



House of Commons
Culture, Media and Sport
Committee

**Channel 4 Annual
Report**

Third Report of Session 2009–10

*Report, together with formal minutes, oral and
written evidence*

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The Culture, Media and Sport Committee

The Culture, Media and Sport Committee is appointed by the House of Commons to examine the expenditure, administration, and policy of the Department for Culture, Media and Sport and its associated public bodies.

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1 Introduction

1. Channel 4 is a unique broadcaster in the UK. Publicly owned, it is a statutory corporation, without shareholders, established and regulated under successive Broadcasting and Communications Acts. It generates all of its revenues in the commercial marketplace but is not-for-profit, its principal focus being the fulfilment of its statutory public service broadcasting (PSB) remit. It receives indirect state funding and other privileges such as free analogue and digital spectrum, “must carry” status and due prominence on electronic programme guides.¹

2. The Department for Culture, Media and Sport (DCMS) is Channel 4’s sponsoring department. Major changes to its legal status and remit are a matter for Parliament. Ofcom, the independent regulator, issues the broadcasting licence(s) and appoints the Chair and Non-Executive Directors for Channel 4, subject to approval by the DCMS Secretary of State.

3. Channel 4 is required to lay before Parliament an Annual Report of its financial accounts and performance. However, as we noted in our Report following our inaugural session scrutinising Channel 4’s 2007 Annual Report, concerns have been expressed that the channel lacks accountability and external scrutiny.² Our establishment of a Channel 4 Annual Report session was a response to this and is intended to provide enhanced transparency and accountability for the report and accounts, and a forum for the discussion of other issues relevant to this publicly-owned organisation.

4. On 12 May 2009, the Culture, Media and Sport Committee held an oral evidence session with Channel Four Television Corporation (“Channel 4”) on its Annual Report and Financial Statements (“Annual Report”) for 2008, which was published on 6 May 2009. This was the second time that we have held such an oral evidence session with Channel 4, the first being in relation to the broadcaster’s 2007 Annual Report.³

5. After the session we received a supplementary memorandum from Channel 4, and we asked additional written questions. We concluded correspondence with Channel 4 at the end of November 2009, and publish this written evidence as part of this Report.⁴

6. During the Channel 4 Annual Report session we questioned the broadcaster on a range of matters relating to its 2008 Annual Report and Financial Statements, its strategy, programming and efficiency, and other issues of current interest including:

- The extent to which Channel 4 is or is not facing a “crisis”;
- The preferences of Channel 4 regarding possible partnerships with BBC Worldwide or Five, and the option of direct public funding from the licence fee;

1 “Must carry” channels are designated channels which must be carried by UK cable operators in their lowest cost package.

2 HC 189 (2008–09), para 3

3 Culture, Media and Sport Committee, Third Report of Session 2008–09, *Channel 4 Annual Report*, HC 189

4 Ev 16

- How programme spend and output are being affected by market conditions;
- The profitability of non-core, non-PSB channels E4, More4 and Film4;
- Investment in and expectations for approval of the (now abandoned) Project Kangaroo;
- Headcount, redundancies and remuneration;
- Children’s and educational programming;
- Investment in the nations and regions;
- Succession of the Chairman and Chief Executive of Channel 4.

7. We consider that Channel 4 has generally responded to our questions directly and with sufficient information. Where the broadcaster has not addressed the issues we raised as fully as we would have liked, we comment on this in the relevant sections of this Report.

8. As we have previously stated, we intend to hold an Annual Report session with Channel 4 annually. The importance of this enhanced scrutiny of the broadcaster is greater than ever in light of the Government’s proposal, contained in the *Digital Britain Final Report*,⁵ to update the statutory remit for Channel 4. Its own desire for a revised and expanded remit was highlighted in its Report *Next on 4*,⁶ which then-Chief Executive Andy Duncan described as “our strategy to accelerate the organisation’s evolution from a public service broadcaster to a truly cross-platform public service network.”⁷ The Government acknowledged that Channel 4 had itself had proposed many of the elements for a new remit and promised that it would take the views of the Channel 4 Board into account.⁸ The proposed changes to Channel 4’s statutory remit are contained within the Digital Economy Bill which is currently before Parliament.⁹ Before considering specific issues raised in the Annual Report session we comment on the bill, and its impact on Channel 4, in more detail.

5 Department for Culture, Media and Sport and Department for Business, Innovation and Skills, *Digital Britain: Final Report*, Cm 7650, June 2009

6 Channel 4, *Next on 4*, March 2008

7 Channel 4, Channel 4 Television Corporation Report and Financial Statements 2008, page 7

8 *Digital Britain: Final Report*, paras 44–48

9 Digital Economy Bill [*Lords*], [HL Bill 32 (2009–10)]

2 Digital Economy Bill

9. The Digital Economy Bill proposes extending the Channel Four Television Corporation's primary functions, which currently relate only to its main Channel 4 television channel (its sole PSB service), to the making, broadcasting and distribution of "relevant media content" on other types of channels and services, including on-demand programme services and other services provided by means of the internet.¹⁰

10. This would be a significant expansion of the broadcaster's statutory remit. Rather than operate as a single channel public service broadcaster, additional channels and services such as E4, More4, Film4 and other online and on-demand activities of the organisation would effectively become part of a multichannel, multiplatform public service network. The drafting of the bill seems to leave the way open for further diversification of Channel 4's offer, with the inclusion of the provision for Channel 4 to provide "other services [...] by means of the internet where there is a person who exercised editorial control over the material included in the service".¹¹

11. If these proposals are enacted, Channel 4 would become more akin to the UK's other publicly-owned, not-for-profit broadcaster, the BBC, which currently provides PSB content via multiple television channels and other services.¹² However, there are fundamental differences in the funding and governance models for the two organisations, which give rise to a number of important issues.

12. Unlike the BBC, Channel 4 generates all of its revenues in the commercial marketplace and a significant proportion of its programme budget and schedule is used for unashamedly non-public service content. The non-PSB content on the core Channel 4 service is intended to generate revenues to fund the PSB output. The extent to which this generates an adequate return of public service content is a matter of legitimate debate, and of interest to this Committee.

13. It is far from clear that the level of PSB content that is broadcast has been properly examined. Indeed at times, the core channel's output appears composed largely of non-PSB programming. For instance, the TV listings for the core Channel 4 PSB service on 1 December 2009 included the US comedies *Everybody Loves Raymond*, *Frasier* (two episodes), *Will and Grace*, *Friends* (two episodes), *Ugly Betty*, *The Simpsons*, and *The Big Bang Theory*, US dramas *St Elsewhere* and *King of the Hill*, US film *The Dead Zone* and the 1968 UK film *Carry on Doctor*. UK and other acquired content scheduled on the day included *Celebrity Life Skills*, *Countdown*, *Deal or No Deal*, *The Paul O'Grady Show*, *Pokerstars.com European Poker Tour*, *Wife Swap USA*, *the Bullrun USA car rally*, *The F Word*, *Gillette World Sport*, *Volvo Ocean Race*, *Channel 4 News*, and drama series' *Hollyoaks*, *The Queen* and *Cast Off*.¹³

10 Digital Economy Bill, Clause 21.

11 *Ibid.*

12 E.g. digital television channels (such as BBC3 and CBBC) and through its website www.bbc.co.uk

13 This is a sample of programming on Channel 4 on that day and does not list every single programme broadcast, which would have included some additional PSB output.

14. According to its Annual Report, in 2008 Channel 4 spent £153m on first-run UK-originated programming on key PSB genres on the core channel (including news, current affairs, education, comedy, single dramas, drama series, religion and arts).¹⁴ However, this comprised a minority of the £390m expenditure on UK-originated programming,¹⁵ and an even smaller proportion of the total expenditure of £516m on programme and other content on the core channel.¹⁶

15. These figures and the sample schedule above would appear to support criticism from the media commentator David Elstein that Channel 4 is “a small public service dog being wagged by a very large commercial tail”.¹⁷ We note, however, that the majority of viewing to the core channel in 2008 was of programmes commissioned by Channel 4 rather than acquired programmes.¹⁸ However, viewing of those programmes which are in key PSB genres¹⁹ is likely to comprise the minority of this viewing given that these programmes account for a minority of Channel 4’s programme expenditure, and generally have smaller audiences than other genres.²⁰

16. A further distinction between the BBC and Channel 4 is that, at present, the BBC is subject to a fundamental requirement to have regard to the competitive impact of its activities on the wider market.²¹ There is no apparent equivalent for Channel 4.

17. The impact on markets in which a public service broadcaster operates can be both positive and negative. Much concern has been expressed – including by this Committee – about the negative impact of the BBC as it has expanded both its public service and commercial activities. The extension of Channel 4’s primary functions beyond the core PSB television channel, along with the growth of its non-PSB activities, means the market impact this public organisation has might increase significantly, raising questions about how this impact should be monitored and controlled. We recommend that the Government consider and address these issues now, during the passage of the Digital Economy Bill.

18. The Digital Economy Bill also contains provisions for monitoring and enforcing the delivery of Channel 4’s new functions. Among other things, it requires Channel 4 to prepare, every year, a statement of media policy, setting out how the organisation proposes to discharge its functions in the coming year. Channel 4 will be obliged to consult Ofcom and have regard to guidance issued by it. Ofcom will also have a new obligation to review

14 *Annual Report 2008*, page 67

15 *Ibid.*

16 *Annual Report 2008*, page 97

17 Institute of Economic Affairs Beesley lecture, “What is the role of public service broadcasting in the digital age?”, David Elstein, September 2009 text available at www.guardian.co.uk

18 The core channel accounted for 8.2% of all TV viewing in 2008 (*Annual Report*, page 60)

19 e.g. news, current affairs, education, arts, religion

20 Programmes (of all types) commissioned by Channel 4 and broadcast on the core channel (“network originations”) accounted for 5.8% of total TV viewing, the majority viewing on the channel (*Annual Report*, page 61)

21 Article 23(c), BBC Charter. The BBC Trust must also adopt and publish a statement of policy on fair trading, and of holding the Executive Board to account for compliance with such statement (Charter, Article 24(2)(k); BBC Agreement, clause 65). It is also required to adopt and publish codes dealing with those aspects of the operation of its public services that could raise significant issues regarding the competitive impact of the BBC’s activities (BBC Agreement, clause 66).

and report on the performance of Channel 4's new duties. New enforcement powers for Ofcom in relation to the fulfilment by Channel 4 of its new functions are also included.²²

19. The Explanatory Notes to the Bill indicate that these new duties “may well include the making and broadcasting of programmes on television”²³ (as opposed to Channel 4's commissioning and acquiring its programmes). This would be a massive change. The current regulatory regime includes a condition “requiring C4C not to be involved, except to such extent as OFCOM may allow, in the making of programmes to be broadcast on Channel 4.”²⁴

20. The proposed changes in Channel 4's remit also raise issues regarding the extent to which its governance framework should be revised. For instance, Ofcom – unlike the BBC Trust, in relation to the UK's other main publicly-owned, not-for-profit broadcaster – does not set overall budgets and strategic priorities for the organisation. The Channel 4 Board, which is comprised of both Channel 4 executives (management) and independent non-executives, undertakes these functions. Yet in the case of the BBC the need to have such functions undertaken by an entity separate and at arms length from the organisation's management (executives) was a key factor in the creation of the BBC Trust.

21. The current governance structure at the BBC is in our view flawed, something which we discussed in our Report on the BBC's commercial activities.²⁵ Nevertheless the potential for the Channel 4 Board, which is not at arms-length from Channel 4 management, to wield significantly greater power is a material issue, especially as it is likely that Ofcom will have a less hands-on role than the Trust does in relation to the BBC.

22. We agree that any expansion of Channel 4's remit, and any extension of its statutory public service activities to services beyond its single traditional PSB service, the main Channel 4 television channel, requires provisions for monitoring and enforcing the new functions. It is far from clear, however, that the monitoring and enforcement provisions proposed will be the most appropriate and effective means for achieving this.

23. Nor is it clear that the existing governance framework for Channel 4 is the most appropriate for its proposed new status. While the BBC and Channel 4 retain different funding models, the evolution of both as publicly-owned, not-for-profit multichannel, multiplatform public service broadcasters, benefiting from direct and/or indirect public funding, calls into question the rationale for maintaining dramatically different governance systems.

22 Digital Economy Bill, cl 22

23 Explanatory Notes to the Digital Economy Bill [Lords] [HL Bill 1 (2009–10) –EN], para 106

24 via Section 295 of the Communications Act 2003

25 Culture, Media and Sport Committee, Fifth Report of 2008–09, *BBC Commercial Operations*, HC 24

3 Annual Report for 2008

Profitability of non-core channels (E4, More4, Film4)

24. During our Annual Report session with Channel 4, we questioned the broadcaster on the investment in and profitability of its non-core, non-PSB channels (E4, More4 and Film4). We also explored this area further in written follow-up questions. Channel 4 refers to these as its “digital channels”, although its core – and only – PSB service, Channel 4,²⁶ is also transmitted in digital on terrestrial, cable and satellite platforms as well as on analogue terrestrial television.

25. Channel 4 has stated that its digital channels:

- “generate substantial profits to be reinvested in public service content, and are a vital part of Channel 4’s strategy to address the structural financial pressure caused by digital switchover.”²⁷
- “[are] an essential strategic investment designed to generate profits and diversify Channel 4’s revenue base. The portfolio of digital channels currently makes substantial profits to be reinvested in public service content on the core channel.”²⁸

26. Critics, however, have claimed that Channel 4’s expansion into non-core, non-PSB ventures has been wasteful and reduced its public service focus. Among these claims is that “Channel 4 has squandered the best part of £300 million on non-core activities: nearly all its accumulated post-tax profits since 1990.”²⁹

27. Channel 4 itself acknowledges in its 2008 Annual Report that while the growing contribution from the digital channels is mitigating the decline in advertising revenues “to some extent, it is not expected to replace lost revenues on the core channel.”³⁰ Furthermore, it could be argued that if monies invested in the non-core channels were derived from the prior year profits and reserves of the core PSB service, Channel 4’s cash reserves would be higher, enabling it to fund its PSB output for a longer period without deficit, albeit whilst still facing long term funding issues.

28. In its Annual Report for 2008, Channel 4 does not give a breakdown of the financial figures for E4, More4 and Film4 on a channel by channel basis. Instead they are grouped under the business segment “4Channels”. For 2008, Channel 4 reported revenues of £175m for the non-core channels collectively and operating profits of £41.1m (up from £16.2m in 2007).

26 Subsequently in the Report references to Channel 4 the main PSB television channel are to the “core channel” or “core Channel 4 service”, with other references to “Channel 4” meaning the overall organisation, the Channel Four Television Corporation.

27 Ev 17

28 *Ibid.*

29 Institute of Economic Affairs Beesley Lecture, David Elstein

30 Channel 4 Annual Report 2008, page 81, column 3, “Financial Review”.

29. During oral evidence we asked whether the three channels “have now more than recouped their start-up costs.”³¹ Anne Bulford, the Group Finance Director, replied that “In terms of their development from when they went free-to-air, they are on track. They have some way to go in terms of turning the full corner in terms of recouping all their start-up costs. Some are further ahead than others”.³² When we went on to ask when these costs would be fully recouped, she went on to say that “It will be about another 18 months before all three come through against the free-to-air plans”.³³

30. This response from Channel 4 – replying in terms of when the channels went free-to-air rather than their inception – meant that we did not obtain the relevant information which we sought due to the fact that the channels, as Luke Johnson, the then Chairman of Channel 4, acknowledged, “only switched free-to-air relatively recently.”³⁴ Film4, however, was originally launched (as FilmFour) eleven years ago, in November 1998, and only went free-to-air in 2006. E4 was launched in January 2001 and only went free-to-air in 2005. Losses incurred during the majority of Film4’s life and half that of E4’s existence were therefore excluded in Ms Bulford’s response.

