

January 2009

OFCOM RESPONSE TO THE EUROPEAN COMMISSION'S DRAFT COMMUNICATION ON THE APPLICATION OF STATE AID RULES TO PUBLIC SERVICE BROADCASTING

Ofcom is the independent regulator and competition authority for the UK communications industries, with responsibilities across television, radio, telecommunications and wireless communications services.

1. General Comments

Ofcom welcomes the opportunity to provide comments to the Commission's draft revised Broadcasting Communication.

Ofcom does not have any direct responsibilities in the area of state aid, which is a matter exclusively for the UK Government. We refer to the UK Government Response to this consultation. As the UK's independent communications regulator, however, we have specific duties to ensure that the quality of public service broadcasting is maintained and strengthened in the UK. Our engagement on this issue has been carried out with the following key objectives in mind:

- **Ofcom Public Service Broadcasting (PSB) Review**: We have just recently published the final Statement of our Second Review of Public Service Broadcasting in the UK. We initiated this second review shortly before the Commission launched its own review of the Communication, and have been keen to ensure that due note is taken of any major or potential changes in the European Commission's interpretative guidance on governance and supervision of PSB schemes.
- **Supervision**: Ofcom licenses and regulates broadcasters, other than the BBC, with specific public service broadcasting obligations (often broadly described in the UK as the commercial PSBs), and assesses their effectiveness in the fulfilment of the public service purposes. In addition, we are tasked with conducting a Market Impact Assessment where the BBC Trust decides to carry out a Public Value Test ahead of the introduction of any new BBC services or of significant modifications to an existing one. As explained below, the Public Value Test is a wider process which also includes an assessment by the BBC Trust of the public value of any new services. Ofcom is keen to contribute to the debate by outlining our experience in both these contexts (supervision and ex-ante evaluation).
- **Competition**: Ofcom has a general duty to further the interests of consumers in broadcasting markets, where appropriate by promoting competition. Ofcom has competition powers specific to broadcasting and also has concurrent powers to apply general competition law in this sector.

Ofcom responded to the initial Commission's consultation launched in early 2008¹, and has been following the debate closely since. We welcomed the Commission's review given the changes in the sector since the Communication was first adopted.

¹ <http://www.ofcom.org.uk/tv/ifi/stateaidrules/ofcomresponse.pdf>

We underscored the need to maintain the existing balance of powers between definition and funding of public service models (which remains a national prerogative), and the possible impact on competition (which is both a national and a European concern).

In this second submission, Ofcom wishes to address the following matters that are relevant to Ofcom's role and remit:

- General approach of the Commission's Communication
- Remit
- Entrustment
- Supervision and ex-ante evaluation

When relevant, we also suggest which paragraphs of the text might benefit from further clarity.

2. General approach

Ofcom welcomes the Commission's thorough and transparent approach in gathering information and actively seeking input from as wide a base of stakeholders as possible for this important review. Ofcom would have liked, however, to see more discussion on the substance of the Commission's own impact assessment report for this policy initiative. For example, what were the outcomes of discussions within the Inter-Service Steering Group? More generally, Ofcom would like to stress, again, the need for greater clarity from the Commission as to the process involved in the publication of impact assessments during consultation processes.

Ofcom supports the Commission's aim to provide clear interpretative guidance on how it will assess competition distortions caused by public funding of PSB activities. In the previous response Ofcom suggested that in order to ensure that this guidance remains valid, and to mitigate against the need for regular future adaptations, the goal should be to have a framework that is as flexible, future-proof and *principles-based* as possible.

While Ofcom agrees that it is helpful to incorporate into the Communication the principles that have emerged from the Commission's recent decision-making practice in specific cases, we would like to stress that each Member State has its own distinct public service broadcasting system, subject to different market and competition dynamics. For this reason, we would echo concerns raised in the first consultation about trying to strictly define governance models in the Communication, or trying to set out the details of ex-ante evaluation mechanisms. We elaborate on this below.

3. Remit

The Commission's Communication recognises that a wide definition of the remit is possible, but stresses that this needs to be clear and precise, so that all *activities* in which PSBs engage can be directly linked back to the remit. Ofcom agrees that a clearly defined remit is essential to provide clarity to commercial competitors and to allow for efficient and effective governance and supervision of public service broadcasting.

The Communication for the first time explicitly recognises that it is legitimate for PSBs to diversify their activities and deliver content across all platforms, including new media, as long as they are subject to strict competition scrutiny. Ofcom fully

supports the Commission's explicit recognition of a broad remit, and its intention to consider the delivery of public service content in a more technology-neutral way. An important conclusion of Ofcom's Second PSB Review is that public service content should be available across all digital media, not just linear broadcasting. We strongly support a similar approach in the revised Communication, reflecting changes in the communications sector and media consumption patterns, particularly the fact that 'traditional' TV platforms might not always best deliver reach and impact for all.

