



HOUSE OF LORDS

Select Committee on Communications

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2nd Report of Session 2008–09

**Public service  
broadcasting:  
short-term crisis,  
long-term future?**

Report with Evidence

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(p) refers to a page of written evidence

# Public Service Broadcasting: short-term crisis, long-term future?

## CHAPTER 1: WHAT IS PUBLIC SERVICE BROADCASTING?

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### Introduction

1. This report responds to the current crisis in public service broadcasting, particularly in the advertiser-funded television sector.<sup>1</sup> It is the product of a short inquiry consisting of five sessions in which evidence was taken from ITV, Channel Four, Five and BSkyB as well as from the BBC and Ofcom. Evidence was also taken from the Minister for Communications, Technology and Broadcasting, Lord Carter of Barnes; Lord Birt; and Lord Burns.<sup>2</sup>

### Definitions

2. There is a plethora of definitions and descriptions of public service broadcasting. Lord Reith, the BBC's first Director General, said that the responsibility of public service broadcasting was to "carry into the greatest number of homes everything that was best in every department of human knowledge, endeavour and achievement; and to avoid whatever was or might be hurtful".<sup>3</sup> In 2000, the Independent Television Commission<sup>4</sup> defined it as "all things to all people at least some of the time ... with a strong emphasis on extending public knowledge, tastes and interests".
3. In 2003, the concept of public service broadcasting was enshrined in the Communications Act<sup>5</sup>, which defined the public service remit for Channels 3 and 5<sup>6</sup> as "the provision of a range of high quality and diverse programming". This remains its only appearance in legislation.
4. Ofcom, which oversees public service broadcasting, measures delivery of programming by the broadcasters<sup>7</sup> against four objectives, or "public service purposes": (i) informing our understanding of the world; (ii) stimulating knowledge and learning; (iii) reflecting UK cultural identity; and (iv) representing diversity and alternative viewpoints.<sup>8</sup>

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<sup>1</sup> Some of the issues involved have also been covered as part of previous inquiries by this Committee (Communications Committee, First Report (2007–08): *The Ownership of the News* (HL 122)), and its predecessor (BBC Charter Review Committee, First Report (2005–06): *The Review of the BBC's Royal Charter* (HL 50)). Our specialist adviser for this inquiry was Professor Richard Collins, Professor of Media Studies at the Open University. Although this was a short inquiry, Professor Collins devoted much time to it and we benefited greatly from his expertise.

<sup>2</sup> Lord Birt was BBC Director General from 1992 to 2000. Lord Burns advised the Government in 2005 on renewal of the BBC's Royal Charter.

<sup>3</sup> Reith, J., *Into the Wind*, 1949.

<sup>4</sup> The Independent Television Commission was one of Ofcom's predecessors.

<sup>5</sup> An extract from the Communications Act, covering the public service remit for television, is at Appendix 3.

<sup>6</sup> Channel 4's mandate is both broader and more specific but still allows much latitude; see Appendix 3.

<sup>7</sup> BBC, ITV, Channel 4, Five, S4C, Teletext.

<sup>8</sup> For a fuller description of Ofcom's public service purposes, see Appendix 4.

5. Significantly, according to Ed Richards, Ofcom's Chief Executive, the setting out of these objectives, which was intended not to be unduly restrictive, resulted in his being "personally taken to task by the director of programmes at ITV ... because we were too precise, this was too much detail and we were trying to tell people what public service broadcasting was" (Q 345).
6. Ofcom's public service purposes are similar to those defined in the BBC's Royal Charter, which came into effect in 2007. But neither Ofcom's nor the BBC's set of objectives is sufficiently discriminating to distinguish between those programmes and services that merit public finance and special regulatory treatment and those that do not. Few programmes screened by any UK broadcaster would not satisfy at least one of the objectives.
7. The claimed advantage of this lack of precision is that it provides flexibility, which encourages innovation and the production of popular programmes. According to Andy Duncan, Chief Executive of Channel 4, *Big Brother* was, at its inception, an example of Channel 4's distinctive "innovative" public service programming (Q 83).
8. Lord Birt, Director General of the BBC from 1992 to 2000, said that public service broadcasting "is a programme tradition [with] the citizen rather than the consumer in mind". He did not attempt a new definition but added: "If you are in the system, you truly know the difference" (Q 391). In other words, it is about how something is done as well as what is done.
9. An alternative approach has been put by Lord Burns (amongst others<sup>9</sup>), who said that the "critical" issue is the "provision of certain types of content ... that the marketplace will not provide" (Q 389). Ed Richards argued that the concept of public service broadcasting is increasingly becoming an "anachronism", and should properly be replaced by the concept of public service content.<sup>10</sup>
10. Such an alternative approach is not problem free. The market has changed fundamentally. With the increase in the number of television channels and the growth of the internet, specialist channels have developed. Such channels do not have the big audiences of the traditional public service broadcasters and are not always universally available and free.<sup>11</sup> A move to public service content would not do away with the need to establish how much content is sufficient and to review regularly<sup>12</sup> whether this was being provided by the market.
11. Nevertheless the interpretation of public service broadcasting as content that the market does not sufficiently provide is gaining increasing support. It implies a focus on defining the core elements of public service provision that should, as a matter of public policy, continue to be supported. Such elements might include, for example, national and regional news, current affairs programmes, the arts, children's programming, programmes dealing with religion and other beliefs and UK content.<sup>13</sup>

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<sup>9</sup> See Culture, Media and Sport Committee, First Report (2007–08): *Public service content* (HC 36)

<sup>10</sup> Speech to the Oxford Media Convention, January 2009. According to Lord Birt, "the old concept of broadcasting will increasingly cease to apply" (Q 388).

<sup>11</sup> "Free" is understood to mean funded either by the licence fee or advertising.

<sup>12</sup> As Graham McWilliam, BSkyB's Group Director of Corporate Affairs, pointed out, this market is "very dynamic" (Q 279). Under the Communications Act 2003, Ofcom is required, at least once every five years, to review PSB.

<sup>13</sup> Our next inquiry will explore the production of UK content in film and television.

12. A number of witnesses added that a further distinguishing characteristic of public service broadcasting is universality of access. According to Mark Thompson, BBC Director General, “one of the ... founding elements of public service broadcasting is an idea of a universal service” (Q 42). We agree with this statement.
13. We do not attempt a new definition of public service broadcasting. We recognise the useful contribution Ofcom has made in specifying its purposes and characteristics and we recognise, as a defining characteristic, universality, by which we mean content accessible to everyone. **For practical purposes, we recommend an approach that focuses on the provision of core elements including national and regional news, current affairs programmes, the arts, children’s programming, programmes dealing with religion and other beliefs and UK content.**

## CHAPTER 2: WHAT IS THE CRISIS IN COMMERCIAL SECTOR PUBLIC SERVICE BROADCASTING?

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14. The commercially funded public service broadcasters all claim that financial pressures are putting at risk their ability to deliver public service content. There are three reasons for this, two of which we drew attention to in our report on *The Ownership of the News* of June 2008. First, the move from analogue to digital broadcasting means that established forms of public support—in particular free or below-cost access to spectrum—are losing value. Second, viewers are increasingly taking advantage of technological developments that provide alternatives to conventional broadcasting. As well as the internet, there are now hundreds of commercial channels competing for viewers' attention. Advertisers are moving away from conventional broadcasting to the internet, which means that public service broadcasters are losing advertising revenues.
15. The effect of these two factors has been to call into question the viability of the advertising funded public service broadcasters. Anne Bulford, Group Finance Director of Channel 4, claimed that the public service broadcasters face a “structural decline ... as a result of increased competition for advertising on channels, the increasing emergence of on-demand services and development of the internet” (Q 85).
16. The third reason, which was not fully apparent even at the time of our earlier report, has been the speed and severity of the current economic recession. This has intensified the fall in advertising revenues, both in line with the general fall in economic activity and by speeding up the effects of the structural changes in the industry.
17. According to Ofcom, in 2007 total television advertising revenue was “relatively steady” in nominal terms at £3.5bn. The share of advertising revenue of the public service channels continued its gradual decline—a 16 per cent fall since 2002.<sup>14</sup> Television advertising expenditure is expected to be at least 17 per cent lower (year on year) in the first quarter of 2009, with no upturn in view.<sup>15</sup> Anne Bulford said: “What we have seen happen as a result of the recession is that structural trend has deepened and consequently we are facing some of the issues that we have been thinking about and trying to plan for in forecasting sooner and deeper than we were anticipating” (Q 85).
18. There is no doubt as to the seriousness of the current situation. Michael Grade, Executive Chairman of ITV plc, told us that he had “never seen anything quite as dramatic or quite as profound as this in terms of the effect on advertising revenues” (Q 132). All commercially funded public service broadcasters are affected, but the impact, and thus ability to withstand the current conditions, vary. As we shall see in paragraphs 33 to 37, there are also important conflicts of evidence. Estimates in the public domain can be partial and based on assumptions that are not always clear. **For policy decisions to be taken there is a need for as much clarity as possible on the financial position of all the public service broadcasters.**

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<sup>14</sup> *The UK Communications Market 2008*, Office of Communications, August 2008, pp 54–55.

<sup>15</sup> *The Guardian*, 12 February 2009, “Ad slump set to continue for ITV and commercial broadcasters”.

### Does it matter?

19. It might be argued that the problems of the commercially funded public broadcasters should be left to the market to resolve. BSkyB told us: “We do not agree the advertising model is fundamentally broken” (Q 295). They further argued that other commercial broadcasters are increasingly providing public service-type content on channels such as Sky News, Sky Arts and Discovery, and hence the alternatives to the BBC’s public service content are increasing and the contribution of the commercially funded public service broadcasters is not as critical as it used to be. In effect, BSkyB and others argue that the market can be relied upon to provide public service content of sufficient quantity and quality.
20. This argument has its attractions, since it appears to minimise the need for public intervention. However, the majority of the evidence we received supported the view that there was a case for what Lord Carter of Barnes called “considered and defined public intervention” (Q 428). The “leave it to the market” approach does not address the fact that such content is not, at present, universally available or free, and thus does not, in our view, meet key requirements of public service broadcasting. Moreover, the volume of public service-type content produced by other commercial broadcasters would not come close to filling the gap that would be left if ITV, Channel 4 or Five ceased to deliver such content. In particular, news and current affairs would be dominated by the BBC. Most people still get their news from television or radio. Leaving it entirely to the market risks unacceptably increasing the BBC’s dominance.
21. The possibility that the BBC, by default, could become an increasingly dominant provider of public service content has focused attention on how media pluralism and other public policy goals can be achieved in changed circumstances. As Lord Birt said, “we should not want to see a return to the pre-1960s world of a BBC” that is “again a monopoly provider. Monopolies are dangerous things” (Q 387). Ed Richards, Chief Executive of Ofcom, made a similar point when he said that “the core question is having a strong alternative public service voice to the BBC” (Q 333).
22. A situation in which the BBC was an overly dominant public service provider would also be bad for independent producers, actors and other suppliers, who would suffer all the disadvantages of dealing with a monopoly commissioner. It would also be bad for the BBC. As Director General Mark Thompson told us, the BBC benefits from competition (Q 47).
23. Most importantly, viewers have said they would not want a BBC public service monopoly. Andy Duncan, Chief Executive of Channel 4, said “the public could not have been clearer. They do not want only the BBC ... They really want a second strong source” (Q 77).
24. Research carried out by Ofcom on what people think about public service content shows that the television audience values each of the public service channels for particular types of content and strongly values the presence of more than one provider. For example, 86 per cent of respondents thought it important that UK-wide news should be available on more than one public service channel. For nations and regions<sup>16</sup> news, the figure was 72 per cent or

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<sup>16</sup> That is, Scotland, Northern Ireland, Wales and the English regions.

more, for UK drama 68 per cent, for UK comedy 64 per cent and for UK children's programmes (parents' views) 76 per cent.<sup>17</sup>

25. **The Committee believes that there is a continuing need for public service alternatives to the BBC. We believe there would be dangers if the BBC were to become an even more dominant provider of public service programming. We believe that intervention is justified to ensure sufficient public service provision that the market will not provide free for the public.**
26. The devolved nations, with their distinctive political and cultural needs, should maintain on Channel 3 a robust alternative to the BBC in news and current affairs. Meanwhile the affordability and practicability of a new Scottish network and digital platform deserve further exploration. **While welcoming the BBC's commitment to commissioning more network programming from the three smaller nations, we feel that a due proportion could be achieved before the target date of 2016. Ofcom should consider whether Channel 4 and ITV plc might also do more in this regard.**

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<sup>17</sup> *Ofcom's Second Public Service Broadcasting Review—Putting Viewers First: Final Statement and Recommendations*, Office of Communications, January 2009, p 25.

## CHAPTER 3: CURRENT POSITION OF THE COMMERCIAL PUBLIC SERVICE BROADCASTERS

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### Five

27. Five is the current holder of the Channel 5 television licence. It is wholly owned by RTL Group, a company headquartered in Luxembourg, which in turn is owned by Bertelsmann, a German private company. Its public service remit, under the Communications Act of 2003, is the “provision of a range of high quality and diverse programming”. No accounts are posted on Five’s website, but RTL’s annual report states that Five’s revenue in 2006/07 rose by 7 per cent to 499m euros, with earnings of 10m euros. In evidence to us, Five said: “we are pretty self-sufficient” and would weather the changes in the industry and the difficult economic conditions, but would like to be bigger, and that a merger with Channel 4 would benefit both organisations (Q 225).

