current requirements of the Channel 3 licensees. The main benefit of this approach would be to sustain current provision at existing levels, at least for a while.
- B.18 The main disadvantages of this approach are that the model of PSB would come under increasing strain as digital switchover approaches, and in any

case the current model does not fully meet audience needs. As our analysis in Phase 2 showed (summarised in Chapter 2 of this report), the current model of PSB will not survive the transition to a digital world. We concluded that we should seek to develop a sustainable settlement for the commercial PSBs that maintains the aspects of PSB most valued by audiences while reducing costs in other areas. Furthermore, audiences say they want more local programming (and, in Scotland, more nation-wide programming) than is currently provided.

Sustained approach

- B.19 Secondly, we could adapt the current model to seek to retain a higher level of dedicated regional programming in the Nations than in the English Regions, and ameliorate the additional costs and scheduling challenges this would create for the licensees in the Nations; consider options for the future of indigenous language broadcasting in a digital age; and implement a planned transition to a reduced level of non-news programming in both the Nations and Regions, in two stages. This is the approach we have summarised in Chapter 3 of this report and described in more detail in Chapter 8, and on which we are now consulting. Our assessment is that this approach will reduce licensees' costs of PSB over time and, in some respects, improve the service to viewers in the devolved Nations (more local programming, more nation-wide programming in Scotland).

Quicker and/or more substantial reductions

- B.20 Thirdly, we could reduce licence obligations more quickly now – for example, by reducing National licensees' non-news requirements in line with our immediate decisions on requirements in the English Regions, or moving earlier to reduce obligations in the Regions. While this would ensure that there was no risk of the licensees in the Nations handing back their PSB licences, we believe that this approach has significant disadvantages. As set out in Chapter 3, this approach fails to recognise the distinctive needs of audiences in the Nations, stemming from the imperatives of devolution, strong cultural identities in the Nations and the findings of our audience research, which suggest that overall, viewers in the devolved Nations appear to attach greater value to regional provision than those in England. It also requires much quicker adjustment by audiences, broadcasters and producers to an environment characterised by much lower levels of regional non-news programming.

Conclusion

- B.21 On the balance of evidence, we reject option 1, because we believe that we are better able to secure our priorities for PSB in the future by identifying and beginning the transition to a new, sustainable framework now. We also reject option 3, because we believe that it allows no period of adjustment for audiences, broadcasters and producers, and it ignores the fact that a certain amount of PSB should continue to be viable for Channel 3 licensees for some time to come. Our preferred approach is option 2, which we believe achieves the right balance between proportionate reductions in PSB costs, and the retention and reshaping of PSB obligations to suit audiences' most important needs.

Annex C

Consultation principles

Ofcom has published the following seven principles that it will apply for each written consultation:

Before the consultation

1. Where possible, we will hold informal talks with people and organisations before announcing a major consultation to find out whether we are thinking in the right direction. If we do not have enough time to do this, we will hold an open meeting to explain our proposals shortly after announcing the consultation.

During the consultation

2. We will be clear about who we are consulting, why, on what questions and for how long.
3. We will make the consultation document as short and simple as possible, with a summary of no more than two pages. We will try to make it as easy as possible to give us a written response. If the consultation is complicated, we may provide a shortened version for smaller organisations or individuals who would otherwise be unable to spare the time to share their views.
4. We will normally allow ten weeks for responses, other than on dispute resolution.
5. There will be a person within Ofcom who will be in charge of making sure we follow our own guidelines and reach out to the largest number of people and organisations interested in the outcome of our decisions. This individual (who we call the Consultation Champion) will also be the main person to contact with views on the way we run our consultations.
6. If we are not able to follow one of these principles, we will explain why. This may be because a particular issue is urgent. If we need to reduce the amount of time we have set aside for a consultation, we will give those concerned prior warning that this is a 'red flag' consultation which needs their urgent attention.

After the consultation

7. We will look at each response carefully and with an open mind. We will give reasons for our decisions and will give an account of how the views of those concerned helped shape those decisions.

Annex D

Consultation response cover sheet

In the interests of transparency, we will publish all consultation responses in full on our website, www.ofcom.org.uk, unless a respondent specifies that all or part of their response is confidential. We will also refer to the contents of a response when explaining our decision, without disclosing the specific information that you wish to remain confidential.

We have produced a cover sheet for responses (see over) and would be very grateful if you could send one with your response. This will speed up our processing of responses, and help to maintain confidentiality by allowing you to state very clearly what you don't want to be published. We will keep your completed cover sheets confidential.

The quality of consultation can be enhanced by publishing responses before the consultation period closes. In particular, this can help those individuals and organisations with limited resources or familiarity with the issues to respond in a more informed way. Therefore Ofcom would encourage respondents to complete their cover sheet in a way that allows Ofcom to publish their responses upon receipt, rather than waiting until the consultation period has ended.

We strongly prefer to receive responses in the form of a Microsoft Word attachment to an email. Our website therefore includes an electronic copy of this cover sheet, which you can download from the 'Consultations' section of our website.

Please put any confidential parts of your response in a separate annex to your response, so that they are clearly identified. This can include information such as your personal background and experience. If you want your name, address, other contact details, or job title to remain confidential, please provide them in your cover sheet only so that we don't have to edit your response.

Cover Sheet for response to an Ofcom consultation

BASIC DETAILS

Consultation title:

To (Ofcom contact):

Name of respondent:

Representing (self or organisation/s):

Address (if not received by email):

CONFIDENTIALITY

What do you want Ofcom to keep confidential?

Nothing

Name/contact details/
job title

Whole response

Organisation

Part of the response

If there is no separate annex, which parts?

Note that Ofcom may still refer to the contents of responses in general terms, without disclosing specific information that is confidential. Ofcom also reserves its powers to disclose any information it receives where this is required to carry out its functions. Ofcom will exercise due regard to the confidentiality of information supplied.

DECLARATION

I confirm that the correspondence supplied with this cover sheet is a formal consultation response. It can be published in full on Ofcom's website, unless otherwise specified on this cover sheet, and I authorise Ofcom to make use of the information in this response to meet its legal requirements. If I have sent my response by email, Ofcom can disregard any standard email text about not disclosing email contents and attachments.

Ofcom seeks to publish responses on receipt. If your response is non-confidential (in whole or in part), and you would prefer us to publish your response only once the consultation has ended, please tick here.

Name

Signed (if hard copy)