Ofcom agrees with the Commission that rigid distinctions between free and paid-for models are increasingly becoming artificial, and notes the Commission's recognition that it is possible to envisage some form of pay service models for the provision of public service content. While we agree that this needs to be cautiously considered, given the objective of universality, the Commission's approach appears to be quite binary (par. 52 to 54). There could be some merit in exploring the possibility of providing publicly funded content at a modest (below cost) rate, if it was considered to be in the public interest providing of course there is appropriate scrutiny and evaluation.

4. Entrustment

Ofcom would like to ask the Commission to clarify its intentions regarding the scope and frequency of the financial reviews of PSBs. At present, the draft Communication (par. 95) appears to link the need for a financial review with the entrustment period, setting out a maximum limit of four years for the former.

However in the UK, entrustment periods are linked with the public service remit (rather than the mode of funding) and typically run for longer periods (in the case of the BBC for 10 years). Changes usually require legislation. We would be grateful if the Commission could clarify its approach by separating the funding aspects from the remit and entrustment exercise.

5. Supervision and ex-ante evaluation

Ofcom agrees with the need for a careful supervision of publicly funded services in order to (i) ensure their alignment with the public service remit; and (ii) minimise the distortion effect that the use of public funds by certain players will have on competition (proportionality test). Such supervision can take different forms and be carried out by different bodies at national level. It can be done through the form of an ex-ante evaluation (in the case of the introduction of new services or significant modifications of existing ones), as well as ex-post through a regular review of the funding arrangements and the general operation of competition law. In the UK, the BBC Trust, Ofcom, the OFT and the Competition Commission all have a role to play in ensuring that any risk of market distortions arising from the use of public funds is duly assessed and mitigated.

Designing the most appropriate evaluation mechanisms is, however, something which depends on a number of specific national factors, including the definition of the remit, the number of operators charged with public service obligations, the internal governance structures of public service broadcasters, and the powers and duties of the independent national regulatory authority. Furthermore, PSB systems are constantly evolving, and are likely to continue to do so. This calls for flexibility in how this supervisory role is exercised.

UK: Ofcom's role in the Public Value Test

The UK already has in place one such model for the ex-ante evaluation of BBC licence-fee funded activities, known as the Public Value Test (PVT)², which was introduced following the review of the BBC Charter in 2006 and was launched in January 2007. This is a test which is undertaken by the BBC Trust (independent supervisory body for the BBC's activities) with respect of any new service proposals of the BBC, regardless of their 'new media' character. The purpose of the test is to weigh the public value of the proposal, against its expected market impact.

In many respects, this model reflects the criteria included in the Commission Communication. For the avoidance of any confusion about Ofcom's specific role in the process, we describe it in some detail once again here.

The BBC Charter and the Framework Agreement³ set out the basis for evaluation of the BBC's public services and "any significant change" to these services. The BBC Trust is required to conduct a "full and proper scrutiny" of any service proposed by the BBC Executive. The Public Value Test (PVT) is the means by which this scrutiny takes place prior to approval of any service.

It is also set out in the Framework Agreement that, for those activities not defined as a 'Service' which may only indirectly contribute to the delivery of a public service to the UK licence fee payers, the BBC Trust may consider whether they raise issues of public value and have market implications and, as a consequence, initiate the PVT evaluation process.

This PVT, which usually takes 6 months, comprises a Public Value Assessment (PVA), which is carried out internally, and a Market Impact Assessment (MIA) which is carried out externally by Ofcom. The PVA consists of an internal evaluation of the value of the proposed service in terms of its contribution to the BBC's public purposes, as defined in the Charter. The MIA considers the competitive effect of the proposed service on other services in the market.

The aim of Ofcom's MIA⁴ is to identify the significant market impacts arising from the proposed service or activity. We seek to identify the effects on consumers and producers of other services, including those that compete with the proposed service as well as those in related upstream (e.g. suppliers), downstream (e.g. buyers) or two-sided (e.g. advertising) markets. The MIA assesses the extent to which the proposed service might deter innovation and investment by the commercial sector, and potentially in the longer term by the BBC itself, if the market fails to grow as it otherwise might. If commercial providers are deterred from seeking to offer competing services, there could ultimately be a reduction in choice for viewers and listeners to the detriment of the public interest as a whole. Where inefficiencies (such as crowding out) are identified, Ofcom can propose modifications to the service for the Trust to consider. In conducting our analysis, we rely, as far as possible, on empirical evidence and expert opinion, comprising on a combination of market and desk research, BBC information and interviews with stakeholders and submissions. We also coordinate closely with the Trust to ensure that the evaluation exercise is comprehensive, coherent and consistent.

The outcomes of both the PVA and the MIA are published and considered by the Trust, who will consult on its provisional conclusions before reaching a final decision. While the result of MIA are not binding, the Trust must be satisfied that any likely adverse impact on the market is justified by the likely public value of the change before concluding that the proposed change should be made.