### ITV

28. ITV plc holds the 11 Channel 3 licences for England, Wales and the Borders (the other four UK licences are held by stv, UTV and Channel Television) and holds the majority of shares in GMTV. It also has the largest single shareholding (40 per cent) in ITN. All Channel 3 licencees have the same mandate under the Communications Act 2003 as Channel 5: “provision of a range of high quality and diverse programming”. ITV plc’s 2008 results show that its revenue fell by 3 per cent to £2bn and its pre-tax profit fell from £188m in 2007 to a pre-tax loss of £2.7bn. ITV plc’s net advertising revenue fell by 4 per cent. In March, ITV plc announced cost cutting measures worth £245m by 2011, which will result in 600 job losses within ITV plc.
29. Michael Grade emphasised ITV plc’s difficulties operating in the current recession, particularly the fall in advertising revenue, but said: “We will survive, and will be in a fitter state when the economy eventually turns” (Q 133). He said that ITV plc would like to remain a public service broadcaster but that this was conditional on two things. First, he wanted regulatory constraints, including on ITV plc’s original content obligations and sale of television advertising, to be relaxed (Q 134). Second, he placed a value of £35m on the spectrum that ITV plc received as a public service broadcaster. He said “we will deliver £35 million of PSB value ... either in cash or in kind, whatever the policy makers decide they would like” (Q 135).
30. ITV has played a critical role as the principal commercially funded alternative public service broadcaster to the BBC. It continues to make a major contribution to UK television, providing national and regional news, and entertainment, including drama and sport, and it remains a significant investor in UK content. Michael Grade told us that ITV plc spent £1 billion a year on UK content (Q 158). John Cresswell, Chief Operating Officer of ITV plc, added: “ITV spends two-thirds of the amount of money invested by the commercial sector in UK-originated content” (Q 167). **Although the public policy debate has concentrated on the future of Channel 4 as a public service broadcaster, in terms of quantity of public service output, employment and investment, ITV plc is the more important player. It will be important that ITV plc’s request for relaxation of regulatory constraints is considered in a way which encourages ITV**

**plc to continue its public service broadcasting role without creating further problems in the commercial television sector.**

**Channel 4**

31. Although Channel 4 is publicly owned, it derives its revenue from advertising. It also receives free spectrum and, like other advertising-financed public service broadcasters, it benefits from other regulatory assets, such as a priority position for its flagship service on electronic programme guides. Channel 4 has the same general mandate as Channels 3 and 5 under the Communications Act 2003, but with the additional requirement that its programming should “demonstrate innovation, experiment and creativity”; appeal to a culturally diverse society; make a significant contribution to educational programming; and exhibit a distinctive character.<sup>18</sup>
32. The Channel Four Television Corporation, which includes businesses other than the public service channel,<sup>19</sup> has significant assets of £452m, including a headquarters building valued at £58m and financial assets of £195m. In 2007, on a turnover of £945m, it made a profit of £500,000, which included a loss of £8m on the public service channel. Most of the Corporation’s revenues accrued from the sale of advertising.
33. Whether Channel 4 will remain sustainable without additional public support is a key question. Ofcom’s analysis suggested that Channel 4 would not be able to sustain its public service broadcasting commitments in the long term. Ofcom predicted a shortfall of between £60m and £100m annually for Channel 4 by the time digital switchover is complete in 2012. Beyond that, Ofcom estimated that the additional initiatives in Channel 4’s 2008 *Next on 4* policy would increase Channel 4’s annual funding requirement to up to £150m by 2012.<sup>20</sup> In evidence to us in January, Anne Bulford said that, according to Channel 4’s current estimates, the funding shortfall would be “the wrong side of £150 million” by 2012 (Q 93).
34. Some others dispute these figures and the seriousness of Channel 4’s position. Mark Thompson, Director General of the BBC, drew our attention to the conclusion of an Enders Analysis<sup>21</sup> report of December 2008 that Channel 4 was in many ways in the financially strongest position of the advertising-funded public service broadcasters (Q 49).
35. Enders Analysis noted that Channel 4 had substantial reserves and no pension deficit or indebtedness. Its report concluded: “As far as we can tell, Channel 4’s supposed funding gap has more to do with the company’s laudable aspirations to extend its business into many new areas ... than any real dangers to its core business during the recession.”<sup>22</sup>
36. Similar arguments have been put by BSkyB, which maintains that Channel 4 has a strong balance sheet and has accumulated sufficient financial reserves to see it through the current recession. BSkyB points to various measures

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<sup>18</sup> See Appendix 3.

<sup>19</sup> Channel 4’s public service obligations apply only to its flagship channel.

<sup>20</sup> *Ofcom’s Second Public Service Broadcasting Review—Phase Two: Preparing for the digital future*, Office of Communications, September 2008, p 31.

<sup>21</sup> Enders Analysis is a commercial research service on the media, entertainment, mobile and fixed communications industries in Europe.

<sup>22</sup> *From Kangaroo to Marquis in a hop?*, Enders Analysis, December 2008, p 5.

that Channel 4 could take to strengthen its short-term position, such as eliminating unprofitable non-core activities, developing new revenue streams and reducing reliance on expensive US imports. BSkyB concludes that, rather than focusing on the claimed funding gap, the Government's first priority should be to ask Channel 4 to produce a plan setting out what it could deliver: "Without this baseline it is impossible to have an informed debate about Channel 4's future."<sup>23</sup>

37. **Channel 4 does not accept that analysis, which underlines the need for an independent review of Channel 4's financial position. This should include potential efficiency savings and the financial implications of its programming initiatives, and should be completed before any decisions are made on its future. Such a financial review should be as open as possible to public scrutiny.**

### **The Position of the BBC**

38. In contrast to the position of advertising-funded television, the BBC is in a uniquely favoured position. The corporation's total income in 2008 was £4.4bn, of which £3.4bn came from the licence fee and a further £284m from Government grants. Under the 2007 licence fee settlement agreed following Charter Review, the BBC has secure funding, which will rise significantly over the period of the settlement, due to the agreed annual cash increases in the licence fee of 3 per cent in the first two years and 2 per cent in the following three years, and the expected increase in the number of households. Ofcom estimates that the increase in cash terms will be of the order of 14 per cent by 2012. In a period of low inflation, or possibly deflation, the BBC is in a financially stronger and more secure position than virtually any other business in the country.
39. **This strength however brings responsibilities. The national economic position has changed radically since the licence fee was agreed by the Government and the BBC. Public service broadcasting outside the BBC is in self-evident crisis. We think that it is impractical to ask the taxpayer for further support. It therefore needs to be recognised—not least by the BBC itself—that the BBC is indispensable to the resolution of the general problems besetting public service broadcasting. This is a time when the BBC must look outwards and think about public service broadcasting as a whole.**
40. In this context, we welcome the announcement in March 2009 that the BBC will provide ITV plc with access to its regional news infrastructure and resources. ITV plc estimates that this will yield a potential annual saving of £1.5m in 2011, rising incrementally to around £7m by 2016.<sup>24</sup> Since the current cost of ITV plc's regional news services for England, the Borders and Wales is around £55m, this measure, while welcome, will have only limited impact on the economics of regional news provision.

<sup>23</sup> *Response by British Sky Broadcasting to PSB2—Letter to all parties*, March 2009, p 2.

<sup>24</sup> "ITV and the BBC work together on the future of news in the English regions and Wales", joint press release from BBC and ITV, 12 March 2009.

## CHAPTER 4: WHAT ARE THE OPTIONS?

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41. A number of ways have been suggested of achieving the public policy objective of securing sufficient public service content (should it prove necessary). These include institutional reorganisation, partnership and competitive funding. They are not mutually exclusive.

### Institutional reorganisation

42. The future of Channel 4 and its possible merger with other institutions has been at the centre of the public service broadcasting policy debate. BBC Worldwide has been identified by both Ofcom, in its second public service broadcasting review, and the Government, in its interim report on its plan for digital transition, *Digital Britain*, as a possible partner for Channel 4.
43. BBC Worldwide incorporates a number of separate businesses, including magazine and book publishing, DVD sales, licensing of BBC (and UK independent producers') programmes, formats and television channels (such as BBC America). It also jointly owns, with Virgin Media, several television channels on various platforms, called UKTV.
44. According to its Chief Executive, John Smith, in 2007–08, BBC Worldwide achieved a turnover approaching £1 billion and realised profits of £118m. Without this contribution the BBC estimates that it would have had to bid for an additional £9 on the licence fee (Q 11).
45. In its second public service broadcasting review, published in January 2009, Ofcom recommended ensuring that “there is a financially robust alternative provider of public service content alongside the BBC”.<sup>25</sup> Ed Richards, Ofcom’s Chief Executive, argued “if you want that strong second public service force it would seem very bizarre not to begin with the established force, capability and potential that Channel 4 represents” (Q 333).
46. The Government is sympathetic to the idea of such a merger. Lord Carter of Barnes told us that there “may be merit—we are still at the point of validating it—in looking at some combination between a revised Channel 4 remit and BBC Worldwide in some structural organisation to be determined” (Q 417). He referred to this as “PSB2” inside the public sector. He envisaged “an entity with a very clear public service remit and set of obligations that would be a multi-platform entity” with “impartial news” as a “substantial part” of its remit (QQ 426, 450).
47. Channel 4 also favours a merger with BBC Worldwide. Although he referred only to “partnership with BBC Worldwide”, Andy Duncan, Chief Executive of Channel 4, suggested that a “proper structural solution” resulting in a “bigger organisation that has the scale to compete” was Channel 4’s “very specific preference” (Q 55). He argued that a “structural partnership” of Channel 4 and BBC Worldwide was required to derive greater economic and public benefit (Q 56).
48. In contrast, Lord Burns argued against “corporate engineering” (Q 389). He told us that if Channel 4 needed public support it was “better just to face up to that straight on and make a decision rather than trying to play around with

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<sup>25</sup> Ofcom’s *Second Public Service Broadcasting Review—Putting Viewers First: Final Statement and Recommendations*, Office of Communications, January 2009, p 113.

the institution and doing rather artificial mergers between different organisations”. He added: “I am not sure that I would be setting about this by trying to create a second institution. My preference is to provide the means by which some public money would be tagged on to content and that would be contestable and it might involve a variety of channels” (Q 393).

49. Three other important questions were raised concerning a merger. First, while there would be some cost savings, the nature of the wider benefits, and particularly those involving exploitation of programme rights, is unclear. For example, Andy Duncan told us that “the majority of synergy that might be there is within the UK” and that “most of Worldwide’s ... profits today come from the UK”, whereas Lord Carter of Barnes said that “BBC Worldwide is essentially a business that exploits rights internationally” (QQ 95 and 448).
50. Second, the position of other companies associated with BBC Worldwide is also unclear. Virgin Media, for example, owns 50 per cent of UKTV. Full realisation of potential benefits, including joint advertising sales, would require acquisition of Virgin Media’s share of UKTV (currently, UKTV advertising is sold through Virgin Media’s IDS sales house). It is not known whether Virgin Media would be willing to sell its stake to the new company; if so, at what price; and how such a purchase might be financed. One estimate puts the value of the Virgin Media stake at £350m.<sup>26</sup>
51. Third, there is also the question of control of the new company. If a merger between Channel 4 and BBC Worldwide were seen as a means of ensuring the survival of a robust public service alternative to the BBC, control of the merged organisation could not rest with the BBC. However, since the benefits of merger appear greater for Channel 4 than for the BBC, it is not immediately clear why the BBC should be willing to cede control.
52. The position of the BBC is obviously crucial. Mark Thompson, Director General of the BBC, said: “I have been given very, very clear direction on this by the BBC Trust ... we should be absolutely in the world of what adds value and what builds value rather than ... what destroys value or expropriates value ... I think there are quite big objections to a proposed merger” (Q 8).
53. In the final event it is important to note that the decision to proceed with such a merger rests not with the Government, nor with Ofcom but with the BBC Trust. Both Ofcom and Lord Carter of Barnes were pressed on this point when they gave oral evidence. In a letter following up on his evidence Lord Carter of Barnes said explicitly:
 

“Under the current Charter, the Trust is the guardian of the public interest in the BBC and has the ultimate responsibility for the BBC’s stewardship of its assets. Consequently under the current provisions a partnership between BBC Worldwide and Channel 4 would require the agreement of the Trust in order to proceed” (p 95).
54. **Although we believe that the BBC must make a substantial contribution to tackling the general problems of public service broadcasting, that does not necessarily mean a merger between BBC Worldwide and Channel 4. There are unanswered questions about the viability of such a merger, and it certainly would not meet the needs**

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<sup>26</sup> *Financial Times*, 25 February 2009, “Virgin Media to decide on TV channels sale”.