31. Ms Bulford agreed at the oral evidence session to provide more information on an individual channel basis “privately if that would be helpful because it is comparatively commercially sensitive at a more detailed level.”³⁵ We subsequently received from Channel 4 more detailed information on the revenues, programme budget and operating surplus of each of E4, More4 and Film4 in 2008, on a confidential basis.

32. After the session Channel 4 submitted a clarification to the transcript that “Channel 4’s digital channels fully recouped their costs since moving free-to-air in 2008; in 2012 the digital channels are expected to fully recoup their start-up costs since inception.”³⁶ Channel 4 reiterated this to us in supplementary written evidence.³⁷

33. We considered that the provision of more complete information was relevant to the issue of the contribution of Channel 4’s non-core channels, including information on the total investment on each of the digital channels since their inception, and when the start-up costs and total operating losses on each of the digital channels will have been fully recouped. Channel 4 claims that “Financial information on a channel-by-channel basis is commercially sensitive and disclosure of this information would put these channels at a competitive disadvantage.”³⁸ It also states that “it is common practice to aggregate this type of information: neither of Channel 4’s commercially-funded public service competitors – ITV and Five – disclose financial information on individual digital channels. Channel 4

31 Q 57

32 *Ibid.*

33 Q 58

34 Q 53

35 Q 54

36 *Ibid.*, fn 1

37 Ev 18

38 *Ibid.*

already discloses a greater level of segmental information and financial detail than its competitors.”³⁹

34. Channel 4 has argued for a new legislative framework for public service broadcasting that would effectively give these channels (and other Channel 4 services in addition to the core channel) PSB status. Channel 4 has stated its clear “ambitions to operate as a public service network, covering the core channel and digital services,⁴⁰ and promotes a future regulatory approach that would take into account its “public service contribution across all relevant channels and services”.⁴¹ In the 2008 Annual Report, Andy Duncan describes the environment as one “in which Channel 4 is evolving from a public service channel to a more broadly-based public service network”.⁴²

35. Channel 4 has told us that it “operates all of its commercial activities, including its digital channels, subject to strict arrangements which ensure that public funds are not used to subsidise commercial activities.”⁴³ It has also indicated to us that early losses in its digital portfolio have not been subsidised by public funds. It notes that these arrangements are set out in Channel 4’s oversight framework for commercial accountability, outlined in Schedule 9 of the Communications Act 2003 (‘the Schedule 9 Arrangements’), which requires Channel 4 to:

- identify, evaluate and properly manage any commercial activities, so as to protect the primary functions of the channel (ie. the core Channel 4 service);
- financially and organisationally separate commercial and primary activities; and
- ensure transparent reporting where there is a connection between commercial and primary activities (for example, shared resources).⁴⁴

36. Channel 4 states that these arrangements are approved by Ofcom, and are published on the Channel 4 website.⁴⁵ Channel 4 further states that it has put in place regular checks to confirm that it is complying with these arrangements, with Deloitte appointed to review compliance on an ongoing basis.

37. Nevertheless there is limited information in the public domain about the detailed workings of these arrangements in relation to Channel 4’s digital channels (and its other commercial ventures). For instance, while Channel 4 states that public funds are not used to subsidise its commercial activities, it not evident whether the digital channels were initially financed in part or whole from surplus profits and/or reserves built up by the core PSB channel in prior years. Discussion during our oral evidence session, where Channel 4 referred to liabilities reflecting “monies owed back to Channel 4 in relation to the [digital]

39 *Ibid.*

40 Channel 4 Annual Report 2008, page 80

41 *Next on 4*; Channel 4 Annual Report 2008, page 76

42 Channel 4 Annual Report 2008, page 9

43 Ev 18

44 *Ibid.*

45 Channel 4, “Channel Four Television Corporation arrangements under Schedule 9 Of The Communications Act 2003 January 2006”, www.channel4.com

channels' share of transmission and other costs"⁴⁶ leads us to believe that this may be the case.

38. The Schedule 9 arrangements subsequently proposed by Channel 4 and approved by Ofcom include, among other things, a requirement that internal re-charges between the core Channel 4 service and the rest of its operations are set to ensure that revenues and costs are fairly apportioned, reflecting the cost of provision of the service or, where appropriate, comparable market rates.⁴⁷ Neither Channel 4 nor its auditors Deloitte, however, publish sufficient detail about how these work in practice. It is therefore not evident, for instance, how costs are allocated between the core channel and the digital channels with regard to matters such as programming that appears on both the core and digital channels, and cross-promotion. Nor is there any requirement for consultation on the arrangements proposed under Schedule 9, other than between Ofcom and Channel 4.

39. We are grateful to Channel 4 for the provision of the information which we sought, but we do not agree that withholding from the public the figures relating to its individual digital channels, E4, Film4 and More4, is justified. Channel 4 occupies a unique position as a broadcaster in the UK and should be transparent on the costs and benefits of its non-PSB channels. It is not obvious to us what, if any, commercial disadvantage Channel 4 could suffer if this information was in the public domain.

40. Moreover, we find this lack of transparency on its digital channels incompatible with Channel 4's ambitions for them to be part of a public service network, as proposed in the Digital Economy Bill.

Children's programming

41. During our previous Annual Report session, covering Channel 4's 2007 Annual Report and Financial Statements, we noted that the broadcaster had proposed to strengthen public service plurality in children's programming by establishing a new pilot fund of £10m dedicated to programming for older children, with commissioning beginning in 2008. Andy Duncan confirmed that Channel 4 had commissioned the programmes, which he said were "currently being made".⁴⁸ However, he said that due to financial cuts: "we do not think we are in a position to play those programmes out [i.e. broadcast them] and we think we might have to hold off playing those programmes out until the following year".⁴⁹ Luke Johnson also highlighted financial issues: "We will have the programmes ready to go, in the stocks. We are waiting on affordability to play them out".⁵⁰

42. We raised this during the 2008 Annual Report session, asking whether these programmes had yet been broadcast. Andy Duncan told us:

"They are on hold because of the budget situation that we are in, both last year and this. I believe, on the three projects, one of them got through script development

46 Q 55

47 Channel 4 Television Corporation, Arrangements under Schedule 9 of the Communications Act 2003, January 2006

48 Culture, Media and Sport Committee, Third Report of Session 2008–09, *Channel 4 Annual Report*, HC 189, Q 47

49 *Ibid.*

50 *Ibid.*, Q 48

stage and was ready to go but was put on hold at that stage. On another one, similarly the development work had taken place. I think we went into production in the end on just one. I would have to double-check exactly where that has got to but we are not in a position to play that out at the moment in terms of the transmission costs, because it affects the P&L at the time we transmit it.”⁵¹

43. He went on to say that this was one of the areas where “it is obviously subject to the funding situation in digital and what comes through in the next few weeks [...]. We remain of the view that we have a very important role to play with that group [10 to 16-year-olds] “but clearly the funding will need to be resolved first”.⁵²

44. We noted the contrast between Channel 4’s representations during the 2007 Annual Report session of programmes having been commissioned and “currently being made”, and “ready to go, in the stocks” (albeit with play-out affordability an issue), and its depiction at the 2008 Annual Report session of “three projects”, of which only one was thought to have gone into production in the end, which Channel 4 still couldn’t afford to transmit. We therefore asked Channel 4, in written follow-up questions, to clarify the expenditure and output of its children’s projects to date, and what the estimated cost was to broadcast the children’s programmes which were made.

45. In response Channel 4 stated that of the £10m pilot it had commissioned only one project – First Year at Big School, a series of twelve 30 minute episodes, which it planned to transmit “in 2009”.⁵³ Channel 4’s memorandum also stated that it has invested “around £200,000 in script and storyline development for half a dozen other children’s projects” but that “all of these projects are on hold, given the financial challenges facing commercially-funded public service broadcasters”.⁵⁴

46. Channel 4’s further replies have not alleviated our concerns. Of the planned £10m dedicated to programming for older children, it is clear that only a small proportion has been committed. This is not consistent with evidence given to us by Andy Duncan and Luke Johnson during our 2007 Annual Report session.

47. We also note that the rationale for the pilot fund, announced by Channel 4 in March 2008 in *Next on 4* (the broadcaster’s vision for its future), was “to strengthen Channel 4’s relationship with younger audiences, and to demonstrate its capability to commission engaging content that connects with them. [...] It will illustrate what more Channel 4 could do with further resources. We hope it will help make the case for the provision of sustained public support that would enable Channel 4 to include children’s TV as a core part of its PSB role.”⁵⁵ Channel 4 also stated that the pilot fund would “strengthen public service plurality in children’s programming” and help address “the gap in the market

51 Q 69

52 *Ibid.*

53 Ev 19. Transmission of the series began in November 2009

54 *Ibid.*

55 *Next on 4*, chapter 4, page 66

identified by Ofcom for originated television aimed at older children”, for which “there is a greater role for Channel 4 to play”.⁵⁶

48. As previously discussed, the Digital Economy Bill currently before Parliament is intended to update Channel 4’s remit. This includes a requirement for Channel 4 to participate in the making of a broad range of high-quality content that appeals to the tastes and interests of a culturally diverse society, and broadcast or distribute such content on a range of different delivery platforms. Channel 4 must, in particular, participate in “the making of relevant media content that appeals to the tastes and interests of older children and young adults”.⁵⁷

49. While in principle we support the inclusion of a public service broadcasting requirement relating to older children in a revised Channel 4 remit, it is clear that Channel 4 did not achieve its aims of demonstrating via a pilot fund its capability to commission engaging content that connects with its intended audience, or successfully demonstrate what it could do with further resources.

Channel 4 and the BBC

Project Kangaroo

50. The cost of Channel 4’s write-off on Project Kangaroo, the proposed video-on-demand (VOD) joint venture between Channel 4, BBC and ITV that was referred by the Office of Fair Trading (OFT) to, and subsequently blocked by, the Competition Commission, was confirmed to us during the 2008 Annual Report session as £6.4m.⁵⁸

51. Andy Duncan told us that the OFT reference “was a surprise to most people”⁵⁹ and that “the general view within the industry was that it would be a good thing. It was clearly in the public interest”,⁶⁰ although he acknowledged that “one or two competitors had clearly complained”.⁶¹

52. In fact, the OFT stated that it had received 30 submissions from third parties involved in the supply of content, the supply of Video-On-Demand services and advertising and that:

“The majority of third parties were concerned about the joint venture and expressed concerns about both the horizontal and vertical aspects of the transaction, anticipating that the joint venture would give rise to market power at the wholesale supply level and the potential for increased incentives to foreclose downstream rivals. It should be noted, however, that due to the confidentiality of the joint venture arrangements, third parties were not usually fully clear as to how the joint venture

56 *Ibid.*

57 Digital Economy Bill, cl 21

58 Q 79

59 *Ibid.*

60 *Ibid.*

61 Q 78

would operate. Consequently, the concerns put to us were based on a worst case scenario”.⁶²

53. In announcing its final report, the Competition Commission stated that none of the remedies proposed, other than blocking the venture, could remove the threat to competition in the VOD market and that:

“We looked closely at the possible benefits to viewers which this joint venture might bring. We found that these and other benefits could come just as well from other projects that were less damaging to competition. We expect these alternatives to be much more likely to develop in the light of our decision.”⁶³

54. We find it difficult to accept Channel 4’s claim that competition authority reference of Project Kangaroo “was a surprise to most people” and that “the general view [of Project Kangaroo] within the industry was that it would be a good thing and clearly in the public interest”, with “only one or two” complaints from competitors. This is contradicted by the number and weight of representations to the competition authorities, and their findings regarding the threat to competition in the VOD market.

55. Channel 4 also made it clear to us on a number of occasions during the session that the BBC Executive led them to believe that Trust approval should automatically follow any clearance by the competition authorities.⁶⁴ Andy Duncan told us:

“[...] it was clearly backed by the BBC Worldwide Board and it was also backed by the BBC Executive Board. So we knew that effectively John Smith in Worldwide and Mark Thompson in the BBC fully supported it and our understanding – I do not know exactly what we had in writing or not but our very clear understanding was they had a series of sessions with the BBC Trust along the way and it was very clearly understood that if the Competition Commission gave it the green light, it was also expected that the BBC Trust would give it the green light.”⁶⁵

56. In our Report on the BBC Annual Report and Accounts 2007–08 we discussed the background and concerns we had regarding Project Kangaroo oversight at the BBC and concluded:

“We find it difficult to reconcile the BBC Trust’s claim to have given only limited authorisation for the Executive to “talk to other players in the industry” with information on the subsequent development of Kangaroo and statements in the provisional findings of the Competition Commission. It is apparent that the Trust reviewed proposals for the joint venture at a number of stages, including a detailed review on 19 June 2008, in advance of our oral evidence session. The statements by

62 Office of Fair Trading, merger decisions 2008, “Joint venture between BBC Worldwide Limited, Channel Four Television Corporation and ITV plc”, www.offt.gov.uk

63 “Project Kangaroo – Final Report”, Competition Commission press release, 4 February 2009 www.competition-commission.org.uk

64 Qq 81, 84–85

65 Q 85 [Andy Duncan]

the BBC Trust Chairman to the Committee therefore appear, at best, incomplete and, as a result, potentially misleading.”⁶⁶

57. In a press release issued on the day of the publication of our BBC Annual Report and Accounts 2007–08 Report, the Trust rejected our findings on its consideration of Project Kangaroo.⁶⁷ Amongst other things, the Trust stated that when it first considered the Kangaroo proposition it agreed with the BBC Executive that “the proposition should be developed further, including work on fair trading compliance and consideration against the commercial criteria, and that formal approval would be required.”⁶⁸ The Trust also stated that when the BBC Executive updated it on progress – the “sessions” referred to by Channel 4 – it made it clear that the proposition would still need to go through the Trust’s formal regulatory processes.⁶⁹

58. There is clearly a disparity between Channel 4’s depiction to us of the BBC Executive’s expectations for BBC Trust approval of Project Kangaroo (based on the Executive’s reported dealings with the Trust), and the position of the BBC Trust. However, we believe that, given the level of investment involved, Channel 4 was unwise to rely on the assurances it received from the BBC Executive, and to make such heavy investment in advance of a decision of the competition authority. This is especially the case given the financial cutbacks by Channel 4 in other areas, such as its pilot fund for children’s programming.

Acquisition of overseas programming

59. During our most recent annual report sessions with both Channel 4 and the BBC we discussed with the broadcasters their decision-making in bidding for overseas programming. As an example, we discussed the bidding by both broadcasters for the series *Harper’s Island*, a horror thriller series first broadcast on CBS America, in which one or more characters was killed in each episode. We heard directly contradictory evidence when discussing the bidding for this programme.

60. Andy Duncan of Channel 4 described the outbidding of E4 by the BBC for *Harper’s Island*, for transmission on BBC3, as “an outrage”.⁷⁰ He went on to say that:

“BBC3 is entirely licence fee funded and meant to be all about innovation and original programmes for the British public [...] we got to a rate beyond which we could not justify going commercially and the BBC paid about one-third more than that [...]. Clearly no-one else was justified in bidding more [...] Sky, ITV, Five, *et cetera*. To be outbid by BBC3 was ridiculous”.⁷¹

66 Culture, Media and Sport Committee, Fourth Report of Session 2008–09, *BBC Annual Report and Accounts 2007–08*, HC 190, para 18

67 “Statement from the BBC Trust in response to the Culture, Media and Sport Select Committee’s report into the BBC’s Annual Report 2007–08”, BBC Trust press release, 28 January 2009

68 *Ibid.*

69 *Ibid.*

70 Q 38

71 Q 39

61. This was in contrast to what Mark Thompson told us during the BBC Annual Report session: “My understanding about *Harper’s Island* was that Channel 4 ultimately decided for editorial grounds that they did not want to pursue this particular programme and withdrew for editorial rather than economic grounds.”⁷²

62. We subsequently informed Channel 4 of Mark Thompson’s statement and asked if Channel 4 stood by what it had said to us. It replied:

“Channel 4 stands by its statement that E4 was outbid by BBC3 for the acquisition of *Harper’s Island*. Channel 4 would not have bid for *Harper’s Island* if it did not believe the programme was likely to be a good editorial fit, and Channel 4 withdrew from the bidding process for economic reasons. As the final price that BBC3 paid for *Harper’s Island* is not in the public domain, Channel 4 is unable to reliably estimate the amount by which BBC3’s bid exceeded E4’s.”⁷³

63. We note and welcome the BBC’s own subsequently announced intention to reduce spending on programmes from abroad, stating that in the main they cannot be an editorial priority, in light of the BBC’s “particular responsibility to invest the licence fee in the UK’s creative industries, supporting talent and producers particularly when other broadcasters are finding it hard to sustain their commitments”.⁷⁴

64. There is a clear disparity between Channel 4’s initial claim that the BBC outbid it for *Harper’s Island*, and the BBC Director General’s claim that Channel 4 withdrew from the bidding for editorial rather than economic grounds. However, we agree with Channel 4 that there does not seem to be any reason for the BBC as a licence fee funded public service broadcaster to acquire programmes such as *Harper’s Island*, let alone outbid others using public money, thereby reducing the resources available for original UK production and talent.