² Further information about the PVT can be found on the BBC Trust website:

http://www.bbc.co.uk/bbctrust/framework/public_value_test/index.html

³ http://www.bbccharterreview.org.uk/pdf_documents/BBCAgreement_Cm6872_july06.pdf

⁴ <http://www.ofcom.org.uk/research/tv/bbcmias/>

To date, Ofcom has conducted MIAs on 4 different BBC proposals: on-demand proposals (i-Player), HDTV proposals, Gaelic Digital Service and Local Video Service. The analysis and results are available on our website: <http://www.ofcom.org.uk/research/tv/bbcmias/>

It is worth stressing that this process was specifically designed with the BBC institutional model in mind, after extensive public national debate through the BBC Charter Review Process. While the experience to date has been positive, different models to assess the public value and the market impact of publicly funded services might be appropriate in different countries, or indeed for different broadcasters within the same country, depending on national circumstances, and respecting the need for transparency, independence and third party consultation.

Ofcom would therefore like to re-iterate the position expressed in our first response:

“While Ofcom generally believes that evaluation exercises are important, we have reservations about the proposal to include any specificities of an ex-ante evaluation mechanism in this revised Communication. We believe that it would be impractical to attempt to identify a ‘one size fits all model’ for evaluation at EU level, given the distinct nature of PSB systems across EU Member States.”

Ofcom believes that the current Commission’s draft, by and large, strikes the right balance in this respect, recognising that it is within the competence of Member States to assess whether new services fall within the PSB remit (par. 57), and to choose the most appropriate mechanism to ensure compliance with the Treaty and the Amsterdam Protocol (par.59). Ofcom would also support the Commission’s emphasis on the need to ensure transparency of the overall process (including what might trigger it), consultation with interested parties, and publication of the outcome of such assessment (para.59).

However, in a few instances, the Commission appears to go beyond providing guidance, setting prescriptive criteria against which it will assess potential complaints. For example, the Commission’s Communication provides substantial detail on how to assess the potential effects of a service on competition as well as its public value (par. 60 et seq). Ofcom considers that the criteria suggested by the Commission are the right ones (e.g. the need for the assessment to be independent and subject to stakeholder consultation), but believes that the Commission at times goes into excessive detail for an EU document of this nature (e.g. when it outlines measures to guarantee independence in the event that the assessment is carried out by an internal body). Furthermore, Ofcom remains unclear as to whether the Commission considers these to be “minimum requirements” (as their FAQ appears to suggest⁵) or whether these are merely illustrative, and non-exhaustive. We would welcome clarification from the Commission that it is the latter.

In addition, Ofcom would like to suggest that greater emphasis is placed in the text (par. 60 and 61) on the fact that the market impact assessment is just *one* of two aspects which need to be weighed in the process, and that Member States remain exclusively competent to consider whether new services indeed meet the democratic, social and cultural needs of society. The provision of public funding for a particular service or activity will inevitably lead to a distortion of the market. The key question is whether it is disproportionate and/or necessary for the fulfilment of public service

⁵ <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/08/671>

remit (the social democratic and cultural needs of society). In the current text there is perhaps more emphasis placed on the market impact (negative impact) than there is on the ultimate evaluation of proportionality to the public good.

Ofcom would also like to ask the Commission to provide further clarification with respect to its role in carrying out a proportionality test, such as in the event of a complaint. In a few places throughout the draft (e.g., par. 64, par. 88 – 89), the Commission explains that it will, or may, go beyond an assessment of whether procedural safeguards are in place, and carry out a substantive test. Ofcom recognises that ultimately it is up to the Commission to decide on the compatibility of any public funding with the competition provisions in the Treaty, within the limits of the Amsterdam Protocol. We agree with the Commission that the existence of appropriate and transparent governance models at Member State level is meant to facilitate that assessment, but we are concerned that, at times, the Commission might effectively end up duplicating the national market impact assessment. We would welcome clarification from the Commission on what exactly they envisage their role to be in this respect.

The Commission has introduced a new final section dealing with “market distortions” and anticompetitive behaviour (par. 101 et seq), and would like to see enhanced mechanisms at the national level to deal with anticompetitive practices directly linked to the use of public funding (in particular, price undercutting and overbidding for premium content rights). The Commission also refers to the need to ensure that third parties have the possibility to bring complaints on anti-competitive practices to an “external body” that should have the necessary powers to impose appropriate remedies and sanctions (par.106). This appears to be in addition to “appropriate mechanisms” to assess the competition impact (par. 56 to 64) and to “control mechanisms” to ensure there is no overcompensation (par.91 et seq).

It remains unclear how the Commission sees the distinction between (a) behaviour which takes the undertaking outside the scope of the exclusion provided by 86(2) and therefore allows the application of Articles 81 and 82 and (b) behaviour which is inside the scope of the exclusion but nonetheless has a distortive effect. Member States already have the ability to deal with (a), without the need for additional mechanisms to be put in place (although guidance from the Commission may assist in deciding when general competition should apply). If the Commission is looking for a mechanism to deal with (b), then it is not clear what those are intended to be.

As stated above, each Member State has different supervisory structures. In the UK, for example, Ofcom has concurrent competition powers for the communications sector (jointly exercised with the Office of Fair Trading), and can act using powers under the Competition Act. These may co-exist, overlap or be different in scope, depending on the institutional and regulatory framework in each Member State. Ofcom would welcome greater clarity on the Commission’s thinking in this regard.