**of other public service broadcasters. We believe that it would be wise for the Government to look at other options.**

### Partnership between Channel Four and BBC Worldwide

55. An alternative, more immediate and less complicated way to help Channel 4 would be for it to form a partnership with BBC Worldwide. Mark Thompson said that the BBC thought that partnership promised to realise benefits for Channel Four exceeding £25m a year (Q 5). We accept that some benefits might accrue through cost reduction, and others by jointly growing businesses—for example, linking BBC magazine publishing to Channel 4 programmes. It is also possible that benefits might be realised through the joint management of Channel 4’s non public service channels and the digital channels that the BBC jointly owns with Virgin Media.
56. **We believe that a partnership of this kind would be a quicker and less disruptive way of making extra resources available to Channel 4 than a merger. The BBC has been criticised in the past for its failure to work successfully in partnership with outside bodies. It is of the utmost importance that this partnership proposal be made to work.**

### Other partnerships

57. In December 2008, the BBC proposed a range of partnerships with other public service broadcasters, including sharing regional news facilities, sharing iPlayer technology and waiving fees for TV programme listings. According to Mark Thompson, “sharing infrastructure and resources at a regional level” would enable other broadcasters to “continue to provide a complete alternative regional television service to the BBC” (Q 5). He suggested that the cost savings of such partnerships would be substantial (Q 30). **We welcome the BBC’s partnership proposals and recommend that the other public service broadcasters take full advantage of them.**

### Merger proposals by commercial companies

58. Another proposal, made by Five, is that Five should combine with Channel 4. Channel 4 has opposed such a merger with Five, describing it as “oil and water” (Q 59). Andy Duncan, Chief Executive of Channel 4, referred to the fundamental “misalignment” between Channel 4’s and Five’s objectives: Channel 4’s objective is “to maximise income to re-invest back into content”, while Five’s is to “maximise profit for its shareholder” (Q 59). Moreover, he claimed: “The absolute scale of the opportunity around Five is quite modest” (Q 59).
59. In contrast, Dawn Airey, Chief Executive of Five, strongly advocated such a merger, describing it as “gin and tonic” (Q 264). She envisaged substantial benefits: “the new company would generate cost savings of more than £100m a year, largely through combining back-office functions”.<sup>27</sup> Such a merger would require primary legislation, and in view of Channel 4’s opposition there seems little chance of it going ahead.
60. More recently, ITV plc has floated publicly the idea of a three-way merger with Channel 4 and Five.<sup>28</sup> As ITV plc itself has indicated that it is not

<sup>27</sup> *The Guardian*, 9 January 2009, interview with Dawn Airey: “I’m Bewildered of Long Acre”.

<sup>28</sup> *The Guardian*, 25 February 2009, “ITV proposes merger with Channel 4 to create broadcasting giant”.

pursuing this proposal, we have not given further consideration to it. There is also speculation that RTL and ITV plc might merge. We believe that, generally, commercial companies themselves are best able to take decisions on possible mergers, subject to competition law and relevant regulation.

### Contestable funding

61. In our view, partnerships are not likely to solve all the problems of public service broadcasting. More is needed. Contestable funding for programme makers has a long history in UK broadcasting. It has been used by Channel 4 since its inception in 1982 for commissioning programmes. Under the BBC's Window of Creative Competition (WOCC), arrangements, BBC in-house producers and independent producers compete to supply programmes. It was also proposed by Lord Burns in 2005 as part of the advice to the Government on renewal of the BBC Royal Charter.
62. As Ed Richards said, the UK has a long experience of contracting for the provision of television news: "ITV contracts from ITN ... They have done it for years and it works very well. Sky won the bid to provide Five's news so the contestable method based on contract is actually familiar to the entire sector and delivers very, very well" (Q 371).
63. In order to ensure the continuation of an alternative to the BBC in provision of regional news, Ofcom has recommended "developing proposals for a new approach based on independently funded news consortia".<sup>29</sup> UTV, the Channel 3 licence holder for Northern Ireland, supports this proposal (p 99). Such an approach might be extended.
64. Contestable funding has a number of advantages. First, it offers flexibility. It would be easier for funding to be reduced or increased as necessary. Second, new entrants would be able to enter the market. As Mark Thompson acknowledged, this can enhance creativity within the industry (Q 47). At the same time, ITV plc could bid for regional news provision, just as Channel 4 could bid for its much admired but loss-making evening news programme. Third, it can reflect changing patterns of viewing as new platforms and delivery systems are made available by new providers. Fourth, it does not close down options for the future—such as possible mergers in the public sector.
65. The main argument used against contestable funding is that it would require a new administering agency. Lord Carter of Barnes expressed concern about the potential difficulties of administration, saying: "I suspect it will turn into a bit of a bureaucratic administrative nightmare" (Q 431). We do not believe that such difficulties are insuperable. Indeed, if Ofcom's recommendation for targeted funding<sup>30</sup> to sustain the provision of news in the devolved nations and English regions is to be implemented, an administrative solution will have to be found. We think the task could be carried out by a small public service broadcasting office, inside or outside Ofcom.
66. **We recommend that an element of contestable funding should be introduced to fill some of the gaps that might otherwise arise in public service broadcasting. This would entail the setting up of a limited fund to which broadcasters and programme makers could apply.**

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<sup>29</sup> *Ofcom's Second Public Service Broadcasting Review—Putting Viewers First: Final Statement and Recommendations*, Office of Communications, January 2009, p 113.

<sup>30</sup> "Ofcom's alternative proposal is for a series of independently funded news consortia in the nations and regions based on secure funding and competitive tender processes." *Ofcom's Second Public Service Broadcasting Review—Putting Viewers First: Final Statement and Recommendations*, Office of Communications, January 2009, p 89.

## CHAPTER 5: HOW SHOULD A PUBLIC SERVICE FUND BE FINANCED?

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67. There are several options for resourcing such a public service fund without turning to the taxpayer for extra support. First, part of the licence fee is already devoted to helping the elderly and disabled with the costs of digital switchover. There is likely to be an underspend on this programme which could become available. More important in the long term is what happens when the scheme ends in 2012. If that part of the licence fee were to be made available to public service broadcasting outside the BBC, it would represent substantial additional funding. According to Ed Richards, “there will be approximately £130 million per annum that could be used for something else which would have no impact whatsoever on the BBC’s programmes and services” (Q 374).
68. A second source of funds also results from digital switchover. Currently the public service television companies receive an implied subsidy from their use of the limited analogue spectrum. With the move to digital and the increase in access, that advantage will go. However, analogue spectrum will still have value because of demand from elsewhere. Part of the receipts which will go to the Treasury could be used for public service broadcasting—thus continuing the policy of support.
69. Third, it may ultimately have to be considered whether a further element of the licence fee might be redirected to support public service provision outside the BBC. Redirecting an element of the licence fee has a long history. It has been used not only for the digital switchover targeted help scheme but also between 1927 and 1961, when a portion was allocated to general public funds. There is no consensus. The BBC is opposed, and Ed Richards did not believe that use of the licence fee was “the best way of solving these problems and creating a diversity and mix” (Q 377). Andy Duncan believed that “the licence fee could still be an option” (Q 68), and Lord Burns recognised the need to redirect “some of the licence fee” (Q 399). The case for taking this step has been made stronger by the financial crisis and the exceptional financial position of the BBC.
70. **On the assumption that cost savings and additional income generated through partnerships will not be sufficient to meet the anticipated funding shortfall in public service broadcasting, we propose that funding for public service broadcasting in the advertising-funded television sector should be provided by (a) the underspend on the digital switchover programme (b) the continuance of funding from the licence fee after 2012 when the digital switchover programme ends and (c) the use of at least part of analogue spectrum revenue after 2012. Consideration may ultimately need to be given to redirecting an element of the licence fee to support public service content provision outside the BBC.**

## CHAPTER 6: THE LONGER TERM

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71. We have one further point to add. As this report makes clear, broadcasting is in a period of profound change. Technological change is taking place at a time of severe economic turbulence. Broadcasters are having to adapt rapidly. Policy makers are having to be flexible. Against that background, we doubt whether a Royal Charter setting down policy for the BBC for ten years in advance is any longer appropriate.
72. Our predecessor committee, the Select Committee on the BBC Charter Review, argued that the BBC should be placed on a statutory basis by Act of Parliament. It set out a number of grounds for this proposal. First, establishment by Royal Charter is an arcane and little understood procedure. Second, the passage of an Act through Parliament is a more transparent and democratic route than agreeing a Royal Charter through the Privy Council. In effect, the Privy Council method is nothing more than an agreement between the Government of the day and the BBC, without recourse to meaningful parliamentary scrutiny. Third, the Charter can always be superseded by an Act of Parliament, in any event, and therefore offers no special protection. Fourth, a statute can more explicitly and more authoritatively enshrine the BBC's editorial independence.<sup>31</sup> The same conclusion was reached by the House of Commons Select Committee on Culture, Media and Sport.<sup>32</sup>
73. Crucially in a time of enormous change such an Act could also provide for periodic review of BBC services and be tied in with Ofcom's own reviews of public service broadcasting. It could also provide for a periodic review of licence fee funding.
74. The changes that are taking place in broadcasting affect the public directly. They bring into sharp relief the question of who truly represents the licence fee payer. We do not accept that this should be the exclusive responsibility of the BBC Trust. The only truly representative body is Parliament.
75. **Accordingly we recommend that the BBC is established by statute. We urge the Government to reconsider its proposal to persist with the Royal Charter and to substitute a democratic process which will enable the public to be consulted more fully.**

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<sup>31</sup> BBC Charter Review Committee, First Report (2005–06): *The Review of the BBC's Royal Charter* (HL 50).

<sup>32</sup> Culture, Media and Sport Committee, First Report (2004–05): *A public BBC* (HC 82), paragraph 246.

## CHAPTER 7: SUMMARY OF MAIN CONCLUSIONS AND RECOMMENDATIONS

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76. There is a plethora of definitions and descriptions of public service broadcasting. We recommend that policy should concentrate on the provision of certain types of content. The core elements would include national and regional news, current affairs programmes, the arts, children's programming, and programmes dealing with religion and other beliefs—and the support of programmes with UK content.
77. We believe that there is a continuing need for public service alternatives to the BBC. There would be dangers if the BBC were to become an even more dominant provider of public service programming. Intervention is justified to ensure sufficient public service provision that the market will not provide free for the public.
78. We believe that before policy decisions are taken, there is a need for as much clarity as possible on the financial position of all the public service broadcasters. In the case of Channel 4, we underline the need for an independent review of its financial position. This should include potential efficiency savings and the financial implications of its programming initiatives, and should be completed before any decisions are made on its future. Such a financial review should be as open as possible to public scrutiny. The following conclusions and recommendations are subject to the findings of such a review.
79. We believe that a partnership between Channel 4 and BBC Worldwide would be a quicker and less disruptive way of making extra resources available to Channel 4 than a full-scale merger. The BBC has been criticised in the past for its failure to work successfully in partnership with outside bodies. It is of the utmost importance that this partnership proposal be made to work.
80. We welcome the BBC's other partnership proposals and recommend that the other public service broadcasters take full advantage of them. However, we doubt whether partnerships will be sufficient to solve all the problems of public service broadcasters. We therefore recommend that an element of contestable funding should be introduced to fill some of the gaps that might otherwise arise in public service broadcasting. This would entail the setting up of a limited fund to which broadcasters and programme makers could apply.
81. We recommend that financing of such a fund should come not from further demands on the taxpayer but from (a) the underspend on the digital switchover programme (b) the continuance of funding from the licence fee after 2012 when the digital switchover programme ends and (c) the use of at least part of analogue spectrum revenue after 2012. Consideration may ultimately need to be given to redirecting an element of the licence fee to support public service content provision outside the BBC.
82. We doubt whether, in a period of profound change, a Royal Charter for the BBC is any longer relevant. We believe, as did our predecessor committee, the Select Committee on the BBC Charter Review, and the House of Commons Select Committee on Culture, Media and Sport, that the BBC should be established by statute. We urge the Government to substitute for the Royal Charter a democratic process which will enable the public to be consulted more fully.