Digital radio

65. During our first Annual Report session, covering Channel 4’s 2007 Annual Report, the Committee noted that the broadcaster was ending its second foray into digital radio. We asked Andy Duncan what the total losses would be. He told us that “we are not in a position to put a final figure on it” because certain negotiations were still taking place, “but the total investment we think is less than 1% of turnover, so quite a modest sum of money, and considerably less, for example, than we have invested in other new business ventures like the launch of new channels or the acquisition of Box TV last year. It is a relatively modest amount [...]”.⁷⁵ The turnover of the broadcaster, he noted, would be over £900m in 2008.⁷⁶

72 Uncorrected transcript of oral evidence taken before the Culture, Media and Sport Committee on 16 July 2009, HC (2008–09) 945-i, Q 55

73 Ev 20

74 BBC Trust, BBC Strategy Review, March 2010, p 56

75 HC (2008–09) 189, Q 36

76 *Ibid.*, Q 37

66. We returned to this issue in our written follow-up questions to Channel 4 following the 2008 Annual Report. Channel 4 told us that its total investment in Channel 4 Radio “amounted to less than £10m over three years, all of which was written off by the end of 2008.”⁷⁷ **We cannot agree with the assessment that such a loss represents a “modest amount”. On the contrary, we believe that this represents a significant amount of funding that could more usefully have been used to maintain the public service content on Channel 4’s core channel.**

67. We also note that Channel 4’s digital radio losses do not appear to be broken out in the 2008 Annual Report. A footnote to Note 1 of the financial statements on “Segment reporting” states that during 2008 the group made the decision to exit its 4Radio venture (“included within ‘Other’”), and “As this undertaking has not started to generate revenues and does not constitute an individual segment on the basis of materiality it has not been disclosed as a discontinued operation.”⁷⁸ The ‘Other’ column referred to comprises a number of different figures, including ‘Other operating expenditure’ of more than £15m and a total operating loss of nearly £20m. Note 2 on “Total operating expenditure” also contains a footnote stating that the figure of £8.1m for “Other business development” expenditure in 2008 “includes pre-trading expenditure relating to 4Radio and Project Kangaroo.”

68. Whether or not accounting rules required Channel 4 to detail the costs and losses of its failed digital plans, we believe that public accountability requirements mean that it should have been clear and transparent as part of its annual reporting process. The opposite was the case. In fact, had this Committee not made its own enquiries, the total figures might never have been disclosed publicly.

Future of the Channel 4 Chairman and Chief Executive

69. During the 2008 Annual Report session we noted that the term of the then Channel 4 Chairman, Luke Johnson, was ending in January 2010, and asked him whether he had given any thought as to his successor. He replied “I am not necessarily involved in it. It is for Ofcom to decide.”⁷⁹

70. We also highlighted that there had been widespread press reports about tensions within the boardroom, particularly between the Chairman, Chief Executive and Director of Television and Content, Kevin Lygo.⁸⁰ This was refuted by Luke Johnson⁸¹ and by Andy Duncan, who said:

“It is a load of nonsense. We have had a succession of tittle-tattle, gossip and rumour certainly for the last five years, all the time I have been at Channel 4. I guess it will carry on. Some of it clearly comes from our competitors and is designed to cause

77 Ev 20

78 Channel 4 Annual Report 2008, page 95

79 Q 90

80 Q 91

81 *Ibid.*, [Luke Johnson]

mischief, presumably, at a key time for Channel 4's future but it is just not true. It is as simple as that."⁸²

71. We asked Andy Duncan whether he hoped and intended to be in post of Chief Executive in a year's time, to which he replied:

"Absolutely! In my interview with Luke and whoever else interviewed me several years ago, my ambition in coming to Channel 4 was to really help Channel 4 fully transition successfully into the digital world. I think we have made very good progress over the last few years. I think there is still some way to go and I would like to finish off that job. There are some very key issues coming up in the next 12 months that I would like to see through, for sure."⁸³

72. Despite his enthusiasm to us at the Annual Report session in May, on 16 September 2009, Andy Duncan announced his intention to step down from his post before the end of 2009 having confirmed his decision to the Channel 4 Board. He further stated:

"The publication of the *Digital Britain* report in June 2009⁸⁴ was also a natural moment for me to take stock and since then I have been in discussion with Luke and other board members about the future. Channel 4 is facing a further period of change, with a fresh regulatory cycle looming and with the cancellation of *Big Brother* signalling the most significant creative renewal in our history. We have mutually agreed that this feels like the appropriate moment for me to hand on the baton to someone else and to move on to a fresh challenge after more than five years at the helm."⁸⁵

73. The media speculated that the real reason for Duncan's departure related to strained relations with Luke Johnson and the inability to secure a Government-brokered bailout amid concerns about its long-term financial security.⁸⁶

74. On 5 November 2009 Ofcom announced the appointment of Lord Burns as the next Chairman of Channel 4, with effect from 27 January 2010, and his immediate appointment to the Board as Chairman-Designate. Lord Burns' appointment as Chairman for three years from 2010 was subsequently approved by the Secretary of State for Culture, Media and Sport, Rt Hon Ben Bradshaw MP.⁸⁷ One of Lord Burns' first tasks was to appoint a new Chief Executive. On 22 January 2010 it was announced that he had appointed David Abraham, Chief Executive of UKTV, to the role.⁸⁸

75. It must be hoped that the appointment of a new Chairman and Chief Executive at Channel 4 will provide the stability which Channel 4 needs to transform itself successfully into the public service broadcaster envisaged in the Digital Economy Bill. We trust that they will work together effectively and look forward to holding them to account for the future performance of Channel 4.

82 *Ibid.*, [Andy Duncan]

83 Q 92

84 Five weeks after our oral evidence session

85 "Andy Duncan to step down as Channel 4 CEO before year end", Channel 4 press release, 16 September 2009

86 "Duncan about to leave Channel 4 after drawn-out boardroom dispute", *The Times*, 15 September 2009

87 "Terry Burns appointed Chairman of Channel 4", Ofcom press release, 5 November 2009

88 "Channel 4 appoints David Abraham as Chief Executive", Channel 4 press release, 22 January 2010

Conclusions and recommendations

Digital Economy Bill

1. The impact on markets in which a public service broadcaster operates can be both positive and negative. Much concern has been expressed – including by this Committee – about the negative impact of the BBC as it has expanded both its public service and commercial activities. The extension of Channel 4’s primary functions beyond the core PSB television channel, along with the growth of its non-PSB activities, means the market impact this public organisation has might increase significantly, raising questions about how this impact should be monitored and controlled. We recommend that the Government consider and address these issues now, during the passage of the Digital Economy Bill. (Paragraph 17)
2. We agree that any expansion of Channel 4’s remit, and any extension of its statutory public service activities to services beyond its single traditional PSB service, the main Channel 4 television channel, requires provisions for monitoring and enforcing the new functions. It is far from clear, however, that the monitoring and enforcement provisions proposed will be the most appropriate and effective means for achieving this. (Paragraph 22)
3. Nor is it clear that the existing governance framework for Channel 4 is the most appropriate for its proposed new status. While the BBC and Channel 4 retain different funding models, the evolution of both as publicly-owned, not-for-profit multichannel, multiplatform public service broadcasters, benefiting from direct and/or indirect public funding, calls into question the rationale for maintaining dramatically different governance systems. (Paragraph 23)

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4. We are grateful to Channel 4 for the provision of the information which we sought, but we do not agree that withholding from the public the figures relating to its individual digital channels, E4, Film4 and More4, is justified. Channel 4 occupies a unique position as a broadcaster in the UK and should be transparent on the costs and benefits of its non-PSB channels. It is not obvious to us what, if any, commercial disadvantage Channel 4 could suffer if this information was in the public domain. (Paragraph 39)
5. Moreover, we find this lack of transparency on its digital channels incompatible with Channel 4’s ambitions for them to be part of a public service network, as proposed in the Digital Economy Bill. (Paragraph 40)
6. While in principle we support the inclusion of a public service broadcasting requirement relating to older children in a revised Channel 4 remit, it is clear that Channel 4 did not achieve its aims of demonstrating via a pilot fund its capability to commission engaging content that connects with its intended audience, or successfully demonstrate what it could do with further resources. (Paragraph 49)

7. We find it difficult to accept Channel 4's claim that competition authority reference of Project Kangaroo "was a surprise to most people" and that "the general view [of Project Kangaroo] within the industry was that it would be a good thing and clearly in the public interest", with "only one or two" complaints from competitors. This is contradicted by the number and weight of representations to the competition authorities, and their findings regarding the threat to competition in the VOD market. (Paragraph 54)
8. There is clearly a disparity between Channel 4's depiction to us of the BBC Executive's expectations for BBC Trust approval of Project Kangaroo (based on the Executive's reported dealings with the Trust), and the position of the BBC Trust. However, we believe that, given the level of investment involved, Channel 4 was unwise to rely on the assurances it received from the BBC Executive, and to make such heavy investment in advance of a decision of the competition authority. This is especially the case given the financial cutbacks by Channel 4 in other areas, such as its pilot fund for children's programming. (Paragraph 58)
9. There is a clear disparity between Channel 4's initial claim that the BBC outbid it for *Harper's Island*, and the BBC Director General's claim that Channel 4 withdrew from the bidding for editorial rather than economic grounds. However, we agree with Channel 4 that there does not seem to be any reason for the BBC as a licence fee funded public service broadcaster to acquire programmes such as *Harper's Island*, let alone outbid others using public money, thereby reducing the resources available for original UK production and talent. (Paragraph 64)
10. We cannot agree with the assessment that such a loss represents a "modest amount". On the contrary, we believe that this represents a significant amount of funding that could more usefully have been used to maintain the public service content on Channel 4's core channel. (Paragraph 66)
11. Whether or not accounting rules required Channel 4 to detail the costs and losses of its failed digital plans, we believe that public accountability requirements mean that it should have been clear and transparent as part of its annual reporting process. The opposite was the case. In fact, had this Committee not made its own enquiries, the total figures might never have been disclosed publicly. (Paragraph 68)
12. It must be hoped that the appointment of a new Chairman and Chief Executive at Channel 4 will provide the stability which Channel 4 needs to transform itself successfully into the public service broadcaster envisaged in the Digital Economy Bill. We trust that they will work together effectively and look forward to holding them to account for the future performance of Channel 4. (Paragraph 75)

Formal Minutes

Wednesday 10 March 2010

Members present:

Mr John Whittingdale, in the Chair

Janet Anderson
Philip Davies
Paul Farrelly

Mr Adrian Sanders
Mr Tom Watson

Draft Report (*Channel 4 Annual Report*), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 75 read and agreed to.

Resolved, That the Report be the Third Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Written evidence was ordered to be reported to the House for printing with the Report.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

[Adjourned till Wednesday 17 March at 10.15 am

Witnesses

Tuesday 12 May 2009

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Mr Luke Johnson, Chairman, **Mr Andy Duncan**, Chief Executive, and **Ms Anne Bulford**, Group Finance Director, Channel 4

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Third Report	Channel 4 Annual Report	HC 415
Second Report	Press standards, privacy and libel	HC 362-I, II
First Report	The work of the Committee in 2008–09	HC 264

Session 2008–09

Seventh Report	BBC Commercial Operations: Further Report	HC 968
Sixth Report	The Licensing Act 2003	HC 492
Fifth Report	BBC Commercial Operations	HC 24
Fourth Report	BBC Annual Report and Accounts 2007–08	HC 190
Third Report	Channel 4 Annual Report	HC 189
Second Report	Work of the Committee 2007–08	HC 188
First Report [First Joint Report with the Business and Enterprise Committee]	Pre-appointment hearing with the Chairman-elect of Ofcom, Dr Colette Bowe	HC 119
First Special Report	Unauthorised Disclosure of Heads of Report	HC 333

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Eleventh Report	Draft Heritage Protection Bill	HC 821
Tenth Report	Harmful Content on the Internet and in Video Games	HC 353 I, II
Ninth Report	Draft Cultural Property (Armed Conflicts) Bill	HC 693
Eighth Report	Tourism	HC 133 I, II
Seventh Report	European Commission White Paper on Sport	HC 347
Sixth Report	London 2012 Games: the next lap	HC 104 I, II
Fifth Report	On-course horserace betting	HC 37
Fourth Report	BBC Annual Report and Accounts 2006–07	HC 235
Third Report	Work of the Committee in 2007	HC 234
Second Report	Ticket touting	HC 202
First Report	Public service content	HC 36 I, II
Third Special Report	European Commission White Paper on Sport: Government Response to the Committee's Seventh Report 2007–08	HC 1029
Second Special Report	On course horserace betting: Government Response to the Committee's Fifth Report 2007–08	HC 549
First Special Report	Public service content: Response from Ofcom to the Committee's First Report of Session 2007–08	HC 275

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Seventh Report	Self-regulation of the press	HC 375
Sixth Report	Caring for our collections	HC 176 I, II
Fifth Report	New Media and the creative industries	HC 509 I, II

Fourth Report	Call TV quiz shows: Joint response from Ofcom and ICSTIS to the Committee's Third Report of Session 2006–07	HC 428
Third Report	Call TV quiz shows	HC 72
Second Report	London 2012 Olympic Games and Paralympic Games: funding and legacy	HC 69 I, II
First Report	Work of the Committee in 2006	HC 234
First Special Report	Self-regulation of the press: Replies to the Committee's Seventh Report of Session 2006–07	HC 1041

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Fourth Report	Women's Football	HC 1357
Third Report	Preserving and Protecting our Heritage	HC 912 I, II, III
Second Report	Analogue Switch-off	HC 650 I, II
First Report	Broadcasting Rights for Cricket	HC 720
Second Special Report	Women's Football: Replies to the Committee's Fourth Report of Session 2005–06	HC 1646
First Special Report	Maritime Heritage and Historic Ships: Replies to the Committee's Fourth Report of Session 2004–05	HC 358

Oral evidence

Taken before the Culture, Media and Sport Committee on Tuesday 12 May 2009

Members present

Mr John Whittingdale, in the Chair

Janet Anderson
Philip Davies
Mr Nigel Evans
Paul Farrelly

Mr Mike Hall
Alan Keen
Mr Adrian Sanders
Helen Southworth

Witnesses: **Mr Luke Johnson**, Chairman, **Mr Andy Duncan**, Chief Executive, and **Ms Anne Bulford**, Group Finance Director, Channel 4, gave evidence.

Chairman: Good morning. This morning the Committee is holding its now annual session in which we look at the Channel 4 Annual Report. I would like to welcome Luke Johnson, the Chairman, Andy Duncan, the Chief Executive, and Anne Bulford, the Group Finance Director.

Q1 Mr Sanders: There is conflicting background to the issue of this report. The question I really wanted to ask is: is there or is there not a crisis for Channel 4's finances and your ability to fund public service programming on the core channel?