## APPENDIX 1: SELECT COMMITTEE ON COMMUNICATIONS

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The Members of the Committee which conducted this inquiry were:

Baroness Bonham-Carter of Yarnbury  
 Lord Corbett of Castle Vale  
 Baroness Eccles of Moulton  
 Rt Hon the Lord Fowler (Chairman)  
 Lord Hastings of Scarisbrick  
 Baroness Howe of Idlicote  
 Lord Inglewood  
 Rt Hon Lord King of Bridgwater  
 Lord Macdonald of Tradeston  
 Baroness McIntosh of Hudnall  
 Rt Rev Lord Bishop of Manchester  
 Lord Maxton  
 Baroness Scott of Needham Market

### Declarations of Interest

BONHAM-CARTER OF YARNBURY, Baroness

*12(f) Regular remunerated employment*  
*Television Executive, Brook Lapping Productions, a subsidiary of Ten Alps Communications plc*  
*13(c) Financial interests of spouse or relative or friend*  
*I also disclose the interests disclosed by Lord Razzall*  
*16(b) Voluntary organisations*  
*RAPT—Rehabilitation of Addicted Prisoners Trust*  
*Other relevant information*  
*Employee, BBC (1984–1993)*  
*Editor, Channel 4’s “A Week in Politics” (1993–1996)*

CORBETT OF CASTLE VALE, Lord

*12(i) Visits*  
*Visit to Hungary (21–23 March) with All-party EU Accession Group. Fare paid through Parliamentary travel scheme. Accommodation and hospitality provided by Hungarian Parliament*  
*Visit to Romania (29 May–2 June). Fare paid through Parliamentary travel scheme. Accommodation and hospitality provided by Romanian Parliament*  
*Visit to Liverpool (23–24 June 2006) with my wife, with European Capital of Culture 2008 All-party Parliamentary Group—accommodation and hospitality paid for by Liverpool Culture Company*  
*13(d) Hospitality or gifts*  
*The costs of the plaintiffs in the case of Lord Alton and others v. The Secretary of State for the Home Department of whom I was one, were met by contributions from Iranian residents in the UK through the National Council of the Iranian Resistance (12 February 2008)*  
*15(a) Membership of public bodies*  
*Chairman, Castle Vale Neighbourhood Partnership Board, Birmingham*  
*President, Josiah Mason College, Erdington, Birmingham*  
*Honorary Member, National Union of Journalists*  
*15(c) Office-holder in pressure groups or trade unions*  
*The Member is an office-holder in various all-party parliamentary groups; details will be found in the register of all-parliamentary groups at [www.publications.parliament.uk/pa/cm/cmparty/memi01.htm](http://www.publications.parliament.uk/pa/cm/cmparty/memi01.htm)*

*15(d) Office-holder in voluntary organisations*  
*Patron, Training for Life*  
*Patron, Hospice of St. Francis, Berkhamsted, Herts*  
*Patron, Chilterns MS Centre, Halton, Bucks*  
*Patron, Hope for Children*

**ECCLES OF MOULTON, Baroness**

*12(e) Remunerated directorships*  
*Independent National Director, Times Newspapers Holdings Ltd (11 December 2007)*  
*15(b) Trusteeships of cultural bodies*  
*Director, Opera North, company limited by guarantee (unpaid)*  
*Trustee of York Minister Trust Fund (not a company limited by guarantee) (unpaid)*  
*16(a) Trusteeships*  
*London Clinic Company limited by guarantee (unpaid)*  
*Other relevant information*  
*Director, Tyne Tees Television plc (1986–1994)*

**FOWLER, Lord**

*12(e) Remunerated directorships*  
*Non executive Director, Holcim Ltd*  
*Chairman, Thomson Foundation (24 July 2007)*  
*15(d) Office-holder in voluntary organisations*  
*Vice Chairman, All-party Group on AIDS*  
*16(a) Trusteeships*  
*Trustee, Terrence Higgins Trust*  
*Other relevant information*  
*Non Executive Chairman, Midland Independent Newspaper plc (Birmingham Post Group) 1991–1998*  
*Non Executive Chairman, Regional Independent Media (Yorkshire Post) 1998–2002*  
*Staff, The Times newspaper 1961–1970*  
*Life member, National Union of Journalists*

**HASTINGS OF SCARISBRICK, Lord**

*12(e) Remunerated directorships*  
*British Telecom PLC*  
*12(f) Regular remunerated employment*  
*KPMG*  
*Former BBC employee (1994–2006) in receipt of BBC Pension*  
*15(d) Office-holder in voluntary organisations*  
*Chairman, Crime Concern*  
*Patron, Volunteering England*  
*Patron, Springboard for Children*  
*Patron, Zane*  
*Patron, Toy Box*

**HOWE OF IDLICOTE, Baroness**

*15(b) Trusteeships of cultural bodies*  
*Trustee, Architectural Association School of Architecture*  
*15(d) Office-holder in voluntary organisations*  
*Member, Council of the Institute of Business Ethics*  
*Patron, Institute of Business Ethics*  
*President, The Peckham Settlement*

*Member of the NCVO Advisory Council*  
*Board Member, Veolia Environmental Trust plc (formerly Onyx)*  
 16(a) *Trusteeships*  
*Trustee, Ann Driver Trust*

INGLEWOOD, Lord

12(c) *Remunerated services*  
*Political Adviser, House of Lords (unpaid) for the Estates Business Group*  
 12(e) *Remunerated directorships*  
*Chairman, CN Group (Media)*  
*Director, Pheasant Inn (Bassenthwaite Lake) Ltd (hotel)*  
*Chairman, Carr's Milling Industries plc (food and agriculture)*  
 12(f) *Regular remunerated employment*  
*Farmer*  
 13(a) *Significant shareholdings*  
*Pheasant Inn (Bassenthwaite Lake) Ltd (hotel)*  
 13(b) *Landholdings*  
*Hutton-in-the-Forest Estate (farmland including residential property in Cumbria)*  
*Wythop Estate (farmland including residential property in Cumbria)*  
*Owner Hutton-in-the-Forest (historic house open to the public)*  
 13(d) *Hospitality or gifts*  
*20 November 2007: The costs of the plaintiffs in the case of Lord Alton and others v. The Secretary of State for the Home Department of which I was one, were met by contributions from Iranian residents in the UK through the National Council of Resistance of Iran (4 March 2008)*  
 15(a) *Membership of public bodies*  
*Chairman, Reviewing Committee on the Export of Works of Art*  
*Governor of Skinner's Academy Hackney (from February 2008)*  
 15(c) *Office-holder in pressure groups or trade unions*  
*Friends of the Lake District (nominated by the Committee for the National Consultative Council)*  
*President, Cumbria Tourist Board*  
*Member, Historic Houses Association Finance & Policy Committee*  
 16(a) *Trusteeships*  
*Trustee, Elton Estate, Cambridgeshire*  
*Trustee, Raby Estates, Co Durham and Shropshire*  
*Trustee, Thoresby Estate, Nottinghamshire*  
*Trustee, Calvert Trust*  
*Trustee, Settle-Carlisle Railway Trust*  
*Trustee, Whitehaven Community Trust Ltd*  
 16(b) *Voluntary organisations*  
*Member, Bar*  
*Member, Royal Institution of Chartered Surveyors*  
*Fellow, Society of Antiquaries of London*  
*Other relevant information*  
*Director, CN Group (1997; Chairman from 2002)*  
*Consultancy, ITV (June 1998–June 1999)*  
*Consultancy, BBC (October 1998)*  
*Patron, Voice of the Listener and Viewer (March 2000)*  
*Consultancy, BBC (April 2000)*  
*Member, Commercial Steering Group, BBC (July–November 2004)*

KING OF BRIDGWATER, Lord

12(e) *Remunerated directorships*

*Non-executive Director, London International Exhibition Centre plc and London International Exhibition Centre (Holdings) Ltd*

*13(b) Landholdings*

*Minority partner in family farm in Wiltshire (including cottages)*

*Partner in woodlands in Wiltshire*

*15(d) Office-holder in voluntary organisations*

*Patron, UK Defence Forum*

*President, English Rural Housing Association*

*Vice President, Royal Bath and West Society*

#### MACDONALD OF TRADESTON, Lord

*12(f) Regular remunerated employment*

*In an advisory capacity, Chairman—Macquarie Capital, Europe whose funds invest in and manage Arquiva (infrastructure operator serving broadcast and mobile communications) and Red Bee (playout and channel management services for digital media)*

*Former ITV employee—Granada and STV—(1967–1998) in receipt of STV pension*

*Member of the Advisory Board of Scottish Power*

*15(a) Membership of public bodies*

*Chancellor of Glasgow Caledonian University*

*16(b) Voluntary organisations*

*Member, Fabian Society*

*Patron, Brighton & Hove Philharmonic Society*

*Patron, Dystonia Society*

#### MCINTOSH OF HUDNALL, Baroness

*12(e) Remunerated directorships*

*Non-executive Director, Artis Education (unpaid)*

*15(b) Trusteeships of cultural bodies*

*Board Member, Roundhouse Trust*

*Council Member, Royal Academy of Dramatic Art*

*Trustee, South Bank Sinfonia*

*Board Member, National Opera Studio*

*15(d) Office-holder in voluntary organisations*

*Trustee, Art Inter-Romania*

*Trustee, Theatres Trust*

*Trustee, Foundation for Sport and the Arts*

*16(a) Trusteeships*

*Trustee, Thaxted Church Trust*

#### MANCHESTER, Lord Bishop of

*12(f) Regular remunerated employment*

*In receipt of episcopal stipend*

*15(a) Membership of public bodies*

*General Synod of the Church of England*

*Manchester Diocesan Board of Finance*

*Manchester Church House Co*

*Manchester Diocesan Council of Education*

*Manchester Diocesan Association of Church Schools*

*Life Governor, Liverpool College*

*Governor, Hulme Hall*

*Council of Bolton University*

*15(d) Office-holder in voluntary organisations*

*Lord High Almoner to HM The Queen*  
*National Chaplain, Royal British Legion*  
*Chairman, Council of Christians and Jews*  
*16(b) Voluntary organisations*  
*Manchester Diocese Mothers' Union*  
*Arches Housing*  
*Disabled Living*  
*Hulme Hall Trust*  
*Wigan & Leigh Hospice*  
*St Ann's Hospice*  
*Manchester University Change Ringers*

MAXTON, Lord

*13(b) Landholdings*  
*Holiday home in the Isle of Arran*  
*A London flat*

SCOTT OF NEEDHAM MARKET, Baroness

*12(d) Non-parliamentary consultant*  
*Centre for Transport Studies (judging and presentation of transport awards)*  
*Atkins (Consultancy)*  
*12(i) Visits*  
*Visit to Norway (29 August–3 September) hosted by the Norwegian*  
*Government under the auspices of the All-Party Parliamentary Norway*  
*Group*  
*Visit to US (September 2005) under the auspices of BA APPG (British*  
*American All-party Parliamentary Group)*  
*Visit to Trinidad (May 2006) under the auspices of C.P.A*  
*Visit to Guatemala and El Salvador (June 2006) under the auspices of I.P.U*  
*Visit to Taiwan (July 28–3 August 2007) meeting with the Ministers,*  
*members of the People's Democratic Party (fellow members of Liberal*  
*International), the British Trade and Cultural Office, parliamentarians and*  
*others. Travel and hotel costs paid by the Taipei office in the UK. Courtesy*  
*gifts received and give*

## **APPENDIX 2: LIST OF WITNESSES**

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The following witnesses gave evidence. Those marked \* gave oral evidence.

- \* BBC
- \* Lord Birt
- \* BSkyB
- \* Lord Burns
- \* Lord Carter of Barnes, Minister for Communications, Technology and Broadcasting
- \* Channel 4
- \* Five
- \* ITV plc
- \* Ofcom
- stv Group plc
- UTV

**APPENDIX 3: EXTRACT FROM THE COMMUNICATIONS ACT 2003***Regulatory provisions***The public service remit for television**

264 OFCOM reports on the fulfilment of the public service remit

- (4) The purposes of public service television broadcasting in the United Kingdom are—
- (a) the provision of relevant television services which secure that programmes dealing with a wide range of subject-matters are made available for viewing;
  - (b) the provision of relevant television services in a manner which (having regard to the days on which they are shown and the times of day at which they are shown) is likely to meet the needs and satisfy the interests of as many different audiences as practicable;
  - (c) the provision of relevant television services which (taken together and having regard to the same matters) are properly balanced, so far as their nature and subject-matters are concerned, for meeting the needs and satisfying the interests of the available audiences; and
  - (d) the provision of relevant television services which (taken together) maintain high general standards with respect to the programmes included in them, and, in particular with respect to—
    - (i) the contents of the programmes;
    - (ii) the quality of the programme making; and
    - (iii) the professional skill and editorial integrity applied in the making of the programmes.
- (5) When—
- (a) determining the extent to which any of the purposes of public service television broadcasting in the United Kingdom are fulfilled, and
  - (b) reviewing and reporting on that matter,
- OFCOM must have regard to the desirability of those purposes being fulfilled in a manner that is compatible with subsection (6).
- (6) A manner of fulfilling the purposes of public service television broadcasting in the United Kingdom is compatible with this subsection if it ensures—
- (a) that the relevant television services (taken together) comprise a public service for the dissemination of information and for the provision of education and entertainment;
  - (b) that cultural activity in the United Kingdom, and its diversity, are reflected, supported and stimulated by the representation in those services (taken together) of drama, comedy and music, by the inclusion of feature films in those services and by the treatment of other visual and performing arts;
  - (c) that those services (taken together) provide, to the extent that is appropriate for facilitating civic understanding and fair and well-

informed debate on news and current affairs, a comprehensive and authoritative coverage of news and current affairs in, and in the different parts of, the United Kingdom and from around the world;

- (d) that those services (taken together) satisfy a wide range of different sporting and other leisure interests;
  - (e) that those services (taken together) include what appears to OFCOM to be a suitable quantity and range of programmes on educational matters, of programmes of an educational nature and of other programmes of educative value;
  - (f) that those services (taken together) include what appears to OFCOM to be a suitable quantity and range of programmes dealing with each of the following, science, religion and other beliefs, social issues, matters of international significance or interest and matters of specialist interest;
  - (g) that the programmes included in those services that deal with religion and other beliefs include—
    - (i) programmes providing news and other information about different religions and other beliefs;
    - (ii) programmes about the history of different religions and other beliefs; and
    - (iii) programmes showing acts of worship and other ceremonies and practices (including some showing acts of worship and other ceremonies in their entirety);
  - (h) that those services (taken together) include what appears to OFCOM to be a suitable quantity and range of high quality and original programmes for children and young people;
  - (i) that those services (taken together) include what appears to OFCOM to be a sufficient quantity of programmes that reflect the lives and concerns of different communities and cultural interests and traditions within the United Kingdom, and locally in different parts of the United Kingdom;
  - (j) that those services (taken together), so far as they include programmes made in the United Kingdom, include what appears to OFCOM to be an appropriate range and proportion of programmes made outside the M25 area.
- (11) The following are relevant television services for the purposes of this section—
- (a) the television broadcasting services provided by the BBC;
  - (b) the television programme services that are public services of the Welsh Authority (within the meaning of section 207);
  - (c) every Channel 3 service;
  - (d) Channel 4;
  - (e) Channel 5;
  - (f) the public teletext service.