Mr Johnson: We do not think there is a crisis but we are under significant pressure. We are hit by two significant forces, the first of which is the substantial structural change undergone by free-to-air television, and indeed most of the traditional media industry, thanks to the digital revolution and the very severe economic downturn which is impacting advertising revenues across all forms of media, I would argue disproportionately. We do not feel there is a crisis. We think we have challenges and we are under pressure to maintain investment in public service output while coping with reducing revenues. Unquestionably, the very robust and successful model that has persisted for over 25 years for Channel 4 needs some adaptation, I think, if we are to continue to maintain a relevant impact from output in the years ahead.

Q2 Mr Sanders: I ask the question because, Andy, you are on record on saying that 2008 has been one of the most difficult years in your history and 2009 will almost certainly be tougher still. Is 2009 turning out to be tougher than 2008?

Mr Duncan: It is, yes. I think the contrast, if you like, between the factors that we can influence and the factors that we cannot is really at the heart of what is behind your question. Certainly in 2008, and even so far in 2009, we have done extremely well in terms of creative success, awards and so on. We have had our best ever year. We have grown our share of public viewing of television, particularly in peak, to record levels. We have grown our share of the advertising market to a record level. But the advertising market itself, partly because of the global economy and partly because of the factors

that Luke mentioned, was down 5% last year but that came more or less all in the last four months of the year. So far this year we are seeing an 18% decline in the first half of the year and we are expecting probably something like a 15% decline for the year as a whole. What that means in real terms is over £100 million of revenue. Although we have taken a lot of cost out of overheads—staff, marketing, new business and other areas—unavoidably it means over 10% of our programme budgets will be reduced this year, which is a very significant cut in programming and output. On what we can do something about, we feel we are doing a good job but obviously there are wider forces at play here, and that is having a direct impact on revenue and in particular therefore on programme and content spend.

Q3 Mr Sanders: In terms of cutting 10%, are you cutting that across the board or is there a bigger percentage cut from one area of all your operations?

Mr Duncan: It is still an exercise that we are going through as we speak. We had already budgeted for a certain level of decline and we have had to increase that further as the year has gone on because of the downturn being even deeper. It will affect every area at some level but we have tried to prioritise peak, for example; so we have taken disproportionately more out of breakfast, daytime and late night. As far as possible, we have tried to protect areas like news and current affairs but obviously what we also need to be careful of is that we do not cut programming and output spend that in turn will damage our commercial income. The balancing act we have to pull off is delivering public value and making sure that the creative and public service aspects of what we are doing remain as strong as possible but also enough share of viewing to generate enough advertising for the next year again. It is a difficult juggling act. I think at some level almost every area will be affected.

Q4 Helen Southworth: I want to ask you if you have been able to differentiate between the decline in advertising which is due to new technologies and the amount which is due to advertisers taking account of the current economic circumstances.

 12 May 2009 Mr Luke Johnson, Mr Andy Duncan and Ms Anne Bulford

Mr Duncan: It is very difficult, I would say, to give an exact split and say that of the 15%, X% was one and Y% was another, but clearly a big part of what was going on both last year and this year was to do with the economy generally and the downturn in the cycle. Most people, and certainly we would agree with this, would be of the view that what it is doing is accelerating structural change that was taking place anyway. For example, switchover, which is now starting in earnest this year, is driving even faster growth of multi-channel. For example, multi-channel has significantly more minutes and ads per hour than the terrestrial channels, but that in turn drives extra supply into the market, which is one of the factors driving the advertising and revenues down. In particular, internet advertising has now overtaken TV and gone well ahead of TV for the first time. Unlike other recessions, we would say by 2010 and at the earliest 2011 maybe it will not bounce back; it might stop declining but it is going to plateau at a new lower level. That is the structural change that is taking place, so a significant proportion of structural change combined with cyclical change but it is hard to pull out those two exactly.

Q5 Chairman: Your projected £150 million funding gap is based on future expenditure projections. How much of that future expenditure is on new services?

Mr Duncan: Dealing with the gap we have, relatively little, so the majority of the gap between what we believe we should be spending to deliver the public remit and what we will have in terms of revenue projections is to do with normal traditional television programmes. The exceptions to that would be three areas, I think: education activities where historically we ran schools programming on the television—we have now moved very successfully to on-line, which is a much better way of getting to that target group who otherwise are at school and that has always been part of what we have done; it is just that we are delivering it now on line; 4iP, which is our digital innovation fund, into which we are putting a relatively modest amount of money, about £4-£5 million; and the third area which at the moment is on hold is our children's pilot, some of which will be television and some of which will be on-line. The majority of that is straightforward television programmes.

Q6 Chairman: You are also intending or planning on having two new high-definition channels, are you not?

Mr Duncan: We have been allocated a slot for Channel 4, which we think is extremely important. We already have a Channel 4 high definition channel on satellite. We have four slots being allocated on DTT, which we think is very much in the public's interest: one will go to the BBC, one will go to ITV and one will go to Channel 4, and that one has already been allocated to us, which we think is absolutely essential. We have also put in a joint bid with S4C for a Film4/S4C joint HD channel, which again we think is very much in the public interest.

That means you are developing high quality, high-definition programming available to everyone for free. We are waiting for an Ofcom decision on that, which I think has been delayed for a few weeks.

Ms Bulford: We have not had the decision as yet. We expect that shortly.

Mr Duncan: At the moment, as things stand, we have one spot allocated. We may or may not be allocated a second.

Q7 Chairman: We understand that ITV for instance is thinking about whether or not it can afford to go ahead with high definition. If you are in such dire financial straits, is it sensible to be planning on two new HD channels?

Mr Duncan: It is very much a live issue. I would say that, as things stand, we are engaged in conversations with the BBC, as are ITV, about how the whole thing is going to be funded because I would absolutely say that there is the problem for us and ITV in terms of the funding of that going forward, yes.

Q8 Chairman: The other thing I wanted to ask you about quickly is this. It is widely expected that there is going to be a change to the contract rights renewal formula. How is that going to affect your future revenue?

Mr Johnson: The positive is that a cap on the market leader's ability to monetise its advertising has, I think there is an argument to say, constrained the industry as a whole; ie any business where the market leader is suffering, which ITV would argue they are because of this regulation, is not necessarily good for the industry. However, if contract rights renewal were lifted entirely without any other compensating mechanisms, then I think we will probably be at a disadvantage.

Q9 Chairman: I would have thought you would be definitely at a disadvantage, and that does seem at least a possibility.

Mr Johnson: We will have to try and cope with it if that is what the regulator says.

Mr Duncan: We have argued against it as a simple stand-alone move because of the fact it is effectively a zero sum gain where ITV would benefit at our expense. I think if it is looked at as part of a wider review of how advertising is bought and sold, that is more an advertising market consolidation, just a general recognition now that TV is much more substitutable with the internet, for example, in terms of advertising. Looked at in the round, then that may well be something that needs to happen over the next year or two, particularly given the extraordinary circumstances. Just as a stand-alone dropping of CRR, that would create problems, I think.

Q10 Mr Hall: You have dealt with the financial difficulties that are facing Channel 4. The other issue that comes out of the Annual Report in other statements that have been made is the challenge of Digital Britain and the quest of Channel 4 to find probably a partner with a symbiotic relationship

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with both organisations actually to secure the future of the company and the programme making that you undertake. You have said that your preferred plan is BBC Worldwide. The Committee have come to a slightly different conclusion that we think it might be better if it looked to Channel 5, which you seem to be dead set against. Could you explain why you think BBC Worldwide would be an ideal partner for Channel 4?

Mr Duncan: Just to take a step back, I know that this Committee looked hard at the whole issue of public service broadcasting over a year ago and I think recommended possibly the use of the licence fee to achieve plurality in the case of Channel 4. I was not aware that you had had a major evaluation of the possibility of partnership between ourselves and Worldwide. I know you had a separate review of Worldwide and then obviously the idea of us doing some sort of partnership with them was also in the ether at that time. To answer your question, I think there are really three points. First of all, regarding Worldwide, we have always said we would prefer something of an indirect solution if possible. Certainly for the last 15 years or so we have been self-reliant and earning advertising income off free spectrum. Prior to that we had a cheque from ITV, so we had in sense some funding from ITV. It goes with the grain of self-reliance and there is real synergy, we think, between ourselves and Worldwide as two public assets that can work together to create additional value on behalf of the public. So it seems to us that is a better mechanism if you are creating more value rather than simply transferring value. Secondly, in terms of real business areas where we can co-operate, people have I think somewhat misportrayed the two businesses as being rather different; they are actually essentially rather similar. Neither of us makes programming in our own right; we both secure rights—in their case from the BBC and in our case from the independent producers—and then we both very effectively earn money off the back of those rights through channels businesses, consumer products businesses, DVD businesses and so on. The possibilities of collaborating in existing business areas, or indeed in new business areas, are very strong. We and BBC Worldwide, I have to say, I think are enthusiastic about the possibility of a partnership and we are hoping that may come through in the next few weeks as part of a Digital Britain process. For Five, in contrast, I think there are some quite significant creative issues but at its very heart it is an issue of economics. Five was a very troubled business. Their advertising revenue, for example, will be down over 30% we believe in the first half of this year with a market down 18%; for example, we will only be down 16%. They also have very significant issues in terms of their share performance not so much at the headline level but against key demographics, and we think they face a similar significant share loss in the advertising market at the end of this year. Although there could be some synergies with Five, we think they have been more than offset by the scale of losses and problems they face as a business economically.

Mr Johnson: We echo that. We looked in detail at the possibility of a merger with Five and felt that it was the wrong thing to do, a few years ago, and, if anything, particularly on the commercial front, the reasons against it have greatly increased.

Mr Duncan: We did exhaustive work for almost two months during March and April looking at this very seriously with stakeholders, with Five, so we have done a lot of work on it, but the economics are very problematic.

Q11 Mr Hall: Did I hear you correctly to say that your negotiations with BBC Worldwide might be concluded within a few weeks?

Mr Duncan: At a headline level, we hope so, yes. What a headline partnership could look like is certainly achievable we think within a few weeks. Making sure that we have enough value being generated and enough value flowing back to Channel 4 is obviously at the heart of the issue. The point of the partnership in a way is to generate more value to flow back into content investment. There might be more detailed issues that would take much longer to sort out but at an absolute headline level we think there is a real urgency to resolve whether we can get the partnerships confirmed.

Q12 Mr Hall: Would you be able to put a timescale on when we may have some announcements and then some actual concrete proposals?

Mr Duncan: As things stand, it is one of the proposals the Government are looking at. I think technically Government are going through a process of looking at a number of options; partnership with Worldwide is clearly one of them; licence fee may be another; and I think Five is technically still another. They are obviously working to a timetable of wanting to reach some conclusions in the next few weeks. To some extent, we are trying to work with the timetable the Government themselves have with their Digital Britain report.

Q13 Mr Hall: One of the criticisms that has been made of a partnership between Channel 4 and BBC Worldwide is that it would actually give BBC Worldwide an even more dominant position in the market. Does that concern you?

Mr Duncan: I do not think it would. I think BBC Worldwide competes effectively in the marketplace. There is always a balance to be struck, and I know your Committee have looked at this very carefully recently. Our view is that the areas of synergy and co-operation would not increase dominance in the market as such but they would be a sensible way in which public assets can be monetised and the British public themselves can get full value back for those assets. The end point of both organisations is to generate as much money as possible to invest back into British content: in BBC Worldwide's case giving it back to the BBC, and in our case we do it within the same organisation. Part of what we are looking at is getting more money back into Britain from the rest of the world for British content. I think it is fair to say that if we wear a broader Digital Britain hat, one of the real concerns at the moment is that, going

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back five or 10 years, the TV advertising market peaked at about £3.5 billion; more than half of that money was reinvested back into British television programmes. If you take the internet advertising market, it has now gone in the space of 10 years from nothing to over £3 billion. Hardly any of that gets reinvested back into British content; most of it goes to the States, to the banks that own the big American on-line companies. One of the things that we and Worldwide believe we could do is more effectively help monetise British content around the world, both in terms of linear format and on-line, and that money flows back into Britain and would be reinvested back into British content and in our case all of it through the independent sector. All of this is very good for the creative economy as well. In our view there are two very good attractions from this. One is that you solve the public service issue; you have more money for public service programming. Secondly, it is very helpful in terms of the creative economy agenda and the creative industries being at the hub of an economic recovery for Britain.

Q14 Mr Hall: You pointed out that there could be direct funding for Channel 4 from the licence fee. We have put that forward as a proposal. I assume you welcome the Committee's recommendation on that.

Mr Duncan: To be very clear, Worldwide would be our preferred route forward but a contestable licence fee we think is a perfectly good idea as well and could be a workable idea. If Worldwide was not possible for any reason, we think some sort of contestable fund around the licence fee is a good idea. Already I think for some areas like regional news it is being pushed quite strongly as probably the best way forward.

Q15 Mr Hall: So you would not be thinking that both would be a better proposition?

Mr Johnson: It is for Government, our stakeholders, to decide. A combination might work, yes. Obviously I guess it depends rather a lot on the BBC, does it not?

Mr Hall: I thought you would have welcomed it with open arms, personally, but never mind.

Q16 Chairman: From all accounts the amount that the BBC is willing to give in terms of partnership with Worldwide falls rather short of your ambitions. Is that still the case?

Mr Duncan: I think it is one of the live areas of current debate, exactly how much value could be generated in total through a series of ventures and how much of that value would flow to Channel 4 and with what level of certainty. I do think at the very heart of the debate is the relative funding gap that has opened up between the BBC and the rest of the market. The Committee I think will be aware that as recently as two years ago the BBC licence fee was at parity to the TV advertising market. Although it is not apples and apples in the sense that some of TV advertising goes to non-public service broadcasting and some of the licence fee goes on radio and on-line, as a proxy comparison for decades and decades they

have been roughly the same. In fact, for most of that time the licence fee was below TV advertising. Last year a £300 million gap opened up. Certainly by next year a gap of well over £1 billion will have opened up. I do think if you contrast that and the £15 billion of guaranteed income the BBC will have in the next four years, in a deflationary environment—so when it was set that was set in anticipation of us and ITV having more money and with cost inflation that is now not happening—with the value of the BBC partnerships in total that they have offered all the industries put together, it is probably a few tens of millions at most between now and 2012. That would apply certainly to their regional news offer to ITV for example, where the much vaunted partnership I think ITV reckon was worth about £1.5 million to them by 2012, and so it does not really address the issue. I think there is a very important policy question which is: given the funding imbalance that has opened up, (a) is that healthy in its own right and (b) if you really want plurality in general terms with Channel 4, in specific terms on news and regional news as with ITV, then looking at that relative funding gap that has never ever been there in the entire last 50 years has to be part of the equation and either more money delivered through partnership or looking at the licence fee, but one of those two. My own view is that the BBC could go a lot further than they have so far in real money delivered through partnership.

Q17 Chairman: Obviously amongst the Worldwide assets there are the UK TV channels which I think you might find particularly of interest but there is the complicating factor of Virgin Media. Are you looking at any of the Virgin Media channels as possible acquisitions?

Mr Duncan: I think obviously it is commercially sensitive in terms of what we may or may not bid for that in terms of commercial deals. It is no secret that Virgin are looking to sell some of their content assets and it is no secret I think that the other half of UK TV in particular is something that the BBC for some time has wanted potentially to find either a better partner for or find a different way of moving that business forward. Those assets could have a role to play in terms of wider partnership but the partnership does not depend on securing those assets from Virgin.

Q18 Chairman: In terms of the Worldwide partnership or other kinds of public support, there is obviously a potential question surrounding state aid. I see you have decided to open an office in Brussels, unlike the other commercial broadcasters.

Mr Duncan: We have made an appointment to have somebody in Brussels. I think that is a reasonable thing to do. We have actually found over the last few years we have had increasing numbers of issues to do with Brussels, most significantly in the last few years for us in advertising regulation. So we had quite a long period of time where in the end we were successfully negotiating to have more advertising on our film channel, for example. We took the view that it would be helpful for us to have somebody based

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there full-time to help us deal with increasing amounts of EU regulation that are affecting Channel 4 in total. On the issue of any state aid or otherwise that might come through from Digital Britain, that is much less an issue for us and much more an issue for Government. My understanding is that across a number of things being considered and possibly that would be proposed as part of Digital Britain, the broadband and telecoms area probably especially, there are some where Government might indeed be needing to put the case effectively for state intervention to justify what they are doing. Obviously they would need to handle that with Brussels. I think that is less an issue for us and more an issue for them.

Q19 Chairman: If it is not about state aid, why is it that you feel it necessary to have an office in Brussels when the other broadcasters do not?

Mr Duncan: I think the BBC have always had quite a long relationship with Brussels and quite a significant amount of resource. In a former life I used to work for a big global multinational and we had an awful lot of resource in Brussels. One person to help us deal across the entire Channel 4 portfolio, there is quite a spread of different issues that touch into Brussels legislation, seems to us more efficient. At the moment what we are doing is outsourcing it to lobbying/legal/regulatory specialists. We think it is both cheaper and potentially more effective to have one person in-house. That was anticipated at the time of our restructure last year. We reduced our overall policy and strategy numbers but we built in an additional role because it is a cheaper and more effective way of dealing with those issues.

Q20 Chairman: Are you also still talking to Al-Jazeera?

Mr Duncan: To my knowledge, we have never talked to Al-Jazeera. They were alleged to have put themselves forward for a potential partnership but I do not think they ever contacted us directly.

Q21 Chairman: You have had no direct contact?

Mr Duncan: We have had no direct contact.

Q22 Chairman: You have no interest in contacting them?

Mr Duncan: It is not at the top of our list at the moment but they have not contacted us.

Q23 Paul Farrelly: I want to try and be a bit more precise when you say that in the next few weeks you expect in headline terms to reach an understanding with the BBC. What exactly does that mean? Usually in a commercial negotiation you will reach what is called heads of agreement, which would cover the assets subject to the agreement and any of the major financial issues, which will then be subject to contract and the final contractual negotiations. Are you saying you expect to reach heads of agreement stage with the BBC in the next few weeks?

Mr Duncan: I think effectively it would be some sort of memorandum of understanding between the two organisations on how partnership or partnerships

could work. I think the requirement of our own board is probably slightly different to the requirement for the BBC Trust and then again in our case we have government stakeholders that we would obviously need to be talking to about that. In essence, whether you call it heads of agreement or memorandum of understanding, it would need a headline understanding of how a partnership would work, yes.

Q24 Paul Farrelly: It would be analogous to a heads of agreement?

Mr Johnson: I think so. It all plays into what we believe is the 16 June publication date for the Digital Britain report and obviously one assumes some weeks before that it will be finalised.

Q25 Paul Farrelly: Usually commercial parties would have the benefit of privacy and secrecy when doing this.

Mr Johnson: We would but then neither BBC Worldwide nor us are normal commercial organisations.

Q26 Paul Farrelly: Exactly. Are you expecting to announce that memorandum of understanding when both sides have signed it off?

Mr Duncan: I would say at the moment that obviously there are commercial sensitivities involved in what we are discussing. As Luke said, we are both public organisations, so it is a slightly strange situation, on top of which we are in the middle of a government process around Digital Britain. The ambition on all sides I think is to try and get to some broad agreement in time for that report, which has about five weeks to go (five weeks today I think). That timetable may move. I do not think it is absolutely set in stone but, based on our current understanding of the likely timetable, that gives us about a month or probably less. Discussions have been going well. It is entirely possible that is exactly where we will reach.

Q27 Paul Farrelly: When you have reached that point with a memorandum of understanding, would it be part of that understanding, either formally in black and white or informally, that you do not then go for the next win, which is top-slicing on a contestable or non-contestable basis?

Mr Johnson: No is the short answer.

Q28 Paul Farrelly: So that is still up for grabs afterwards?

Mr Johnson: Yes.

Q29 Mr Evans: Despite the core budget last year being reduced by £18 million, the original output went up by £10 million. What sacrifices have you made to be able to do that?

Mr Duncan: In particular last year we dropped acquisitions by a very significant amount. This was partly a reflection of the policy that we announced at the time of trying to invest in particular in original programming. I have said programme budgets tend to ebb and flow across the years anyway in terms of

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particular shows and ideas that come through, but we cut back in one or two areas like drama; there were fewer drama singles for example than we had done previously. In particular we tried to focus outside of peak and, as I said earlier, take as much as possible. Anne could probably give more detail on exact movements,

Ms Bulford: In the programme budget, as Andy explained earlier, we looked across a range in terms of balancing the public service content against the more commercial output in order to try to maintain revenue. The balance was struck across the whole schedule. Most of the cuts fell outside of peak, so very significant reductions comparatively in late night programme and at weekends, Saturdays. In some parts of the schedule you will see a higher incidence of repeats running through. In terms of the core originated budget, we have sought to protect news and current affairs, specialist factual and as much as possible of the drama. That will prove more difficult in 2009.

Q30 Mr Evans: I see current affairs fell 14% as the quiz and game shows increased by 6%.

Mr Duncan: I think we are doing substantially more than we were doing a few years ago on current affairs. The cornerstone of what we do remains *Dispatches*, of which we do 40 episodes a year, one hour in peak (for example, the BBC only do half an hour of *Panorama* which they counter-scheduled against us) and *Unreported World*, the only significant international strand of current affairs that anyone does in Britain, 20 episodes a year. They remain the cornerstone of what we do and that is substantially higher than we were doing three or four years ago. The reason for the variation in the budget was partly an allocation issue. We had a big one-off drama single *Mark of Cain* based on Army prisoner abuse, which the previous year got played out and that was categorised as current affairs, as occasionally those drama singles do. A smaller and rather less successful show had been *The Insider* which was dropped last year in order to focus the budget on *Dispatches* and *Unreported World*. I would say we remain very proud of our investment in current affairs and in particular the commitment to air time and we continue to do that. On your quiz shows point, certainly compared to BBC1 and ITV1, we do really no significant quiz shows or game shows in peak. That is just not part of what Channel 4 does. But it does play a commercial role for some day time. We successfully have shows like *Deal or No Deal* that make money for us but help us invest then in other parts of the schedule. I think there was a new quiz show last year, a day-time quiz show with Terry Wogan. We obviously have *Countdown* where we have cut down the cost, but there is a batch of day-time shows for a different sort of audience that do a good job for us and help with money from the advertising market and in other ways to reinvest back in. The core ambition of what we have been trying to do is protect the public service programming, particularly in peak, and I think we did a pretty good job of that last year.

Q31 Mr Evans: The Chairman asked you the question about Al-Jazeera. If you were shameless enough to take some money off people from Qatar maybe it would change the character of Channel 4 which we have all come to know and love.

Mr Duncan: In any scenario, protecting the independence of Channel 4 is paramount. That is crucial. Secondly, and I am sure the Committee have had a chance to look at it, we introduced for the first time this year the Public Value Report; it is the first time in 26 years that we have had a very substantial part of the Annual Report trying to document and quantify more rigorously the public value we deliver. We think delivering the particular purposes that we have pulled out at Next on 4 remain crucial. It is not just about public service plurality; it is about the type of distinctive contribution Channel 4 makes in contrast to the BBC or indeed that which will be provided by the market. I do think the board would be very concerned if any solution put any of that at threat.

Q32 Mr Evans: As we look to the upcoming 12 months, particularly with the crisis that is hitting all the TV and radio sector, apart from the BBC which is clearly in a jacuzzi of cash, what do you see is going to happen over the next 12 months because of the financial crisis? What are we going to notice most about Channel 4, the changes that will take place?

Mr Johnson: We hope you will not notice it through clever commissioning and scheduling, but there is no doubt behind the scenes, particularly as we said earlier outside of peak, we have less resources available and the schedule will not feel as rich later on this year and next year. Of course there is a lag effect and this is why in a way these accounts are very historic. The rate of fall of advertising revenue is very material. A lot of the very finest programmes that won BAFTAs and other awards in recent times were actually commissioned and at least part paid for some while ago, even two years ago, or more in some cases. As time goes on and we are faced with declining revenues, there will be a threat of death by a thousand cuts in scheduling.

Q33 Mr Evans: Would that not be the death of Channel 4 by a thousand cuts as well because if you start to put on rubbish or less good quality television, you are going to start to drive away the audience that you require, which means then that the advertiser is going to be less interested in Channel 4? Is there another solution to this?

Mr Johnson: Our solution is that we believe in trying to be as ingenious as we can with our cross-subsidy model so that we do produce for example highly commercial quiz shows that generate surplus to fund public service broadcasting, but also we would argue that because we are almost deliberately investing money in things like *Channel 4 News* that we know will effectively lose us money, then there is a need, if society and our stakeholders feel they believe in the plurality of public service broadcasting, for some form of support, and that is what we have been asking for for some time. We feel very passionately that Channel 4 does deliver something very

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important to the choice out there and it is very healthy for the broadcasting industry as a whole; it is very healthy, I believe for the BBC. Therefore, a solution should be found.

Q34 Mr Evans: What is the threat then? Is it that if you do not get that support, the documentaries, *Channel 4 News* and *Dispatches* are all for the chop?

Mr Johnson: We will continue whatever and we will manage as best we can with self-help, but over time the damage will become material, yes. I do not think, as we said at the beginning, it is a short-term crisis but I do think, medium and long-term for what is relatively speaking compared to the £3.6 billion very small sums of support, we will maintain what we think is an outstanding service that, as I have said, has a beneficial effect on those around us.

Q35 Mr Evans: Do not get me wrong, Luke, I do not disagree with you but what sort of timescale are we talking about?

Mr Johnson: It does depend a lot on whether there is any recovery in advertising revenues in 2010–11. If there is a similar, very severe decline next year in ad revenues, partly for structural or partly for economic reasons, then that will present us with some very unpleasant choices. I would argue that things like *Dispatches*, *Channel 4 News*, et cetera would be the very last things to be hit but important dramas like *Endgame*, which was on last week, and *Red Riding* and all these sorts of things will come under threat.

Mr Duncan: It is worth saying that this is an unprecedented level of ad market decline. In previous recessions there has been nothing remotely on this scale. As we said earlier on, the worry is that with the structural change as well it simply will not bounce back. If you look at what has happened elsewhere in the market, ITV have effectively pulled out of arts with the demise of the *Southbank Show*; that is last on the list with children's programming, religion, science, history and current affairs. Five I think are able to invest relatively little in British content this year. I think the policy question is: if you really want plurality, and the conclusion of the last several years of debate is that Channel 4 absolutely is the key to providing that plurality in most of the genres, then over 10% of our programme budget is down this year and probably more again this year. That is very damaging at some level. We will do the best we can to continue to deliver the best public value we can. We are not in danger of going bust as some people have tried to portray it but that will have real damage to our creative output, the public value we can deliver and the plurality we deliver. We have already seen what has happened in other organisations. I think it would be a huge mistake just to sit back for another two or three years, particularly given the speed of change. The media world is changing dramatically now in terms of timescale. We cannot afford in another two or three years to have the same policy debate. Your Committee first identified this nearly 18 months ago. This is to some extent predictable and now is the moment that we need the action.

Ms Bulford: It is also worth adding that in terms of the programme budget we are very determined to get best value for money out of our producers with whom we work closely. Clearly of course if we have a problem, they have a problem and there is a knock-on effect into the creative community. Our interests in getting as much programming as possible and giving value to viewers on screen are wholly aligned. When we came to see you in the autumn we explained that we have consistently exceeded our production efficiency targets through procurement and clever scheduling. We work to a minimum target of 5% annual efficiency and we have been achieving between 9% and 11% annually by working closely with independent producers, trying to get best value for money out of the way in which we buy and schedule programmes and making best use of new technology and these sorts of things coming through. It is a big challenge for Channel 4 because to do with our remit we have a very high incidence of new programming coming through in singles. Like any manufacturing model, it is more difficult when you make it the first time than it is when you make it the second time, but we work very hard on that as part of our self-help agenda.

Q36 Mr Evans: May I ask one final question and I know we always ask the BBC this. I suspect that you have nobody on £6 million a year like the BBC is reputed to have. Do you think, and you can tell us factually, this is having an impact on the sort of remuneration that you are paying some of your people?

Mr Johnson: Unquestionably. We are getting more for less, I would argue, potentially across the board and talent is feeling the pinch. Frankly, that is no bad thing. I think the sort of sums you were talking about was absolutely a high water mark. We are going back to renegotiate and we are in some cases improving terms dramatically. There are some positives coming out of this downturn but, nevertheless, it is not easy to cut some of these budgets where some independent producers would argue in areas like for example current affairs that they are not really making any money anyhow.

Q37 Mr Evans: Are some of your top stars threatening to walk if you do that?

Mr Johnson: In some cases, *Countdown* for example, they have and we survived.

Q38 Chairman: You have talked about acquisitions and you said that was an area where you were cutting back. There has been a huge increase in the amount of hours devoted to acquisition and the costs over the course of the last five years. Kevin Lygo I think recently said that you would be spending nowhere near the levels that you did in the past "and it is unlikely we will buy a new show this year unless we get a good deal". What is a good deal of those?

Mr Duncan: First, to put it into context, our level of acquisitions broadly in the last few years is lower than it was in the early years of Channel 4 when Jeremy Isaacs was running it, or for that matter in

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Michael Grade's time. The proportion of British-originated programmes on Channel 4 has generally been at a high level in the last few years. We absolutely undertook and said around the time of Next on 4 last spring that our ambition is to do even more of original British content and less of US acquisitions. The hours thing you have referred to, John, is a factor of less original programming, particularly in non-peak hours, so late night, and we are repeating more American programming late night; we are repeating American programming in the morning. We do not do any original breakfast show any more, for example. Also, on the digital channels in some cases we are not commissioning as much new material as we would like to be. It is that factor. In terms of cost, Kevin Lygo's comments are exactly right; we are not in a position to go out and buy a major show for Channel 4. Where we could find a suitable show that would be sensibly priced, it could have a role to play, particularly on the digital channels again. It was very disappointing, going back to earlier remarks, that E4 for example, which has a very good tradition of US acquisitions, can make money on those US acquisitions that allows them then to invest in original programming or provide money back to the core channel to invest in original programming. E4 was recently out-bid by the BBC for an acquisition, which we think was an outrage.

Q39 Chairman: Which was that?

Mr Duncan: BBC3 out-bid E4 for *Harper's Island* and BBC3 is entirely licence-fee funded and meant to be all about innovation and original programmes for the British public. E4 has a substantially bigger reach than BBC3 and we think more effectively gets to younger audiences but the fact is that it was out-bid; we got to a rate beyond which we could not justify going commercially and the BBC paid about one-third more than that. Provided everyone is playing a fair game, we would hope we might be able to get one or two shows at a more reasonable price but it was particularly disappointing to be out-bid by the BBC. Clearly no-one else was justified in bidding more money—Sky, ITV, Five, et cetera. To be outbid by BBC3 was ridiculous.

Mr Johnson: Clearly on all acquisitions we are always ruthlessly commercial, so we would never ever acquire a US import if it did not make us money or we thought it was not going to make us money.

Q40 Chairman: So the £1 million an episode you spent on *Desperate Housewives* was commercially sensible?

Mr Johnson: We thought it was the right thing to do at the time. It was a signature show that is a huge draw to the channel.

Mr Duncan: It is worth saying that we are paying substantially less than that now. It was absolutely the key part of an advertising sales position at the time that was commercially justified. It was the peak of the market and we have renegotiated that price substantially down.

Q41 Philip Davies: Following on from that, one of the most interesting pages in your report is your top tens. On the point about *Desperate Housewives*, it appears that despite spending all that money on it, it is the fifth most criticised individual programme on Channel 4. With that in mind, do you still think it was worth paying £1 million an episode for that?