(12) The following are public service broadcasters for the purposes of this section—

- (a) the BBC;
- (b) the Welsh Authority;
- (c) the providers of the licensed public service channels; and
- (d) the public teletext provider.

(13) In this section—

“belief” means a collective belief in, or other adherence to, a systemised set of ethical or philosophical principles or of mystical or transcendental doctrines; and

“drama” includes contemporary and other drama in a variety of different formats.

*265 Public service remits of licensed providers*

- (1) The regulatory regime for every licensed public service channel, and for the public teletext service, includes a condition requiring the provider of the channel or service to fulfil the public service remit for that channel or service.
- (2) The public service remit—
  - (a) for every Channel 3 service, and
  - (b) for Channel 5,
 is the provision of a range of high quality and diverse programming.
- (3) The public service remit for Channel 4 is the provision of a broad range of high quality and diverse programming which, in particular—
  - (a) demonstrates innovation, experiment and creativity in the form and content of programmes;
  - (b) appeals to the tastes and interests of a culturally diverse society;
  - (c) makes a significant contribution to meeting the need for the licensed public service channels to include programmes of an educational nature and other programmes of educative value; and
  - (d) exhibits a distinctive character.

## APPENDIX 4: OFCOM'S PUBLIC SERVICE PURPOSES AND CHARACTERISTICS

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

High quality—well-funded and well-produced

Original—new UK content rather than repeats or acquisitions

Innovative—breaking new ideas or re-inventing exciting approaches, rather than copying old ones

Challenging—making viewers think

Engaging—remaining accessible and attractive to viewers

Widely available—if content is publicly funded, a large majority of citizens need to be given the chance to watch it

# Minutes of Evidence

TAKEN BEFORE THE SELECT COMMITTEE ON COMMUNICATIONS

WEDNESDAY 14 JANUARY 2009

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Present	Bonham-Carter of Yarnbury, B	Inglewood, L
	Corbett of Castle Vale, L	King of Bridgwater, L
	Eccles of Moulton, B	Macdonald of Tradeston, L
	Fowler, L (Chairman)	McIntosh of Hudnall, B
	Hastings of Scarisbrick, L	Maxton, L
	Howe of Idlicote, B	Scott of Needham Market, B

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## Examination of Witnesses

Witnesses: MR MARK THOMPSON, Director-General, Ms CAROLINE THOMSON, Chief Operating Officer, and MR JOHN SMITH, Chief Executive—BBC Worldwide, BBC, examined.

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**Q1 Chairman:** Mr Thompson and colleagues, welcome. Happy New Year.

**Mr Thompson:** And to you.

of course we had our one or two—literally one or two—problems with individual programmes, but I think, overall, the strongest year editorially since I have been Director General.

**Q2 Chairman:** Are you looking forward to 2009 being a better year than 2008?

**Mr Thompson:** We like every year to be a great year for public service broadcasting, and for the BBC in particular, so I hope it will be, yes.

**Q4 Chairman:** Okay. We will not go backwards—

**Mr Thompson:** It was rather you who raised the point, my Lord Chairman.

**Q3 Chairman:** 2008 was not one of your greatest years, I think.

**Mr Thompson:** To be honest, I think in broadcasting terms it was a very strong year. Highlights of the year would include our coverage of the Beijing Olympic Games—which I thought were wonderful. I do not know if Members of the Committee got a chance to watch and listen to the BBC over Christmas, but we had a quite exceptional Christmas on the air. Ten years ago, the BBC would have relied on big American feature films as a large part of the offering on Christmas Day. This year we had three original programmes in the middle of Christmas Day, which, interestingly enough, though people say you cannot get outstanding programmes from anywhere in the UK other than London, were *Wallace and Gromit* from Bristol, *The Royle Family* from Manchester, the *Dr Who* Christmas special from Cardiff. We are seeing outstanding programming coming from across the whole of the UK. There were two other highlights of the year. The *Proms*. Interesting fact: 12 million people watched some of the *Proms* on BBC television—before the *Last Night*, so the *Proms* season. We can get 12 million people watching the *Proms*, as well as, of course, many millions listening to it on the Radio 3. And drama across the piece, television and radio, had a really outstanding year. So

**Q5 Chairman:** Looking forward to 2009, it seems to be the case that the long debate on the future of public service broadcasting is coming to a culmination. We would like to come to the detail in a moment, but in broad terms the position is that there is a predicted funding gap affecting, I suppose particularly, Channel 4, and the argument is that if we want public service broadcasting to be sustained then funds or at least resources from elsewhere need to be found. Is that an analysis that you broadly agree with? You want competition in this area. Can you set out in broad terms what your solution would be?

**Mr Thompson:** We do agree with the Ofcom analysis that there are real threats to the broader PSB system, to public service provision on television beyond the BBC. We believe that the shortfall is somewhat less than Ofcom sees but still substantial. You will know that in December the BBC laid out a number of proposals under the heading of public service broadcasting partnerships which, in various ways, we believe offered opportunities for the BBC to open up its infrastructure, its scale, its technology, and its potential, also, to look for other commercial partnerships with other PSBs which we believe could make a material difference. Indeed, taken together with, as it were, the regulatory levers available to Ofcom itself, we believe that could make up the shortfall that Ofcom identifies. Examples of that would include sharing infrastructure and resources at a regional level to achieve economies which would

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enable ITV or another commercial provider potentially to continue to provide a complete alternative regional television service to the BBC. Since December, indeed, we have been involved in detailed discussions and negotiations with ITV and I think those are progressing very well. We would hope to be able to find a way in which a regional television news service on ITV, if that is what is wished for by ITV, by Ofcom, and by government, could be maintained, certainly until the end of the Charter period—so into the middle of the next decade—and, indeed, that that arrangement, potentially with ITV or another provider, could continue thereafter. So long-range support for plurality of regional television. A second example: in December we announced a joint venture between the BBC, BT, and ITV to develop an IPTV standard which we believe could be delivered to the market within 12 months from today—so 2010 at the latest—and that is really potentially providing a way in which the advertising-funded public service broadcasters could see a clear and affordable pathway through to the new digital on-demand world. A third example is something we mentioned in December but on which we have been talking since the summer. John Smith has been heavily involved in this—John is Chief Executive of BBC Worldwide, our commercial division. We have been talking to Channel 4, in a process of discussion and negotiation which has been brokered by CapGemini, on commercial partnerships potentially between the BBC and Channel 4. We said in December that we thought those could yield benefits of up to £25 million per year for Channel 4. Since then, we have been working further with CapGemini and we think we can get that figure rather higher than that. We are again open to ways in which our commercial arm BBC Worldwide's access to audiences, not just in the UK but also around the world, could be a platform for other public service broadcasters beyond Channel 4 to get their outstanding British content to consumers around the world. That is not a complete list but there is a broad list of proposals, many of which we have made progress even since we announced in December.

**Q6 Chairman:** You have mentioned ITV and the talks that are going on there. Michael Grade was saying yesterday, in one of the articles which seem to be sprouting up, that they were going well. Channel 4, on the other hand, do not seem to be as enthusiastic. In your article in the *Financial Times* you seem to be going a little further than what you just said. You seem to be arguing there for consolidation in the commercial sector and you are reported as favouring the merger of Channel 4 and Five. Is that your position?

**Mr Thompson:** Not exactly. First, to complete the partnership thought: we believe that the primary thing that the BBC can bring to the table and the most

effective use of the BBC and, indeed, of licence fee income in helping to address this issue, is exactly as I said: a series of partnerships. However, I said in my article and I believe that there are a number of other issues which should be addressed, of which the possibility of consolidation is one. It is a matter of public record that when I was Chief Executive of Channel 4 I believed at the time that, although there was a lot of complexity involved, constitutional complexity, governance complexity, there were compelling economic reasons for looking hard at a merger between Channel 4 and Five. But it is worth saying two quite important caveats: that was two years ago and quite a lot has changed since then, and I am no longer Chief Executive of Channel 4, I am Director General of the BBC, and it is not for me to say that any one or other model of consolidation is the right one. I can say that in some European markets currently, on the idea of a couple of large, advertising-funded, successful broadcasters, people are wondering whether you need to consolidate from two to one. There are a number of different possible consolidations that could take place, but I do not know many people in our industry who believe it is going to be possible, let us say 10 years from now, to sustain three different public service broadcasters, all funded by advertising, all with competing sales houses. I think the issue of what the structure looks like beyond the BBC is one which I would say needs to be part of this debate

**Q7 Chairman:** Except it is quite clear from what you are saying that part of your solution is consolidation and there are not that number of options when it comes to it. There is no particular reason why you should go back on your proposal about Channel 4 and Five.

**Mr Thompson:** To be perhaps pedantic about it, even five years ago I did not propose Channel 4 and Five; I said it should be looked at quite closely. Indeed it was and at the time it was not found by the parties to make sense. One absolutely accepts that. Now—I was careful what I said in my piece in the *Financial Times*—I am not making any such proposal either. I think the right thing to do is to say that industrial logic, in terms of the costs you can save by consolidating, and by the opportunity both to have a stronger position in certain markets (for example, the selling of advertising impacts) but also in terms of planning the migration of these services from the current space into the digital space, suggests there are strong arguments for consolidation. Broadcasting is not exceptional in this. I think we are going to see a period in British history where issues of consolidation and merger are going to appear in many industries and I think it is an important but rather unremarkable point to make.

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**Q8 Chairman:** Another proposal, again on Channel 4, is that BBC Worldwide should merge with Channel 4. That would be a way of providing the income to keep Channel 4 as a public service broadcaster. Do you have any views on that?

**Mr Thompson:** First, overall, are there ways in which a partnership between Worldwide and Channel 4 could make sense and drive value and therefore make Channel 4 more sustainable? Our answer to that would be yes. However, we want to pursue those conversations, we are pursuing those conversations, and I would say—but John can give you a more immediate read out—that they are productive and going well. BBC Worldwide is a success, it has grown substantially in recent years, and it has grown substantially because we have given it rather clear objectives and they are commercial objectives. The point of this part of the BBC is to get as much value as possible for the licence fee and return it to the BBC, so that it can be spent on the BBC's UK public services. We have been very clear that it is a commercial division and the decisions about its future should be commercial ones. The spirit that we have gone into the conversation with Channel 4—and I have been given very, very clear direction on this by the BBC Trust—is that we should be absolutely in the world of what adds value and what builds value rather than, as it were, what destroys value or expropriates value. I believe that any good solution is going to be one which helps Worldwide itself to grow and to be a powerful engine for getting great British programming to audiences around the world. The criteria by which we judge what should happen to Worldwide is around that and I am very, very unpersuaded that the level of synergies between Channel 4, a broadcaster which, because of the current terms of trade, has very little intellectual property . . . . The basic way BBC Worldwide works is by taking the BBC's intellectual property and the BBC brand, exploiting that in the UK and around the world, and then making money out of it. Essentially, the core of Channel 4 is buying licenses to show programming on Channel 4, with independents keeping the residual intellectual property rights. It is very, very hard to see how, at a group level, you can merge these two businesses, which are very different businesses, unless the plan is simply to use BBC Worldwide as a kind of cash machine to generate cash which can then cross-subsidise a failing UK ad-funded business. At a group level I think there are quite big objections to a proposed merger.

**Q9 Chairman:** I take “very, very unpersuaded” as meaning no.

**Mr Thompson:** I think the right thing is that we have looked at it quite hard and we cannot see the merits in the argument. But we are still in the middle of a live debate and it is always wrong, in my view, to shut off

any possibility. John has been much closer to the discussions.

**Q10 Chairman:** Mr Smith?

**Mr Smith:** Thank you, Chairman. I suppose I would add to Mark Thompson's answer—all of which I completely agree with—with just a couple of extra points of detail, the first of which is that Worldwide essentially is acting on behalf of UK TV licence fee payers. Over the last few years—you know the story—the company has almost doubled in size, and the profits have trebled, and so on, but it creates about £9 for every TV licence fee-paying home in Britain in terms of the value that is coming from Worldwide.