Mr Duncan: I am not sure what the nature of the complaints was.

Mr Johnson: I think it is criticised heavily because it is watched heavily. If you have a lot of viewers for a show, it will almost always end up being heavily criticised as well as heavily praised.

Mr Duncan: One of the major sources of complaint about *Desperate Housewives* last year was that we broke off the series half-way through and so for budget reasons we did not play the entire 22 parts of the series out. I think we played eight or nine.

Mr Johnson: That was to do with the scriptwriters' strike in Hollywood.

Mr Duncan: Yes, you are right. So we broke it and we had quite a lot of complaints and when it came back on people did not know it had re-started.

Q42 Philip Davies: Is this not an interesting perspective on customer feedback—and I am sure this does not apply to any of your other businesses—the concept that the more criticisms you get, the better it is? Is that a new style of customer service, a new manual that we should all be following?

Mr Johnson: If you have a very popular show, inevitably more people watch it, so inevitably you are more likely to get criticisms. By way of contrast, I would think that *Desperate Housewives* probably got an audience of five to 10 times that of the fourth show on the list, which was more heavily criticised. Inevitably the likelihood is more people will criticise it for the reasons possibly Andy was saying.

Q43 Philip Davies: The most interesting of course in the top tens is the *Alternative Christmas Message*, which is the most criticised but also happens to be the second most complimented as well. That is interesting. Perhaps that backs up Luke's theory that it must have been particularly well watched on that basis. With hindsight, what are your views now about the *Alternative Christmas Message*?

Mr Duncan: With hindsight, we think it was an exactly justified thing to do. It was subject to an Ofcom investigation based on some of the complaints they had received, and they also totally vindicated it. It is worth saying that virtually all the complaints that came in did so before it was aired. There has always been a tradition with the Channel 4 Christmas message of providing an alternative perspective on things. One of our core purposes is to present different perspectives on the world around us. Before the event there was some substantial noise around it and a number of people did complain. We contextualised it very clearly. There was a set-up video around what was going on in that particular country and some of the views of the president. We also deliberately did not counter-schedule it, which we had normally done, head to head against the Queen to be somewhat sensitive around that. After

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the event, we ended up with significantly more complimentary audience feedback than we did complaints, and there were very few complaints after it was aired. Quite often we find this with programmes. Increasingly now when it is easy for people to contact us on-line, you get complaints before a programme has gone out that then fall away quite quickly afterwards. In that case it was looked at by the regulator and given a green light.

Q44 Philip Davies: Do you think there is a perception amongst the public that Channel 4 perhaps, although it is well known for trying things out that other people might not, sometimes potentially becomes gratuitously different; it aims to shock deliberately and it perhaps goes over the top in that sometimes?

Mr Johnson: I think Channel 4, throughout its history, has always been provocative in terms of the sorts of programmes it shows. It tries to experiment. Sometimes we get it wrong, and I think we accept that. Coming back to your point about complaints, if you have a look at this, you can analyse for yourself that certain groups of viewers and certain subjects are likely to solicit both complaints and praise. It is rather an interesting sociological phenomenon that we could analyse.

Q45 Philip Davies: In order to keep pushing the boundaries back, as Channel 4 seem to want to do, what can we expect from this year's *Alternative Christmas Message*? Are we going to have an al-Qaeda terrorist perhaps or something similar? Where is Channel 4 going this year with their *Alternative Christmas Message*? What can we look forward to?

Mr Duncan: The *Alternative Christmas Message* is commissioned by the news and current affairs department and over the last decade or so there has been a very interesting range of perspectives and voices, which I say again is one of our core purposes. First of all, I think it was entirely justified as a one-off piece of programming. You also have to look at it in the context of what we do year-round. Yes, Channel 4 is controversial; yes, we can be provocative. I would hope that we could always justify that against a public benefit of it. In the case of our coverage of international issues, our coverage of issues around the world helping people in Britain understand what is going on in the world around them, I genuinely would argue that Channel 4 is second to none, even the BBC. As for the international coverage within *Channel 4 News* and *Unreported World*, which we talked about earlier, some of the documentaries and even some of the dramas that deal with issues taking place abroad, I would say that Channel 4 does a fantastic job throughout the year of really helping people understand what is going on in the rest of the world. That *Alternative Christmas Message* was a small part of a much bigger set of programming across the whole year. I think you have to look at it in that context. Going back to your earlier point, in any case where Channel 4 is doing something controversial and provocative, there should be some

sort of purpose behind it and there should be some sort of justification, whether that is creative, editorial or otherwise.

Q46 Paul Farrelly: Shipley may have been Royalist in the Civil War but Newcastle-under-Lyme, sided with the New Model Army, so I am always willing to appreciate new perspectives and messages. That is just to give a bit of balance. Can I move on to your non-core channels? First, of all, I do not know what *Harper's Island* is, so I betray my ignorance. What is expensive? What is *Harper's Island*?

Mr Duncan: It is a straightforward American drama acquisition. I think it is one hour and it is doing reasonably well in the States. It is not the sort of programme that would justify going on to a main peak slot on Channel 4, BBC1 or ITV1 but it is ideally suitable for a youth-targeted channel like E4.

Q47 Paul Farrelly: Is that an isolated incident of one sudden rush of blood to the head by one particularly enthusiastic executive in the BBC?

Mr Duncan: My own view on this is that I do not understand why any of the licence fee now is spent on US acquisitions, not one penny.

Mr Johnson: Or indeed films.

Mr Duncan: They compete against the likes of ITV and ourselves and others for feature films; they compete against us for US series acquisitions, all of which would appear in some way, shape or form on British television in some other way. If they did not spend any money on acquisitions, that money could either be spent by them on British content or in other ways or used for some other purpose. Meanwhile, it means everyone else would get those acquisitions somewhat cheaper and less money would be flowing out of Britain going into Hollywood. It does seem to me there might have been a day decades ago when everyone wanted to watch the BBC1 Christmas film but that day has long since gone. Personally, I think it is a serious question mark for the BBC going forward as to why they spend any money on US acquisitions.

Q48 Paul Farrelly: Given that they do, is this symptomatic across the board or is that just one instance?

Mr Duncan: To be fair, I would say that there have been a few occasions in my time at Channel 4 when we have been out-bid by the BBC for shows that we would have liked to have shown and certainly on most occasions they have gone higher than we could have justified commercially. On feature films packages, it is the same point really, that they absolutely spend a lot of money on one big significant feature film package. I guess you would need to talk to the likes of ITV and Sky and get their perspective on it but one or two things the BBC have done, like *The Wire* for arguments sake, or *Mad Men*, they would argue "quite niche, quite cult" were not necessarily going to be picked up. A lot of the money they spend would be on shows that would otherwise be bought by somebody else and shown to the British public anyway.

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Q49 Paul Farrelly: Are there instances where ITV and Five might level similar charges of Channel 4?

Mr Duncan: I have never heard them make that complaint. It has always been the case since 1982 that Channel 4 operated in the commercial marketplace. That is the model which we have set up. Acquisitions for the entire existence for the big part of Channel 4, certainly for the first 20 years of Channel 4, were the most significant area of commercial profit, and they were the biggest driver of investment in British programming. I am sure ITV and Five would prefer it if we were not competing for US acquisitions but, given that we have to compete in the commercial marketplace, and I think for advertisers it would be quite a problem if we did not, and as long as we can make money out of it, I think it is a legitimate thing to do.

Q50 Paul Farrelly: I want now to come on to the non-core channels and for clarity, in the notes to the accounts, when you have four channels, that is E4, More4 and Film4, is it not?

Mr Duncan: Yes.

Q51 Paul Farrelly: We are talking the same language. They are phenomenally profitable for you.

Mr Duncan: Yes.

Q52 Paul Farrelly: How do you make them so profitable when stations like Five are struggling so much?

Mr Johnson: To a degree there are things like cross-promotion from Channel 4, which helps drive audiences, and to a degree they benefit from being part of a group, so we will buy and commission shows to be able to use them across the network. There is no doubt that that is a benefit.

Mr Duncan: It is fair to say that in simple quantitative terms they are doing very well. All of our digital channels are effectively out-performing the competition, whether that is BBC or ITV, relatively speaking. We have driven very successful share growth over the last few years on digital channels and that continues again this year. We partly benefit from their being very clearly positioned and targeted. E4 is now by some distance the strongest digital channel affecting younger audiences. It is bigger on most nights of the week than Five, for example, for 16-34 year olds. Because it is so highly targeted, advertisers pay a relative premium compared to some of the other digital channels. Film4 speaks for itself. We have had a glorious 25 or 26 year track record as a quality free-to-air film channel. For a lot of homes, if you are on Freeview, it is the only significant film channel you can get. More4 is very distinctive in terms of factual documentary, true stories, *More4 News* and so on and out-performs both ITV4 and BBC4. These have the advantages that you have mentioned but they have also been very successful. In terms of advertising, our sales team has done very well in terms of monetising that success.

Q53 Paul Farrelly: Just for the record, the channels in the last year more than tripled their operating profits of £41.1 million on revenue of £175 million.

Ms Bulford: Yes, their revenue went up from £148 million to just under £170 million.

Mr Johnson: You have to remember they were only switched free-to-air relatively recently, so their audiences have been going up pretty dramatically under Freeview.

Mr Duncan: It is pretty much in line with what we set out to achieve three years ago, with the strategy of going free-to-air, and in More4's case in particular, it is fair to say that its profit last year was boosted by the fact that we did, reluctantly, cut the programme spend a bit so in the end we did less original programming than we would have liked on More4 and that also boosted profits.

Q54 Paul Farrelly: You do not split the three channels out but are those operating profit margins just below the mid-twenties equivalent across all three?

Ms Bulford: I will be very happy to provide more information on the channels privately if that would be helpful because it is comparatively commercially sensitive at a more detailed level but all of the channels are profitable and their profits are all growing, so it may be best to just give you some more data.

Q55 Paul Farrelly: That would be appreciated, I am sure. In terms of the balance sheets of the three channels, last year the liabilities were £92.2 million. What does that reflect? The assets were just £23 million. What do the liabilities reflect?

Ms Bulford: They are predominantly monies owed back to Channel 4 in relation to their share of principally transmission costs and any other allocated costs out to those channels so they are inter-company transactions effectively.

Q56 Paul Farrelly: Are they reflective of start-up costs as well?

Ms Bulford: To some extent, yes, but in terms of the funding of those channels and their commercial basis, as the Committee will know, we have our Schedule 9 arrangements where we need to ensure that, firstly, the way in which costs are allocated and secondly, the way in which the profitability of commercial ventures grow, meets the criteria set out in the Broadcasting Act and that audit is undertaken each year and Deloitte's is looking to ensure there is no inappropriate cost subsidy through either costing or allocation of capital to support those businesses.

Q57 Paul Farrelly: Given the phenomenal profitability this year, would you say that the three channels have now more than recouped their start-up costs?

Ms Bulford: In terms of their development from when they went free to air, they are on track. They have some way to go in terms of turning the full corner in terms of recouping all the start-up costs. Some are further ahead than others.

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Q58 Paul Farrelly: When would you expect them to fully?

Ms Bulford: It will be about another 18 months before all three come through against the free-to-air plans.¹

Q59 Philip Davies: First of all, can I thank you for removing that meaningless phrase from your report last year, which we had a discussion about, wanting to have a workforce that reflects the country at large. I am very grateful that you have removed that meaningless sentence. My next hope is that you will reduce the number of times you put “diversity” in your report. That is my hope for next year but I suspect I might be struggling on that one. In terms of headcount, you have reduced the number of people from 2007-08 from 965 to 905. You announced in September that you were cutting a further 200 people. Does that show that you were grossly over-staffed beforehand?

Mr Duncan: No, I do not think it does. The figures you refer to were before the full-year impact of the restructuring. We went through a very painful restructuring process last autumn. We did it very quickly, I have to say, but the net result is that we are now down to just over 700 full-time employees at Channel 4. That is nearly a 25% reduction. I think it is fair to say that that has been very tough. In part it reflects reduced activity. In some areas, like new business development, for example, we are simply not doing anything, and in other areas, some of our marketing activity, some of our commissioning activity, we have actually cut back. So part of it is a reflection of a real reduction in activity. In virtually every area I would say that we are now expecting people to do more, and I would say in some areas that is proving very difficult. For an organisation of our size and scale, in terms of what we deliver, to only do that with 700 people is pretty tough. Compared to our key competitors, we have quite limited resources, I would say, in virtually all our key departments. It is early days; we are only a few months into the post-restructuring situation but I would say that the staff are doing a very good job and in some cases are probably too thinly stretched. That is one of the things we need to watch quite carefully, that it does not either drift into affecting commercial performance, so it does not affect, for example, on the advertising sales side, our ability to get enough money back, or our creative performance in terms of commissioning or marketing and so on. I think it has been very tough. I think we were right to get on with it early, and we have gone a lot farther and a lot faster than most other organisations that I can see.

Q60 Philip Davies: Inevitably, the core Channel 4 business takes the brunt of it because that is where the biggest amount of employees are. I understand that you shave off a few here in corporate affairs and human resources and that kind of thing. I

understand how that happens but there has been, it seems to me, as a layman, an astonishing reduction from 87 to 36 in transmission and engineering.

Ms Bulford: There are two things that have happened in transmission and engineering. The first is that we closed a studio in the period, which reduced the number of people, and the second thing is that in August we outsourced transmission and distribution to Red Bee Media, which transferred out over 100 staff, and that flows through to those average numbers in the accounts. One of the reasons that the headcount goes down is the restructuring programme, which resulted in a loss of posts, and the outsource of that major operation from Horseferry Road out to Red Bee at White City, which took out more heads there.

Q61 Philip Davies: So you have not actually lost all these people; in effect, all you have done is you have transferred their employment from Channel 4 to an outside body.

Ms Bulford: In terms of the outsource of transmission, the staff have absolutely been transferred across, and that saved us between 10 and 15% on the cost of that operation through the new contractual arrangement. In terms of the restructuring programme, more than 200 posts were closed.

Q62 Chairman: Can I turn to remuneration? Can you tell me roughly what proportion of your staff are paid over £100,000 a year?

Mr Duncan: Yes. I think this was in the public domain a few months ago following the Freedom of Information request. I think the number is around about 80 staff in total post the restructuring.

Q63 Chairman: So it is about 10%.

Mr Duncan: It would be something like that, yes. We can double-check and give you an exact figure.

Q64 Chairman: Do you think that compares favourably or less favourably with other broadcasters?

Mr Duncan: In terms of absolute numbers, I think it compares favourably, given the fact that we are a lean organisation in terms of absolute number of employees. Clearly, the profile of Channel 4, on the basis that we do not have any production base as such, so we do not have a significant number of relatively low paid production staff but we have a significant number of quite senior people who have to do major things like commissioning decisions and some of the other key functions that we operate in. It reflects the kind of profile of the organisation but in absolute numbers, I think favourably; in terms of percentage, it may be slightly different.

Q65 Chairman: Many people would say that having 80 people all being paid over £100,000 a year is grossly excessive.

Mr Duncan: I think that would be an unfair view. First of all, all of the remuneration issues are obviously looked at very carefully and benchmarked very carefully in terms of other people. We obviously

¹ *Note by witness:* Channel 4’s digital channels fully recouped their costs since moving free to air in 2008; in 2012 the digital channels are expected to fully recoup their start-up costs since inception.

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operate in a commercial marketplace. We are competing, for example, in the advertising sales area with organisations like Sky and ITV. We have a very good team who have managed to grow the share of the ad market every year for the last five years. You need very good people to do that sort of job and compete commercially with some very big, tough competitors, for example. If you look at it area by area, those are the sorts of things we are dealing with and we have had, I think, a very strong creative and commercial period. Having said that, reflecting the difficulties of the economic environment we are in and reflecting the tough impact of the recession on Channel 4 itself, certainly all of our better paid people did not take any sort of bonus for last year, and in fact, on top of the restructuring, we have implemented a pay freeze for the whole of this year. It is fair to say that senior people were not protected in that sense in the restructuring and a very significant number of our more senior people were also affected by the restructuring recently; we had a corresponding reduction at senior levels as well as junior levels. So I think it is fair and proportionate and I think it reflects the tough and, in some cases, significantly bigger nature of most of our competitors, both creatively and commercially.

Q66 Chairman: Both you and Kevin Lygo have volunteered a pay reduction but nevertheless, both of you are left earning rather more than the Director General of the BBC. Yours is an organisation of 800 employees and his is an organisation of 20,000. How do you justify that?

Mr Johnson: We have benchmarked the pay. We are part of the private sector in the sense that we have to generate all our revenues in the marketplace, and we fight to keep the best talent with the likes of Sky, ITV and others, who pay very significantly more than we do. I do not think there are many organisations where the two top people have volunteered big pay cuts like that. It is a well-rewarded industry that has traditionally been a very profitable industry. It is going through a substantial restructuring and no doubt in the years to come, as when talking about talent, average levels of pay will go nowhere or possibly even fall.

Q67 Chairman: You say that in the commercial sector it is comparable but, actually, you are now in a position where you are coming to the Government, asking for finance, financial help, from the public purse. Can you understand why a number of commentators have been very critical of the level of senior management pay of an organisation that is asking for a taxpayer bailout?

Mr Johnson: I can, although I do not think they are necessarily right. I think things are changing and will change in the future probably on that front, yes. It is one of the possible consequences of accepting more direct subsidy.

Mr Duncan: It is worth saying that, after the pay cuts that I and Kevin volunteered, I believe we will be substantially below the Director General of the BBC. I also think it is worth saying that you have to look at the much more generous pension scheme in

place for the BBC, for example. Just to be factually accurate, I think we move to a level substantially below that.

Q68 Chairman: Just on the pension scheme, one narrow question: looking at the figures in the report for the value of pension pots, Andy Barnes comes in at £2.2 million, which is four or five times the size of anybody else. Why is that?

Mr Johnson: Longevity of service. He has been with Channel 4 for 12 years and, to my understanding, he brought with him something of his previous pension. So it was not all accrued while he was at Channel 4.

Q69 Helen Southworth: Can I take you on to the issue of children's programming? We have spoken in previous years about the gap that you had highlighted in teenage programmes, or older children, certainly. You told us last year that you had commissioned the programmes for the pilot children's programming project, that they were in process of being produced but there was a delay on the broadcast. Have they been broadcast yet? If not, what is happening to them? What do you intend to do?

Mr Duncan: Effectively, they are on hold because of the budget situation that we are in, both last and this year. I believe, on the three projects, one of them got through script development stage and was ready to go but was put on hold at that stage. Another one, similarly, the development work had taken place. I think that we went into production in the end on just one. I would have to double-check exactly where that has got to but we are not in a position to play that out at the moment in terms of the transmission costs, because it affects the P&L at the time we transmit it. I have to say, it is one of the areas where—back to the earlier point—alongside some of the new initiatives online, for example, where it is obviously subject to the funding situation in digital and what comes through in the next few weeks. At the moment we are having to cut back anyway on existing activity and it is very hard to justify doing something completely new like that at that time. We remain of the view that Channel 4 will be a very effective organisation at targeting particularly the 10-16 year old group. If anything, our relationship with that audience has strengthened over time and in particular we are seeing some early evidence of a very good online relationship with that age group as well. We remain of the view that we have a very important role to play with that group but clearly the funding will need to be resolved first.

Q70 Helen Southworth: Yet with Channel 4's profile and its wider target audience, the people who find Channel 4 attractive, households with children and younger people in, must be a very large percentage of your audience.

Mr Duncan: Yes, we have a lot of people of that age group watching Channel 4 programmes and E4 programmes generally anyway, but to do very specific targeted activity for that age group is very difficult to justify commercially. One of the reasons ITV have pulled out and the market itself does not

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provide anything for that age group really is that it is very difficult to monetise and, of course, some of the, in my view, valid restrictions around product placement and some of the limits around advertising to children have made it even more difficult commercially to justify. It would very much be something we would like to do but it would fall into the category of loss-making programming and therefore in terms of resolving the funding, it can only be afforded if there is some sort of funding solution.

Q71 Helen Southworth: It is very disappointing though, is it not? When you actually think of the potential there is, the growing audiences around really good quality children's—ask J K Rowling. It is not that this is something which is a niche market for a small number of people. If you do this well, like *Doctor Who*, you make huge profits and you drive the market internationally. As a creative body, is it not something that you really want to look at?

Mr Duncan: As I said, it is something that we are keen to do but we think we would lose money, and in our case bear in mind that, over and above the fact that it is very difficult to monetise in advertising, in our case we keep very little of the proceeds of any international sales, for example. So in terms of the situation there, it would lose us money. It is as simple as that. So we would like to do it but it has to be part of a package where the overall funding issues are resolved. Just at a time where we are cutting deep in every other area, it is very difficult to justify funding something that would actually further increase that funding gap.

Q72 Helen Southworth: Can I explore a bit the education: you have a core public service ethos, yet one of the things that perhaps Channel 4 promotes itself on is the fact that you are good at popularising education. Can you just explore a little your thinking behind that? Some people, for example, have been critical about some of the programmes that you have put out, in that they are really popular programmes rather than education programmes. How do you see the relationship between the two?

Mr Johnson: I think one of the things that Channel 4 does very cleverly is to deliver a whole lot of accessible programmes that are not pitched overtly as education but actually do educate. For example, there was a brilliant series on earlier this year called *The Hospital*, a three-part documentary about the stresses on the NHS to do with younger people. One was about teenage pregnancies, one was about violence and alcohol, and one was about obesity. They were not actually classified as educational but I would argue that they fulfilled both categories: they would have been informative for teenagers to watch and they would have been educational to anyone who was interested in the stresses and strains faced by the NHS. I think Channel 4, in the various ways it delivers communication, is ingenious at reaching and being appealing to groups who, if programmes are packaged as very worthy, will not watch, and it is important to make programmes accessible. This is

one of the successes and the importance of Channel 4, that it delivers these substantial audiences because it is seen as a good place to go to watch interesting programmes. It is partly about making the packages appetising to audiences who would not turn to programmes that they would see as dull.

Mr Duncan: It is worth saying that the way education programmes are categorised is slightly odd. As Luke said, a lot of programmes that you would absolutely see as educational would not necessarily be called education. The same would apply to a lot of arts, science, religion and history output. So David Starkey or the Christianity series or the two-hour documentary on the Qur'an that we ran at peak, are all in my view highly educational but would not be classified as that. It is worth talking also about what we have done in terms of our schools education programming, because we have a particular quota commitment around that, and we continue to play out schools programming in the morning, but we very successfully shifted our originated content spend on line in education, and had some real success. For example, *Battlefront*, which was all about young people campaigning for different ideas and different initiatives, ranging from green issues and better rubbish collection through to anti-street crime. One person had a friend who had been killed and he was now on a mission to teach other young people about not carrying knives and so on. Those sorts of things we continue to be very effective on as well, with relatively modest resources. Back to your earlier point, we have a very good connection with that kind of teenage age group. So I think that the breadth of the different ways Channel 4 tackles education, from the formal schools programming commitments and the on-line activity to the sort of programming that Luke was talking about through to the much more serious specialist factual type programming, it is a very big part of what we do and our factual, documentary and education output, I think, remains very strong indeed.

Q73 Helen Southworth: Can I move on to the nations and regions issues, something that many members of this Committee are extremely concerned about. We have very extensive discussions about this with all broadcasters. We want to see the boat consistently being pushed out to make sure that the nations and regions do get the opportunities for people to develop creativity and also make commercial success. Can you just explore with us a little bit what you think your successes have been over the past 12 months but also what you want to see done better?

Mr Duncan: Certainly. I would say for Channel 4 we have a very strong track record in the English regions. I will come back to the nations in a moment. A substantial amount of our output comes from all around England. In particular, quite a lot of our programming comes from the South-West, from the Midlands, from the North-East. We have had some award-winning programmes, *Embarrassing Bodies*, *Embarrassing Illnesses*, from the Midlands and in the North-West we have had a real run of success in

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terms of drama, things like *Hollyoaks* and *Shameless* but also some of the one-offs. The English regions story I think remains a very good one, although it has actually been affected by the downturn; in the sense that all our programming budgets are coming under pressure, that has been affected. I would say in terms of the nations it is a much bigger challenge for us. We have an aspiration to do substantially more programming sourced from in particular Scotland and Northern Ireland. I will not leave out Wales but there is a slightly different relationship there. I would say the story of the last year is a mixed one actually. In terms of positive developments, we have put in place a nations pilot fund. One of the problems is that we do quite a lot of one-off programmes but we do not have enough returning series coming from some of the nations. The nations pilot fund is in particular designed to try and come up with ideas around drama and comedy that could lead to a returning series. So far most of that money has been committed and we are yet to see what comes through in terms of the ideas but that is encouraging. We have been pleased with 4iP, our digital innovation fund. The first base was in Birmingham. We have others being set up in Yorkshire and the South West and the Midlands, as I have already mentioned. We are in particular hoping to get to the point where one of those bases will be in Scotland, one will be in Northern Ireland and one will be in Wales. I think that digital innovation opportunity in the nations is very exciting. We have also announced a series of measures, including putting some commissioning presence in Scotland for the first time. Kevin Lygo announced in a speech a few months ago that we have an ambition to have more of our output coming through from the nations. The very clear tension against that at the moment is twofold. One is, when you are cutting overall budget levels, it is quite difficult to be putting more money into the nations. It is a bit like the children's issue. Secondly, we are finding a bit of a problem with the independent production sector. To give you an example, we have made a commitment that a certain number of our current affairs programmes, *Dispatches* and so on, would be made outside England, ie in one of the nations. Similarly, a certain amount of our cutting-edge documentary strand will be made. We are struggling to find indies who can cope with that, who can get enough business to then make a profit from it. In isolation, it is difficult for us to change the whole industry. It has to be part of a properly joined up approach where, for example, the BBC are also spending a lot more in the indie sector. At the moment they are spending a lot more in the nations but a lot of it is being spent in-house in the BBC, and the trick might be they and we together spending more outside of the BBC to develop the indie sector. I think it remains a very clear policy objective because the diversity in our supply—I am sorry to mention that word, Philip—is a key strength of Channel 4. We had over 300 producers last year and that is a big part of our output. If we could get more of the output coming from the nations, we would like to see that. I hope over the next two or three

years we can make real progress in that area but there are some problems along the lines that I mentioned.

Q74 Helen Southworth: How important do you see that as being in terms of your public service responsibilities?

Mr Duncan: I think Channel 4 has always been about anyone in Britain coming up with a great idea, and we can take that idea and take it to the British public. Therefore, the greater the range and breadth and diversity of where those ideas are coming from, the better, creatively, I would say. We want to be nurturing new talent, finding new ideas, helping new indies develop and grow, and the more that can happen in the nations as well as in England, the better.

Mr Johnson: I think there is always a risk that any media organisation becomes so London-centric that it overwhelms other output. The idea that creativity and innovation can only come from London is ludicrous. It is about nurturing independent production companies to develop sufficient critical mass outside of London to be viable. It is not easy. Channel 4 has been at it for decades, trying to cultivate these organisations, but it does not happen quickly or easily.

Q75 Helen Southworth: In terms of the skill base, what are you currently doing in terms of relationships with the universities, for example, or in training and development opportunities or in skills sharing and those sorts of things? What do you think should be done across the nation to make it work?

Mr Johnson: A lot of it is, bluntly, about confidence and ambition, because once people reach a certain degree of success, they tend to leave the nations and regions and come to London. This does not just apply across the media industry; it applies across many walks of life. It has an economic impact and it is not all good. One needs to try and develop centres of excellence across many spheres outside of London that encourage people to stay.

Mr Duncan: It is worth saying that we invest a lot of money and talent in training. We obviously support big organisations like Skillset and the National Film School. We also have a whole series of 10 creative cities actually outside of London, where we try and invest in local companies, local schemes, to help nurture new talent. The 4iP digital innovation fund is an important new way of doing that, in some cases in conjunction with the screen agencies. Although we have been under very severe budget pressure, and we have had to cut back that spend, we have only cut it back to the tune of around 20%, so in line with spending cuts we have had to make elsewhere. Many other organisations have cut their spending altogether in those areas. So I think we have tried to retain that investment but it is obviously difficult at a time when budgets are so tight. A lot of it comes down to giving new talent a chance and actually we are disproportionately good at backing new

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companies, giving new people a chance, whether it is actors on the screen or behind the screen, and I think that remains very important but it is a challenge at the moment. There is no doubt about it.

Q76 Paul Farrelly: In terms of taking risk, can I just prod the entrails, for want of a better word, of Kangaroo? You had a third stake in Kangaroo. Was that both the initial equity investment and all three contributed the same amount in terms of revenue funding? Is that correct? Did you all lose the same amount?

Mr Duncan: We were all equal partners in that sense, yes.

Q77 Paul Farrelly: Your write-off was, what, nearly £6.5 million?

Mr Duncan: Yes. In that sense, it is commercially sensitive.

Q78 Paul Farrelly: It is in the back. Yes, it is £6.4 million.

Mr Duncan: It was costly. I think our perspective on it was that it was a very good thing to try and be part of. Bearing in mind that ITV are substantially bigger than us in content production terms and BBC are even bigger again, to be a one-third stakeholder/shareholder in that was a very good deal from our point of view and it partly reflected the fact that we were the first to launch 4 On Demand and get in there early. I think it was a valid investment. It was very disappointing. It was blocked. I think it would have been very strongly in the public interest and we still have strong ambitions in the video on demand area with Channel4.com and various syndication deals and so on that we are looking to do. I think it was disappointing that Kangaroo was not allowed to happen.

Q79 Paul Farrelly: Did the OFT reference come out of the blue? Were you shocked by it?

Mr Duncan: I think it was a surprise to most people, yes. Although one or two competitors had clearly complained, I think the general view within the industry was that it would be a good thing. It was clearly in the public interest. I think the body language until quite late in the day seemed to be that, given some of the remedies that the three parties were prepared to make, we certainly all felt that wholly answered some of the concerns that had been raised by the process, so when the final block came out, that was a surprise—not just to us but to many commentators—and it was a disappointment. There is no doubt about it.

Q80 Paul Farrelly: With the project, you were not just exposed to the risk of the competition authorities pulling the plug but there was also the issue of the BBC Trust not having given its own formal approval. How did you mitigate against that risk?

Mr Johnson: We took assurances, I think, from the BBC Executive that they would succeed in convincing the Trust that it was a good thing to do and I think, as Andy said, in terms of offering

consumers a great place to come for a batch of programming, it did represent a good service, and I believe it is a great shame that it was blocked. I think Channel 4 does compete in the marketplace in an enterprising sense and we are trying to reinvent the organisation in terms of new media. So Kangaroo was a valid attempt. Sometimes these things fail and that is the nature of commerce.

Q81 Paul Farrelly: Given that there was the risk of the BBC Trust not finally approving it because it was a new venture, how did you seek assurances? Did you get written comfort from the BBC Executive?

Mr Duncan: We had very substantial ongoing discussions with the BBC, as did ITV, of course, and it was our very clear expectation that, on the basis it was allowed by the Competition Commission, that the path was also clear for the BBC Trust to agree it. So I think the risk was not a substantial risk around the BBC not blocking it. I think they themselves saw significant public interest, and one of the ironies is that money that would have effectively been retained by the BBC, ITV and Channel 4 and been invested back into British content has now opened up the way for probably foreign-owned platforms to come in and any money that might be made is going to disappear out of Britain. So from a British plc point of view, it was disappointing.

Q82 Paul Farrelly: But in terms of the assurances from the BBC Executive, in what form did they come? Were they written assurances?