**Q11 Chairman:** How much do you make overall?

**Mr Smith:** Total turnover is approaching £1 billion. Profits last year were £118 million. The value we are creating is a mixture of profit, plus the amount that we spend buying rights from the BBC (which is a line in the P&L account), plus the value that we are building round individual brands like *Top Gear* and so on—the company itself is worth quite a lot of money. So it is about £9 per licence fee, and, of course, anything which either diminished that number—because essentially you were putting two things together which did not create value, they destroyed it—or alternatively simply transferred value from the BBC and therefore the licence fee payer to somebody else, is not really addressing the fundamental problem. It is not adding any additional money into the broadcast ecology; it is simply either diminishing it or transferring it around. I should emphasise that we have spent four months working directly with Channel 4—very collaboratively, by the way: the two teams headed by Andy Duncan on one side and me on the other, using CapGemini as a firm of impartial consultants in the middle. For four months we looked at what synergies could come from us doing things together. There is a whole load of things we can do together. You can imagine that if we have the third largest magazine publisher in Britain, publishing 60 titles, you do not have to think too hard about the kind of programming on Channel 4 to see that there are things around which we could produce magazines and make some money. It is just a small example. There are many, many bigger examples than that. But the great thing about this work with CapGemini was that it identified that we could both make extra money: increasing the amount of money being delivered to licence fee payers and at the same time helping Channel 4's problem. As Mark said, we estimated that work would give to Channel 4 an increase in their P&L of up to £25 million a year. We are at phase two of that CapGemini work and we are now looking at whether that partnership could be deepened by a relationship with Channel 4 in the UK which is more than simply us doing things together but combining forces in some

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areas. For example, at the moment in the UK sector there are several big TV ad-sales houses: ITV have the biggest, Channel 4 have one, Five have one, Virgin Media have one. We use the Virgin Media ad-sales house for UK TV—it is perfectly successful: it has 12/13 per cent of the market. Channel 4 have their own—also successful: I forget the exact number, but 17 per cent/18 per cent of the market. You can imagine that working together or doing something together could produce really genuine additional synergies by offering a more premium ad-sale rate and some cost synergies by having one house rather than two. That is an example of where, in phase two, we are looking at what else we could do to deepen the relationship beyond the £25 million we have already identified, and I think probably we are looking at maybe another £20 million or even more per annum on top of that when phase two finishes shortly. My final point is to emphasise that all of that work is recognising the fact that Channel 4 is essentially a UK broadcaster with no international footprint at all. It is essentially, therefore, a synergy opportunity that applies here rather than in the rest of the world. As Mark said, the idea of crashing the two companies around the world does not deliver anything, because Channel 4 do not have a brand outside the UK and they do not generate any rights which have any commercial value.

**Mr Thompson:** If you are not careful, you end up with a situation where services like *BBC.com* (the global website) BBC America, and BBC children's channels (which now are available in many markets) would be run not by the BBC but by Channel 4—which feels odd, to be honest.

**Q12 Chairman:** There must be a personal thing about this, that, having spent a lot of time building up the business, to have it taken away would seem a bad reward.

**Mr Thompson:** I would make a slightly different point. I would think the right question for us but, also, I would argue, for policymakers and for you to ask is: this a success story: it is the biggest distributor of television programmes in the world, outside the very big American players; it has a credible digital strategy; much of its revenue now comes from businesses which did not exist four years ago—

**Mr Smith:** Forty per cent

**Mr Thompson:** — Forty per cent from businesses that did not exist as recently as five years ago, what is the best way of taking this on to the next stage so that it delivers more value for the licence payer; in other words, the British public? When you think of the partnerships BBC Worldwide could have, you have to benchmark partnerships with Channel 4 with the other players who could potentially bring intellectual property, bring access to global markets, and so forth. In a way, I would say, let us be hard-headed about

what is the best way of getting this particular success story to go on to its next stage of development.

**Q13 Lord Inglewood:** Mr Thompson, I picked up a remark of yours, which I think I took down accurately, that you were discussing this problem from the perspective of the BBC and then looking at the structure of industry beyond the BBC. Is the dog that has not barked in all this debate looking in at yourselves to see whether, in fact, as part of the wider possible reconfiguration of public service broadcasting, that in the UK the BBC itself might have things to, as it were, throw out? You yourselves do an enormous amount—you are easily the biggest player—and perhaps part of it would involve yourselves becoming slightly smaller.

**Mr Thompson:** We are currently two years into a 10-year Charter which sets out very clearly the mission that the UK Government wishes the BBC to fulfil between now and 2016, and that itself, Chairman, talked about the culmination of a debate about public service broadcasting. My experience in recent years is that there have been a number of culminations. We had two and a half years or three years of debate before the Charter about the BBC's mission. It is set out very clearly in the Charter and Agreement, including every single service that is required of the BBC. The licence fee settlement was reached, again with the BBC's current mission set out very clearly, and in opening the debate, the Secretary of State has made it very clear that he sees the debate as being about what happened to public service broadcasting beyond the BBC; in other words, assuming and recognising that the Charter remains government policy as far as the BBC itself should go. That does not mean that as we go through this Charter and as media changes the BBC should not go on considering whether the mix of services, the mix of spend across those services, is appropriate. That is something which will need to happen. It is worth saying that the very extended public debate about the BBC's mission was one over a number of years which culminated in the Charter two years ago.

**Q14 Lord Inglewood:** From what you have told us, would it be the case that you feel that you are constrained in this debate by the terms of reference that the Government have circumscribed your organisation with? No man is an island. The world is changing very rapidly. If you did not have the constraints of the Charter on you, would you be doing this differently?

**Ms Thomson:** I think what we are saying is that we have a 10-year Charter. We only two years ago finished a very big public debate about the BBC. The DCMS conducted the biggest ever piece of consultation, as well as a very wide industry consultation and the conclusion was that the BBC

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should be what it is and that was written into the Charter. It is sort of the Maoist concept of continual revolution or continual scrutiny. Obviously it is very important that the BBC continues to scrutinise itself—and I want to say a bit about that in a minute—but we need a level of certainty for the BBC and, indeed, I think all the evidence is that the audience wants a level of certainty. You do not have to take the BBC's view for that, Ofcom's own research, as part of its review of public service broadcasting showed there was very little support indeed from the public for a smaller BBC. Two things are really important. I am probably on record in front of this Committee as having said the first one already, which is that the BBC needs to be, as it operates, much, much more conscious of its impact on the market. If that is what is lying behind your question, not only would we be sympathetic to that but that was one of the things the Charter and all the new arrangements around the public value test tried to institute for us. For example, you will have seen that the Trust has decided, as a result of the public value test with Ofcom, that we should not move into the local television market and the proposals that we had there. We have taken BBC Jam down, the educational service online, and we are being very cautious about how we develop the new educational service precisely because of the problems of market impact. I think you are seeing a change in behaviour as we move forward in the BBC. My second point is that I think on the partnership stuff that we are talking about now: it is a transformation in the culture of the BBC in this, in the sense that one of the things you are looking at or the body politic is thinking works best for the market is the BBC which is conscious of its position in the market, is more porous to outside ideas, but also sees its role as being a catalyst. I lived through the BBC—Mark was at Channel 4 for a bit of the time—where Greg Dyke was making press releases crowing about how we were beating ITV in the ratings. We are now talking about a world where the BBC will share its facilities with ITV for regional news in order to ensure that ITV can continue in regional news. That is a dramatic sea change in the culture of the way we are working and I believe the right one, moving forward, in terms of how we can deliver more benefit off what is an enormous privilege of the licence fee—we have to accept that.

**Q15 Lord King of Bridgwater:** Could I go back to the BBC Worldwide aspect of this. I may have got it wrong but I get the impression that the way that this has been presented is alternatives: top-slicing is directed at the income of the BBC and therefore raised financial problems for you, and that somehow BBC Worldwide and that combination was something that was a way round avoiding those problems. But surely the reality is that BBC Worldwide or top-slicing in purely financial terms

might have a very similar impact. Presumably the profits of BBC Worldwide were taken fully into consideration in the discussion of the level of the fixing of the licence fee.

**Mr Smith:** Yes.

**Q16 Lord King of Bridgwater:** In that connection, what estimates did you make from profits going forward that were taken into account in the fixing of the licence fee for BBC Worldwide?

**Mr Smith:** If I may say, the answer to your questions is yes, yes, yes. In terms of the profits, at the time of the settlement the profits of the company were £37 million. Since then we have had this big review and change of focus and it is all about growth. They are now £118 million, as I have mentioned. Our five-year plan, which ends at the time the settlement ends, is for the profits to be £200 million.

**Ms Thomson:** If I may interject, Chairman, at the time of the licence fee negotiations one of the things we proposed was a level of self-help in the licence fee, which included the growth of Worldwide's profits. The licence fee was set with Treasury targets in mind for us to grow Worldwide's profits.

**Q17 Lord King of Bridgwater:** Are you at the moment on budget for what you budgeted in the licence fee settlement?

**Mr Smith:** We are ahead of target at the moment.

**Mr Thompson:** We are ahead of target.

**Q18 Lord King of Bridgwater:** By how much?

**Mr Smith:** I cannot remember the exact number we had in mind.

**Q19 Lord King of Bridgwater:** I am sure you can.

**Mr Smith:** Relative to the plan we had three years ago, I cannot remember.

**Q20 Lord King of Bridgwater:** But you made a budget.

**Mr Smith:** Right at the moment—and, unfortunately, events of the last few months have made matters a bit more uncertain, obviously—as of last year, we were very significantly ahead of our budget for that year. From memory, about £20 million more than we were expecting. This year again we are on budget, but the events of the last few months have been really quite difficult, and, as you will expect, we are not insulated from the effects of a recession and collapse in some retail outlets—Woolworths being the key one that sells a lot of our DVDs and so on. We are affected by that, but I still feel pretty confident that we will get to £200 million at the end of the period.

**Mr Thompson:** I think the Worldwide plan, as it were baked into the licence fee settlement, is achievable, but now feels like a stretch, given trading conditions. If I may say, Lord King, I think you are absolutely

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right that a simple transfer of dividend from Worldwide to another broadcaster is functionally identical to top-slicing. It is exactly the same because it is the opportunity cost of a dividend which would have gone back in to support the licence fee. However, a partnership with another broadcaster, let us say Channel 4, which helps growth and builds new value might potentially deliver benefit to another broadcaster without disbenefiting the licence payer. The CapGemini work has been focusing on activities and combinations that we could do with Channel 4 that would grow the profitability and therefore the dividends of Channel 4 further than the current plan.

**Q21 Lord King of Bridgwater:** While you keep the Worldwide income.

**Mr Thompson:** Yes—the current income. You are building something bigger which therefore can maintain the dividend flow into the BBC but also provide benefits to another broadcaster.

**Q22 Lord Hastings of Scarisbrick:** I want to go back, if I may, to Lord Inglewood's point, but, before I do that, can I add to the list of great programmes *The Diary of Anne Frank* over the course of the last week which has been absolutely outstanding. The point which I think Lord Inglewood was making is that in your article Mr Thompson you say in the concluding paragraph: "Now is the time, in the light of the rest of what is going on in the economy, for simplification, consolidation, and the right kind of public/private collaboration." Taking those first two words of "simplification" and "collaboration", one of the things that in the design plan for the digital channels, particularly BBC Three, was that it would be the resting home for younger adults. It has not succeeded in doing that because younger adults are the pursued audiences in many, many other arenas. A lot of what BBC Three does is now BBC One content: its brilliant content is on BBC One. If you are looking at money that could be found to meet this £250 million gap, there are areas of the BBC which are at stretch which are not necessarily meeting their original purposes because the rest of the market has developed elsewhere. Does any of that fit into the need, in the light of the wider economy, to simplify your own service portfolio?

**Mr Thompson:** I do not think I agree with your analysis of BBC Three, which I think is hitting not just its general share-and-reach targets but also specifically is reaching our expectations in terms of young adults and has been a real success story. Particularly at a moment when other television broadcasters are understandably struggling to find the space and the money to invest in new drama and new comedy, BBC Three is a really important place in which new talent—new writers, new on-air talent—can be exploited, talent which can potentially—and

*Gavin & Stacey* will be an example of this, again playing over the Christmas period on BBC One—ultimately reach very big audiences indeed. Of course, one of the parts of the new settlement under the present Charter and Agreement is that the BBC Trust should systematically examine the services of the BBC, their performance against their service licences, and also assess their performance against the various criteria, ultimately the criteria of the public purposes of the BBC, measured in terms of audience performance but also in terms of the quality of the content and so forth. There is effectively a rolling programme of review in which consultation/audience research plays a vital part, and these reviews are themselves published and absolutely opened by the Trust to public scrutiny. There should be, but there is, a continual programme of assessing the BBC's own performance against its public purposes which is ongoing. I would say, though—and Caroline mentioned the fact that Ofcom research suggests there is very little appetite in the public for a smaller BBC—that the mission of the BBC in this Charter period is bigger than it has ever been. There are new services. You perhaps know that today we are launching a new Persian television service, paid for through grant-in-aid rather than licence fee, but the aggregate desire by the public, by government, and by others, is for the BBC to get engaged in new things, from the targeted help scheme in digital switchover, to our partnership of the Gaelic Media Service, to the launch of BBC ALBA, to the new Arabic and Persian television services. There are continuing new missions added to the BBC slate as well. Although of course we should look at our services and we should not be ashamed if a service is not delivering value for money to adjust its budget—BBC's Three's budget is a little bit lower now than it was at launch—at the same time I think you need to recognise that the mission which the BBC has been set in its Charter is a very broad one.

**Q23 Lord Hastings of Scarisbrick:** It is, indeed, but the research you have referred to, of course, is before the current economic cycle of difficulties, so, although the critical point Mr Thompson makes is absolutely right, what you refer to in your article is the need to reflect the economic downturn. Is it always going to be the case that there is never a BBC service, once created, that can be changed, other than things like Jam which are relatively small? In television or radio terms, when does the belt ever come in?

**Mr Thompson:** I think a good example would be the very extensive closures . . . . We saw 12/13 radio services in Central and Eastern Europe which we shut down as part of the strategic redirection of the BBC World Service.

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**Q24 Lord Hastings of Scarisbrick:** But those are grant-in-aid funds.

**Mr Thompson:** If I may say so, exactly the same principles applied. We are absolutely up for examining continually whether a given service has done its job or is not working, and between those and Jam and BBC Local you can find examples, both in the UK and in terms of external services, of us either deciding to shut services or deciding—the BBC Trust is fully involved in this—that a given proposal should not go ahead. This is new in the BBC. The idea of services shutting or of major proposals which have a lot of backing inside the organisation not going ahead is a relatively new phenomenon in the organisation.

**Q25 Lord Maxton:** Could I raise one question about top-slicing, which is a question which is quite practical in a sense. Some of the money in the licence fee at the present time has been allocated to help the digital switchover. In the one area of digital switchover was the budget used fully? Do you estimate as it goes on whether there will be a surplus from that? If so, what do you think that surplus should be used for?

**Ms Thomson:** You are absolutely right, there is a portion of the licence fee which is ring-fenced to be spent on digital switchover. It is spent, essentially, on two things: financing the organisation Digital UK, which is leading switchover—and particularly its marketing budget is entirely funded by the licence fee—but the lion's share goes on something called the targeted help scheme, giving boxes to the elderly and the poor, essentially in order to make sure they can access digital television after switchover. At the moment, that money is all being spent. It is absolutely up to budget and it is very early days. The only area we have switched so far, as you may know, is the Selkirk transmitter patch in the Scottish Borders area—so it is very early days—however, we will be, during the course of this year, further switching the rest of Borders, the West Country, Wales, and, crucially, the Granada region, so we will have a very good view by the end of this year as to whether, in particular, the money on the targeted help scheme, on the free boxes, which, as I say, is the lion's share, is likely to be spent. The honest truth at the moment is that we think there may well be an underspend. The take-up of the targeted help scheme looks as though it may be going to be lower than was projected when the figures were done, but we have yet to do a big conurbation and I think it would be foolish to count on it until we have done that. It is ring-fenced money. If it is not spent on the targeted help scheme and digital switchover, then there will have to be a public debate about what it goes on. It is not up to the BBC to spend it. Indeed, we cannot.

**Mr Thompson:** Indeed, it will have been contributed to by the British public for a specific purpose around the analogue to digital television switchover, so the public will have paid it for a specific purpose and there should be a proper debate, given that the public have been asked to pay for it for one purpose about how it should be spent or whether it should be in some way clawed back and, as it were, handed back to the public through future reduced licence fee rates or whatever. There are a number of different ways in which you might address the issue of an underspend.

**Ms Thomson:** Ofcom did ask the public what should happen to this money at the end of digital switchover—so not looking specifically at an underspend on the existing pot but going forward—and 63 per cent of people said that the money should go back to the licence fee payer. The next most popular option was spending it on building out broadband. And then the third most popular was helping to support—I am pleased to say, for Lord Inglewood and Lord Hastings—extra BBC services or supporting Channel 4.

**Q26 Chairman:** It was a highly questionable policy to begin with, was it not? You were not happy with this policy of having this ring-fenced money.

**Ms Thomson:** It was a very unusual thing for us to agree to. Let us put it that way.

**Q27 Chairman:** I think that also means no.

**Ms Thomson:** We were given by the Government, in the way Mark is describing, the capacity for the Government to give extra duties on the BBC. We were given a duty of building digital Britain. Clearly the principle of universality is enormously important to us, so making sure that the poor and the elderly can receive all our digital services is an enormously important principle for us, and on that basis we were prepared to accept it.

**Chairman:** They would regard it as social security, I would have thought.

**Q28 Baroness Scott of Needham Market:** You have made it fairly clear that you regard the current situation as one resulting from long-term structural faults. Five took a different view. They referred to temporary circumstances coming out of the downturn and its effect on advertising revenues. I wonder whether you could say a word or two about the relationship between the current economic situation and the longer term, whether it is possible to separate these out in their effects, and whether it makes any difference. As we are looking for longer term solutions, are there dangers in framing solutions in a downturn?

**Mr Thompson:** Are there dangers in framing a solution in a downturn? The answer to that must be yes, because obviously the danger is that you mistake

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short-term potentially tactical problems for long-term structural ones. However, many people believe, many people in commercial and advertising-funded broadcasting, and, indeed, in the rest of UK media, strongly believe that one of the effects of the downturn may be to accelerate structural change anyway. It may be that when advertisers are thinking about where best to spend more limited marketing budgets they are more tempted, for example, to switch from newspapers to the web. You may get an effect where the downturn slightly accelerates the structural issues, and we need to keep an eye—and it is very hard to analyse these things and be sure—if the money is going down swiftly, whether it is because of obvious and immediate issues or whether there is a structural component—but there can be a connection, I would say. Essentially, it seems to me, the right thing is to try to take a five- or 10-year outlook. Also, I think it is important to recognise that if you simply project forward on the basis that advertisers will not evolve, that broadcasters will not find new revenue streams, and that they will not invent new business models, you can paint a very dire picture. I hope that what we will see in this country is a lot of innovation, and new ideas around how you find business models so that everyone can go on investing in high quality content. It is going to need some new ideas. I think the way ultimately the public consume television and radio is changing and that means that we need to change the way we think about how it is monetised. If you take television viewing, over the Christmas period, over the whole of 2008, television viewing is not declining. The public's appetite for really high quality programming and their willingness to attend to it is still very high and the business model challenge across the industry is to try to find ways of harnessing that attention and that appetite and finding ways therefore of justifying the investment and making money.

**Q29 Baroness Howe of Idlicote:** I am intrigued by this figure that you have arrived at of £250 million as being really what the real deficit is. I quite see that Ofcom have done their sums and they are considerably higher than the sums you have done. Where exactly did you find the savings? £250 million is apparently the gap that you have identified. Their estimate was between £330 million and £420 million. I think it is quite important to know where you have found, as it were, savings that they clearly have not identified.

**Ms Thomson:** You are absolutely right to identify it. Our figure was £250 million; their gap is between £330 million and £420 million. It is important to say that this is done on the basis of economic modelling by both of us. They have access, to be frank with you, to a fair amount of data that we do not, so our model is probably a bit cruder than theirs. We would be very happy, I think, to share the underlying work with you,

if that helped, but the simple explanation of it is that what they have done is essentially looked at what the current ITV and Channel 4 and Five schedules are, the mix, and they have taken it genre by genre and looked at: If you were to replicate the precisely same schedule in 2014, which genre would be unprofitable and by how much? How much is spent and how much is unprofitable? We have done a similar exercise. The essence of our difference is that we believe there is perhaps a bit more value for the networks themselves in being mixed genre networks. Where Ofcom believes some genres are likely to be marginally profitable, we think they might be a bit more profitable. The classic example of this would be news, because to run a national mixed programme network without news is something that just would not be very successful, so the way our economists have attributed some value differed from the way that Ofcom's people have attributed value. We can give you the underlying work but that is the explanation. I do not think it offers you a saving; it is a different basis of calculating the economic model.

**Q30 Lord Corbett of Castle Vale:** Mr Thompson, you estimate that the BBC partnership proposals can deliver more than £120 million a year to other public service broadcasters. Can you just say what it would cost the BBC to do that and what has been the reaction of other PSBs to its proposals?

**Mr Thompson:** To be honest, the cost we gave an estimate when we announced this in December of around £20 million per year in the current licence fee settlement, so that would gross up to £100 million, I think, but it is worth saying that the cost of what you do very much depends on the precise nature of the partnership. For example, the regional news discussion, where it was only after that announcement in December that we really started closing with ITV in terms of how could it work and what could we do. We know an awful lot more about what it might cost the BBC to make that possible. We are quite close to understanding that in some detail. We are talking of substantial costs to the BBC, but what is interesting and almost exciting about what is going on is that we think there is a really big multiple, that for a relatively smaller investment—and let us take that figure of £20 million per year as an example—you could potentially drive benefits which are maybe five or six times that much. What is interesting is that it seems to be quite an effective way of using the licence fee to generate really quite a lot of value. I think regional news would be one example, but another example which is a fairly obvious one is if other PSBs do decide that they want to share the iPlayer—its brand, its technology—manifestly it means they will not have to go into anything like as much investment themselves, or in marketing themselves. With each of the proposals we think there is potentially quite an interesting and

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valuable multiplier effect. I think it is fair to say, if we take ITV, first of all, and its reaction, ITV have engaged very fully with us in a number of projects. We have already reached agreement with them on the IPTV project and we are close to agreement on regional television. More broadly, ITV have been positive about this whole approach from the BBC. Five also have been very positive and welcome the entire approach. Channel 4 have not been positive about much of the partnership proposals, though I have to say they have also engaged very positively in the whole discussions about Worldwide. We have also been talking to S4C, to STV, UTV and so on. Although—and you will understand why individual PSBs' reactions to individual proposals varies enormously depending on their issues and their perspective—it is fair to say that we thought some of these were going to be welcome but, overall, we have been very encouraged, I would say, by the positive reactions we have had as a whole from the other PSBs.

**Q31 Lord Maxton:** Is the iPlayer on Virgin Media a commercial operation between you and them or is that a partnership?

**Mr Thompson:** I would describe it as a partnership. We do not derive revenue from it. It is an opportunity for licence payers who are connected to Virgin Media to get one of the BBC's public services.

**Q32 Lord Maxton:** You have not offered it to Sky.

**Mr Thompson:** I am not quite sure whether it has begun yet, but we have reached agreement on a syndication with Sky for Sky's online aggregation service—now, I think, called a Skyplayer: there are technical difficulties why it will be potentially difficult to get the iPlayer on to the satellite platform. But, again, I want to be very clear: our objective is always to get BBC public services on all platforms which are relevant to licence players and that absolutely includes Sky, where we have had BBC services for decades and where we are always keen to get BBC public services. We have had a very successful partnership with Sky, for example, on high definition, which we got on to the Sky platform very early on, so we do not discriminate between platforms in terms of getting our public services on.

**Q33 Baroness McIntosh of Hudnall:** Can I look at this issue from a slightly different standpoint. You have talked a lot about value in terms of the commercial value to your partners and to you of engaging in these partnerships and, also, the value, as you have just said, of getting BBC public service content out across a wider range of possible outlets and platforms, but there is another kind of value which I assume particularly the BBC is trying to accrue, which is political credibility and value that comes from having shared your resources in a way which presumably

helps to push away some of the criticism or implied criticism of the BBC's receipt of large quantities of public money. How are you assessing the political capital that you are accruing, if any, and to whom are you addressing, as it were, your evaluation of that? Because presumably you are trying to make a case over the medium term at least that says, "Don't top-slice because we've a better idea and it's going to make you stronger when it comes to defending your position the next time these issues come up for review."

**Mr Thompson:** I think that our partnership proposals will be absolutely judged on the tangible results. If we take regional news, there is a fairly straightforward test, which is: "Do the BBC's partnership proposals around regional news enable Ofcom and the other parties and, indeed, ITV itself, to sustain a regional news service on the ITV system for a longer period than otherwise would be the case? Rather than imagining that this is a kind of policy level debate—and it obviously has that dimension to it—the key thing is that there is a series of challenges (sustainability of plurality of regional news, sustainability of public service broadcasting across the other PSBs with particular attention to Channel 4, to what extent can the PSB group help with the broader agenda of broadband roll out, universal access to broadband, IPTV and so forth) and in terms of who we are addressing, I would say, ultimately, the British public but also government. And governments over the next five years will judge this whole approach on its practical efficacy in addressing a number of specific issues, some of which are economic—and we have talked quite a lot about that this morning, but some of which also are very much to the public purposes of the BBC; for example, availability of plurality of news, the use of something like the iPlayer to get high quality public service content from other providers to as many people across the country as possible. These are forms of social and cultural value which I think the BBC can be very supportive of.

**Q34 Baroness McIntosh of Hudnall:** This is hypothetical, but one of the bits of information that came out of the last inquiry that this Committee did that addressed the public service broadcasting issues was that there was the potential for the BBC to become, in effect, the only public service broadcaster. That is why Ofcom and everybody else is very exercised about it, and you have just said that it is in the BBC's interest for there to be a plurality of public service broadcasters—or you seem to be saying that.

**Mr Thompson:** It is in the public's interest, and because it is in the public's interest it is something the BBC can and should support.

**Baroness McIntosh of Hudnall:** That is a very good answer and I will leave it at that.

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**Q35 Baroness Bonham-Carter of Yarnbury:** If it would be that these partnership proposals you are putting forward are not sufficient to fund the likes of Channel 4 in the future and more direct public funding is required, who would you wish to administer the public funding?

**Mr Thompson:** It is really not for us to say. I believe that one of the reasons we have had historic plurality of content in UK public service broadcasting is because we have had a plurality of business models and a plurality of funding and, crucially, a plurality of governance, and so I would say that if there were to be other sources and other directions of public funding in public service broadcasting it is quite important that it does not come down the same pipe, as it were, as the licence fee. That implies, probably, some new entity. I think logic suggests that it should not be Ofcom, in the sense that Ofcom has a mission which is about scrutinising and assessing public service broadcasting once every five years in their quinquennial reviews of public service television but, also, in between those reviews, and I think you would end up with a rather complicated conflict of interest if Ofcom were both dishing it out and also assessing how successful it has been; so it would probably be some new entity, and that has the disbenefit of obviously bringing yet another, as it were, regulatory tier or component or an Arts Council of the Air into the equation. That I think is where logic takes you if that is decided by the Government to be appropriate.