Mr Johnson: They did not at any stage say, “It is certain to be approved by the Trust.” There was nothing like that.

Q83 Paul Farrelly: “We will use our best endeavours”?

Mr Johnson: Of that sort of nature, absolutely.

Q84 Paul Farrelly: “We are sure we can convince them”?

Mr Johnson: They were committing time and money to it, so you had to believe that they would not have done so unless they felt highly confident that the Trust would approve it, yes.

Q85 Paul Farrelly: And you have that in writing?

Mr Duncan: You have to bear in mind the deal we did was with BBC Worldwide and it was clearly backed by the BBC Worldwide Board and it was also backed by the BBC Executive Board. So we knew that effectively John Smith in Worldwide and Mark Thompson in the BBC fully supported it and our understanding—I do not know exactly what we had in writing or not but our very clear understanding was they had a series of sessions with the BBC Trust along the way and it was very clearly understood that if the Competition Commission gave it the green light, it was also expected that the BBC Trust would give it the green light.

Q86 Paul Farrelly: Is anything out of your investment in Kangaroo recoverable? Is it all wasted?

12 May 2009 Mr Luke Johnson, Mr Andy Duncan and Ms Anne Bulford

Mr Duncan: No. There are confidential discussions going on at the moment about a possible sale of parts of the investment that we made. It is still possible that we will recoup some money from that. Secondly, clearly, a substantial amount of what we invested and what we learned along the way we are still exploiting successfully in video on demand. So we are having a record year actually so far in video on demand on Channel4.com and we are talking to potential third-party partners that we may also provide programming to, and we still have a very strong position in the video on demand world, and given how quickly that is likely to grow, you would not say it was all wasted. Clearly, some money was lost and that was disappointing.

Q87 Paul Farrelly: So in terms of any transfer of what has already been invested, is that on a tripartite basis?

Mr Duncan: Yes. Any money recouped would be divided equally between the three parties.

Q88 Paul Farrelly: So there is potential for a resurrection of Kangaroo by hiving it out to someone else?

Mr Duncan: No. The original idea of Kangaroo itself is officially dead. That was blocked by the Competition Commission. Some aspects of the technology, for example, might be of value to other parties and that is what we are currently exploring.

Q89 Paul Farrelly: So there is no Kangaroo 2?

Mr Duncan: Not as a consumer proposition as put forward to the Competition Commission.

Q90 Chairman: Luke, your term comes to an end in January next year. Has the process begun? Have you had thought as to your successor?

Mr Johnson: I am not necessarily involved in it. It is for Ofcom to decide. If it happens in the same way as I was appointed, I think it starts cranking into motion in the late summer, and early September, and I think they officially announce it towards the end of the year, as far as I know.

Q91 Chairman: You will also be aware that there have been widespread press reports about tensions within the boardroom, particularly between you, Andy, and Kevin Lygo, and indeed between the two of you. What truth is there in this?

Mr Johnson: Well, I would refute it all. I think there is healthy debate within the Board of Channel 4. I think the non-executives do hold the executive to account. We take our role of stewardship very seriously. We are custodians of taxpayer assets. Speaking for the others, I think we care, as I said before, passionately about the future success of Channel 4 and, as I say, we have robust discussions about decisions, and so we are no pushover. I do not think there is any truth in those rumours. I do not know if you want to comment, Andy?

Mr Duncan: I totally echo what Luke says. It is a load of nonsense. We have had a succession of tittle-tattle, gossip and rumour certainly for the last five years, all the time I have been at Channel 4. I guess it will carry on. Some of it clearly comes from our competitors and is designed to cause mischief, presumably, at a key time for Channel 4's future but it is just not true. It is as simple as that. We have had a very good creative and commercial track record over the last five years and have been very aligned on what we want Channel 4 to continue to be able to do going forward. We are all of the same view, which is that we want as much money as possible to invest in programming to do that job properly. I would say the whole Channel 4 Board is aligned, there is good debate, as Luke said, and certainly the executive team I think get on very well and are very aligned in what we are trying to do and have worked very successfully together for several years now. It is a load of nonsense.

Q92 Chairman: You would hope and intend to be in post this time next year?

Mr Duncan: Absolutely! In my interview with Luke and whoever else interviewed me several years ago, my ambition in coming to Channel 4 was to really help Channel 4 fully transition successfully into the digital world. I think we have made very good progress over the last few years. I think there is still some way to go and I would like to finish off that job. There are some very key issues coming up in the next 12 months that I would like to see through, for sure.

Q93 Chairman: Do you hope that Kevin Lygo will continue as Director of Programmes?

Mr Duncan: I think Kevin Lygo is a first-class director of television content. He has done a fantastic job and I would very much like Kevin to continue in that role for the foreseeable future as well, yes.

Chairman: Thank you. In that case, that is all we have. Thank you.

Written evidence submitted by Channel 4

Channel 4 would like to make a brief written submission addressing two of the issues raised by the Committee in the oral evidence session on 12 May 2009.

DIGITAL CHANNELS

At Qq 50–58 there was discussion of the individual profitability of Channel 4's digital channels E4, More4 and Film4. Anne Bulford indicated that Channel 4 would be happy to provide further information in confidence as these data are commercially sensitive.

Channel 4's digital channels generate substantial profits to be reinvested in public service content, and are a vital part of Channel 4's strategy to address the structural financial pressure caused by digital switchover. In total, Channel 4's digital channels generated profits of £41 million in 2008—more than double the profits of £16 million in 2007.

Table 1
OPERATING SURPLUS OF DIGITAL CHANNELS IN 2008 (£m)*

	<i>Total</i>
Revenues	175
Programme budget	(84)
Operating surplus	41

* Information for individual digital channels has been redacted.

At Q55, in reference to the balance sheets of the digital channels, Paul Farrelly MP quoted liabilities of £92.2 million and assets of £23.0 million in 2007. Anne Bulford indicated that these liabilities reflected monies owed back to Channel 4 in relation to the channels' share of transmission and other costs. Channel 4 would like to note that in 2008, liabilities have reduced to £58.8 million and assets have increased slightly to £23.9 million. This is due to the improved profitability of the channels as digital switchover progresses—Channel 4 expects the liabilities of the digital channels to continue to fall in 2009.

REMUNERATION

At Qq 62–63, John Whittingdale MP asked about the proportion of Channel 4 staff earning over £100,000 a year.

In response, Andy Duncan highlighted that Channel 4 operates in a commercial marketplace and carefully benchmarks its staff remuneration against its commercial competitors, such as Sky and ITV. In addition, he noted that Channel 4 had implemented a pay freeze for the whole of this year and added that senior staff did not take any sort of bonus for 2008. Andy Duncan estimated that the proportion was around 10%, and indicated that Channel 4 would be able to provide the exact figures later in writing.

Channel 4 can confirm that 78 employees are paid over £100,000 per year. This equates to just under 10% of a total 785 actual employees, including the 55 Channel 4 employees that are part of the Box Television joint venture with the Bauer Group.

Channel 4 hopes this information will be of assistance to the Committee.

June 2009

Supplementary written evidence from Channel 4

On 8 July 2009, the CMS Committee wrote to Channel 4 with some follow-up questions on Channel 4's Annual Report 2008.

This submission sets out Channel 4's responses to the Committee's questions. Channel 4 is happy for the majority of these answers to be published. However, for the reasons set out in response to question 4, Channel 4 has redacted some of the information in the answers to questions 1–3.

DIGITAL CHANNELS

1. *What has been Channel 4's total investment on each of the non-core channels since their inception?*
2. *When does Channel 4 expect the start-up costs and total operating losses on each of the non-core channels to have been fully recouped?*

Expenditure on Channel 4's digital channels is an essential strategic investment designed to generate profits and diversify Channel 4's revenue base. The portfolio of digital channels currently makes substantial profits to be reinvested in public service content on the core channel. In 2007, Channel 4's digital channels generated profits of £16 million, which in 2008 more than doubled to £41 million. In future, as the core channel faces greater financial pressure due to the structural changes in the market caused by digital switchover, the digital channels will become even more important in helping to sustain public service content on Channel 4.

In addition, the digital channels are making an increasing contribution in creative and public service terms, providing valuable opportunities to innovate and experiment and reach diverse audiences, such as younger viewers. E4, for example, has invested in a range of UK-originated programming, including the award-winning E4 commissions *Skins* and *The Inbetweeners*. More4 continues to provide high-quality UK

and international factual programming, and allows viewers to catch-up with Channel 4's unique inventory of quality programmes. The appeal of Channel 4's digital channels has been a key driver for viewers to take up digital television, aiding progress towards digital switchover.

The financial performance of Channel 4's digital channels is best considered in two phases. First, the years in which the digital channels were available only on pay TV ("the pay TV years"); and second, the years after Channel 4 took the strategic decision to shift the digital channels to free-to-air TV ("the free-to-air years"). Film4 was launched on pay TV in November 1998 and was moved free-to-air in July 2006; E4 was launched on pay TV in January 2001 and was moved free-to-air in May 2005. More4 has been available free-to-air since its launch in October 2005.

During the pay TV years, Channel 4's digital channels received insufficient revenue from satellite and cable platform operators to generate profits. As a result, Film4 and E4 incurred losses in the years prior to the channels moving free-to-air. Since Channel 4 took the strategic decision to move these channels free-to-air, Film4 and E4 have been more successful than they ever were as pay TV channels and have both generated net profits.

[Financial information on digital channels has been redacted.]

At Q58 of the evidence session, there was a discussion of when the profits from Channel 4's digital channels will fully recoup the channels' costs. On 4 June 2009, Channel 4 submitted a correction to the transcript stating that: in 2008, the portfolio of digital channels fully recouped their costs since moving free-to-air; and in 2012, the portfolio of digital channels were expected to fully recoup their costs since inception.

Individually, More4 has outperformed its launch plans and is expected to fully recoup its start-up costs in 2009. Both Film4 and E4 have already fully recouped all start-up costs since moving to free-to-air.

[Forecasts of financial performance of digital channels have been redacted.]

Channel 4 operates all of its commercial activities, including its digital channels, subject to strict arrangements which ensure that public funds are not used to subsidise commercial activities. These arrangements are set out in Channel 4's oversight framework for commercial accountability, outlined in Schedule 9 of the *Communications Act*. Schedule 9 requires Channel 4 to:

- identify, evaluate and properly manage any commercial activities, so as to protect the primary functions of the channel (ie. the core Channel 4 service);
- financially and organisationally separate commercial and primary activities; and
- ensure transparent reporting where there is a connection between commercial and primary activities (for example, shared resources).

The Schedule 9 arrangements are approved by Ofcom, and are published on the Channel 4 website.¹ Channel 4 has put in place regular checks to confirm that it is complying with these arrangements, and Deloitte has been appointed to review compliance on an ongoing basis.

3. *Question on non-programme expenses for individual digital channels*

[Financial information on digital channels has been redacted.]

4. *Can Channel 4 justify further the reasons for providing the requested information on individual non-core channels only on a confidential basis?*

In its Annual Report and Financial Statements, Channel 4 publishes financial information relating to the digital channels E4, More4 and Film4, aggregated as "4 Channels". On 4 June 2009, Channel 4 provided the Committee—in confidence—with financial information for each individual digital channel in 2008. Channel 4 has now provided further information on each individual digital channel in response to questions 1–3 above, again in confidence.

Financial information on a channel-by-channel basis is commercially sensitive as disclosure of this information would put these channels at a competitive disadvantage. It is common practice to aggregate this type of information: neither of Channel 4's commercially-funded public service competitors—ITV and Five—disclose financial information on individual digital channels. Channel 4 already discloses a greater level of segmental information and financial detail than its competitors.

¹ http://www.channel4.com/about4/pdf/C4_arrangements.pdf

CHILDREN'S PROGRAMMING

5. *Can Channel 4 clarify the expenditure and outputs of its children's project to date?*

6. *What is the estimated cost to Channel 4 to play-out the children's programmes that are made and "in the stocks"?*

Channel 4 sees programming for younger audiences as a core part of its current and future public service role. Among the existing public service broadcasters, Channel 4's brand resonates particularly strongly with younger audiences and the organisation speaks with an authenticity of voice which is not easily replicated by other public institutions. As a result, Channel 4 already appeals strongly to older children: its portfolio share of viewing by 10–15 year olds has grown substantially over the last five years.

To build on these strengths, Channel 4 announced a £10 million pilot fund for projects for 10–15 year olds as part of its Next on 4 strategic vision. Under this initiative, one project—*My First Year*, a series of 12 30 minute episodes—was commissioned and is planned for transmission in 2009 at a cost of [redacted].

In addition, Channel 4 has invested around £200,000 in script and storyline development for half a dozen other children's projects. All of these projects are on hold, given the financial challenges facing commercially-funded public service broadcasters.

EUROPEAN AFFAIRS

7. *Has Channel 4 had any contact with policymakers in Brussels in which it has raised issues relating to state aid? If so, how many such meetings has Channel 4 had, and have Channel 4 board members participated in these meetings?*

A wide range of European policy and regulatory issues have an impact on Channel 4's business. In recent years, Channel 4 has engaged with European issues in a number of areas, such as audiovisual content regulation, advertising regulation, electronic communication regulation, intellectual property policy, media literacy, and public service broadcasting issues including the application of the state aid framework. To help address these issues, Channel 4 is a long-standing member of the European Broadcasting Union, which brings together Europe's public service broadcasters to make representations to European institutions on audiovisual policy matters.

During 2008 and the first five months of 2009, Channel 4 staff visited Brussels on three occasions for routine relationship building meetings with MEPs and European officials. At these meetings a range of European regulatory issues were discussed, including state aid. The only visit to Brussels by a Channel 4 Board member during this period was by Andy Duncan, who attended a Channel 4 screening of the film *Happy-Go-Lucky* and met with a European Commission official responsible for Education and Culture. In addition, Channel 4 staff visited Paris and Strasbourg on one further occasion each to observe or participate in European Parliamentary business. On one of these occasions, Channel 4 staff observed a European Parliament hearing on the "Communication from the Commission on the application of state aid rules to public service broadcasting".

In the light of the increasing weight of European regulatory issues affecting Channel 4 and broadcasters in general, on 1 June 2009 Channel 4 appointed a Brussels-based European Affairs Manager. Since this appointment, the European Affairs Manager has attended routine introductory meetings with a number of European officials. In relation to state aid, the European Affairs Manager has attended an academic workshop on "European State aid policy and its impact on Member States' regulation of public service broadcasting".

CHANNEL 4 PROGRAMME COSTS

8. *Can Channel 4 explain the discrepancy between the figures quoted for "programme and other content" in the operating expenditure table, and programme costs in the programme transmissions table?*

Programme figures are reconciled in the "Sources of Programmes" table at the top of page 132 of the Annual Report. The relevant extract from the table is reproduced below.

Table 2
CHANNEL 4 PROGRAMME COSTS FOR
CORE CHANNEL

	<i>£m</i>
Programme transmission costs	508.9
Other direct programme costs	7.4
Total programme and other content	516.3

"Other direct programme costs" include payments to collecting societies, payments for access services (eg signing, subtitling and audio description) and educational programme support.

DIGITAL RADIO

9. *What was the total cost to Channel 4 of its 4Radio venture, from inception through to any final write-offs?*

Channel 4's total investment in Channel 4 Radio amounted to less than £10 million over three years, all of which was written off by the end of 2008.

3 September 2009

Further written evidence submitted by Channel 4

In response to a request to clarify our answer to Questions 38–39, Channel 4 would like to submit the following information:

Channel 4 stands by its statement that E4 was out-bid by BBC3 for the acquisition of Harper's Island. Channel 4 would not have bid for Harper's Island if it did not believe the programme was likely to be a good editorial fit, and Channel 4 withdrew from the bidding process for economic reasons. As the final price that BBC3 paid for Harper's Island is not in the public domain, Channel 4 is unable to reliably estimate the amount by which BBC3's bid exceeded E4's.

25 November 2009