**Q36 Baroness Bonham-Carter of Yarnbury:** We might contemplate what Lord Burns had suggested.

**Mr Thompson:** I think Lord Burns had a slightly different model, which also went to the governance of the BBC and, indeed, to the licence fee, which was a kind of transmogrification of the BBC governors into an Arts Council of the Air public service broadcasting commission, dispensing through a contestability model to multiple providers. To me that has some quite serious drawbacks, not least that public service broadcasting becomes something which is in the eye of a single beholder, so you have one body which is deciding every penny in defining public service broadcasting. I think that one of the strengths of our system is that we have had very different cultures and different funding models and different perspectives. I think public service broadcasting has been immensely enriched by the fact that frequently over its history great creative figures at ITV and at Channel 4 and elsewhere have had very different perspectives on what public service broadcasting should be and have taught the BBC plenty of lessons along the way. That business of variety of funding to me is key to our system.

**Ms Thomson:** I would echo that and say that I have always thought the genius of the British broadcasting system and the reasons why we have such a good one

is that you have the public service broadcasters competing for audiences but not for revenue. This has put the audience needs absolutely at the heart of the system and has meant that audiences have been served fantastically well with very good programmes. You tinker with that at your peril. The only other thing I would say is that both Mark and I, and Mark in a more elevated position than me, have spent a number of years working at Channel 4: very committed to it as an institution but a bit like Michael Grade, who, of course, was Chief Executive there for a while as well, I would be very hesitant if I was Channel 4 about a mixed funding model. I think it creates very different and difficult problems about mixed incentives, about how you run an organisation, and if you look abroad mixed funding models of public service broadcasting are not entirely comfortable and for Channel 4 in particular the level of public scrutiny and debate which comes with public funding might make it difficult to sustain the very thing we really want Channel 4 to be delivering for the system.

**Q37 Baroness Bonham-Carter of Yarnbury:** Could I go back briefly to the BBC Three point. I think that the content on BBC Three is often remarkable. The recent documentary *Jack's Story*, for instance, seemed to me to be an obvious programme for BBC Two. In the present climate, how do you justify content like *Gavin & Stacey* and *Jack's Story* being commissioned by a digital channel rather than being commissioned for a channel that already has a larger audience?

**Mr Thompson:** Outstanding documentaries and comedies on BBC Three, partly because we show them quite a few times on BBC Three, as you have probably noticed, would themselves gather very big audiences. Often on BBC Four, for example, documentaries would, because we show them half a dozen times, get audiences absolutely equivalent to the same programme on BBC Two. In terms of delivering to audiences, the digital channels are getting more and more effective at reaching the people who want to find the programmes. But we do have our own economic issues as we go into this period. The commercial property market means that there our projections on commercial property sales are not making sense, we are going to have to keep a very close eye on our pension scheme and so on, so we have issues and we will be looking very, very closely at value for money across the network. You will—I hope judiciously—see an attempt to exploit more fully all of the originations we make, though we are very keen—we think in the downturn the whole of the broadcasting sector benefits from the BBC continuing to invest high levels of money in high quality British programmes. We get 38 per cent of our programmes from the independent sector; it is very important that

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in a downturn the BBC goes on investing in original new programmes for all of our networks.

**Q38 Chairman:** Picking up the penultimate point that Lady Bonham Carter made, Caroline Thomson you were saying, as I understand it, that you are sceptical about a mixed funding solution as far as Channel 4 is concerned.

**Ms Thomson:** I would be cautious if I was Channel 4 about the mixed funding.

**Q39 Chairman:** If that is not the solution, does that not lead you back to the consolidation route?

**Ms Thomson:** It leads you back to other routes. I think all other routes should be explored. Obviously it is not for us to tell Channel 4 how to run itself, but consolidation is one thing. Looking for an organisation like Channel 4, which makes none of its own programmes itself, at how the balance lies of economic benefit between independent producers and the channel is perhaps another thing you would want to do.

**Mr Thompson:** But also commercial partnerships. Commercial partnerships which very much go with the entrepreneurial spirit of Channel 4, where the incentives are to build things and create value, and to take the Channel 4 brand and some intellectual property and bring that to new audiences in other countries and in new ways to audiences in the UK, is all very congruent with the spirit of Channel 4 and could deliver real value into other things.

**Q40 Chairman:** The problem is that they are saying that is not enough.

**Mr Thompson:** One of the parts of this debate—and I do not think we have got to the bottom of this part of the debate—is how much is enough. What I think is not in doubt now, is common ground, is that the commercial partnerships could make an economically significant contribution. We are well above £25 million per year of benefit. We believe that the other partnership proposals being made could make a similar level of benefit—perhaps slightly more—so the idea that you could see from the BBC partnership proposals before you start looking at Ofcom’s levers, that you could have a significant, over £50 million of benefit per year to Channel 4 from four or five years from now, feels like it is going a long way to fulfilling even quite a large future gap.

**Q41 Lord Maxton:** Just over three years from now everybody in the United Kingdom will have to have digital television. They will therefore, at minimum, have access to something like 15 channels. Many of those could be defined as public service broadcasting. There will be access to 24-hour news services, to Discovery channel, to history channels, to a whole range of things which can only be defined as public

service broadcasting. Are we not wrong to concentrate entirely on this idea of five channels being public service broadcasting? Is not Sky entitled to say it is a public service broadcaster? Is Virgin entitled to say it is a public service broadcaster? Certainly Freeview is entitled to say it is a public service broadcaster.

**Mr Thompson:** Freeview, it is worth saying, first of all, is a delivery platform. It is not a content provider.

**Q42 Lord Maxton:** Yes, but it is a delivering public service broadcasting.

**Mr Thompson:** Freeview is quite important. I certainly do not think we should ever claim that the only form of high quality broadcasting is public service broadcasting. It is perfectly possible for commercial broadcasters to produce outstanding content. Quite apart from British broadcasters, we can see some outstanding American drama and comedy which is made by entirely commercial players. However, I think it is worth saying that very good services—and they are good services—like Discovery and Sky Arts are subscription services. They are only available in households where there are devices which can take subscriptions. That means that 11 million households, and probably, ultimately, 12, 13, 14 million households—around half of all households—which have Freeview will not be able to get these services. Moreover, you have to make a choice of paying for them. I would say that one of the elements and the founding elements of public service broadcasting is an idea of a universal service which is free at the point of use. I have talked about the *Proms* and 12 million people bumping into the *Proms* before the *Last Night* on BBC television. Sky Arts is a subscription service which has a weekly reach of around 200,000 people who absolutely have chosen to subscribe to the basic tier and then to watch it, but as a vehicle for getting arts to the UK population, Sky Arts is not a complete solution. I think it is to be welcomed that it is there, but if you believe that any young person, let us say, in any household in the country should have access to high quality arts, I believe that the subscription world of Discovery and Sky Arts will not give it to you: it will give the arts to people who already know they want the arts and it will give it in hundreds of thousands rather than millions. Across the BBC’s services we can still get many, many millions of people to bump into classical music, into literature, into dance, and into poetry and so forth. One of the things that is precious about our system is exactly that: it is not just programmes of culture and education, broader learning and information for those who can afford it, for a privileged few; it is for everyone and available to everyone. That, even in a post-digital world, will still be an issue, I put to you.

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**Q43 Baroness Eccles of Moulton:** Mr Thompson, would you maintain, from what you have just said, that, first of all, you have to have a licence fee which is subscribed to by all households who have television and radio, you then have as a result of the licence fee a free service which is provided to all households, and without those two starters it is impossible actually to provide public service broadcasting, that they are inextricably linked?

**Mr Thompson:** I believe that the UK, from the 1950s onwards—and whether it be a miracle of design or a miracle of accident you can debate—devised a system which found a number of different routes for delivering universal free-to-air high quality content. The centrepiece was and remains—and I believe should and will remain—a BBC funded by the licence fee. It is one of the odd accidents of history that a pooled investment in high quality content given to households across different devices which, to be honest, the BBC and the Government had got to in the mid-1930s in this country, makes an extraordinary amount of sense in a fully digital world. It is still a model which works surprisingly well. There are issues, potentially fiscal issues, about how you define the licence fee and therefore how you collect it but the fundamental notion of pooled investment to guarantee universal access to high quality content is remarkably future proof. The challenge, and what this whole debate is about, is whether there are ways of adjusting the rest of the model such that the other models—which grew up in an age of spectrum scarcity, relying on a small number of other players who had privileges: access to spectrum either for nothing or simply exclusive access to spectrum for which they would in return provide significant amounts of high quality public service broadcasting—can continue as well. Although it is a very challenging time, frankly, for all media—newspapers, and we are talking television principally here, but radio manifestly, and it is challenging not just here but in practically every country in the world—we believe that it is possible to reconfigure the system in ways which do not weaken the BBC's ability to deliver public service broadcasting but greatly enhance the opportunity of other public service broadcasters to continue to deliver PSB content.

**Q44 Baroness Eccles of Moulton:** You have very much stressed high quality content but surely another responsibility of public service broadcasting is to pay attention to minority content which does not have commercial attraction. How highly do you rate that?

**Mr Thompson:** I think that is an incredibly important part of public service broadcasting. I do not believe it is the only job of public service broadcasting. There are some countries where it is believed that the only

form of public service broadcasting should be, as it were, defined by strict genre-by-genre market failure, so it should only be those kinds of programmes and those subjects which are never touched on by the market which public service broadcasters should adopt. I think that is very short-sighted. I think there are many forms of public service broadcasting, for example, news and current affairs, where there is a social benefit across services in getting as many people to connect with them as possible. Sometimes I think getting a broad audience—a broad audience, for example, for a literacy campaign, the more people you can get to watch a literacy or numeracy campaign, the better. Sometimes the public services go for the big audience but we should always at the BBC see part of our duty as making sure that we do go on investing in those areas—we might talk about religious output, we might talk about some aspect of the arts, certain aspects of the coverage of democracy and public affairs and current affairs and so forth—where we can be pretty sure that most commercial broadcasters will not deliver very much and we remain committed to that. I think that part of the BBC's mission is going to become more important and the BBC should attempt to deliver that better and to become more distinctive over the coming years rather than less so.

**Baroness Eccles of Moulton:** That is good news.

**Q45 Baroness Bonham-Carter of Yarnbury:** We talked about subscription channels. I am interested in what your response is to the argument that there should or could be a levy on subscription channels to plough a minimum amount back into British content.

**Mr Thompson:** As you know there are a number of levy models and there are one or two other European countries, I think in Greece there is a levy on electricity. You get a levy on your electricity bill to pay for public service broadcasting. Such models are possible. I have to say, though, that at a time of pretty acute pressure on all media providers in this country, including subscription providers, my instinct is where we can look for models—and the Worldwide partnership would be an example of this—which generate value rather than running the risk of handicapping other media players. The ideal is to try to find a way of getting more investment in high quality content into the system, and the worry obviously with, let us say, a levy on subscription is that you transfer the problem from one part of the forest to another part of the forest. You might decide to do that because you want to privilege public service broadcasting over commercial broadcasting, but the danger is that you might end up with a total aggregate investment in media going down. Although we can look at other European countries and see a range of models for levies, our tradition has been not to look at levies.

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**Q46 Baroness Bonham-Carter of Yarnbury:** I suppose the argument is that they are accruing income through the broadcasting system. It is acquired programmes rather than any investment in—

**Mr Thompson:** I guess that is right, but it must be said that we should also acknowledge the fact that the arrival of subscription services, spearheaded absolutely by BSkyB, has itself immensely broadened choice in this country and is to be welcomed. Enormous risk was taken by Sky and others in coming into this market and creating the market for pay television. At the BBC I would say we welcome the choice and the range of choice which subscription players like Sky have brought into the market. The fact that a subscription service like Sky Arts—which I do not want to criticise because I think it is very good—does not quite do the job which I would define as public service broadcasting does not mean that I think it is a bad thing. I think it is a very, very good thing that Sky is getting behind such a challenge.

**Q47 Lord Macdonald of Tradeston:** Would you accept that there is a particular political and cultural context in Scotland which might present a very real problem if ITV is further centralised in London with reduced public service broadcasting obligations, which would leave BBC Scotland really as the sole significant provider of Scottish programming? Good though it is, and much as I welcome your promise of increased network production coming from Scotland as well, if I could take you to the report by the Scottish Broadcasting Commission, which of course has the unanimous support of all the parties in Holyrood, they have argued that because of this potential crisis in Scotland there should be a Scottish digital television channel providing a “secure and sustainable source of competition for the BBC in high quality public service content produced for Scottish audiences”. Do you agree that there is a role for such a channel? Would it have an impact on your business as BBC in Scotland? How would you envisage perhaps trying to support such a proposal?

**Mr Thompson:** First, we are fully committed to building stronger services for Scots and also for greater investment in network production, greater programming which can be seen across the UK but which is made in Scotland and with Scottish talent. In creating our new headquarters Pacific Quay in Glasgow, it is quite interesting that seven or eight years before we opened the doors we were talking to STV, to Channel 4, to Scottish Screen and so forth about how we could share facilities there and work with them. In some ways Pacific Quay is one of our early examples of trying to come up with a solution for the BBC where facilities could be shared with others, and we are absolutely in favour of as much plurality as is achievable across the UK and definitely in Scotland. Moreover, there are clearly models—and one model

elsewhere in the UK is the BBC’s partnership with S4C—where we produce a range of programmes: news programmes (Newyddion), a very popular continuing drama *Pobol y Cwm* (*People of the Valley*) for S4C. There are models of the BBC that work, paradoxical as it might seem, to help an alternative public service broadcaster in a given market. The one point to make, obviously, is that Scotland has, in STV, a strong English language channel based in Scotland with Scottish talent. One question it seems to me is exactly how one thinks about STV and its future alongside the possibility of another channel which presumably potentially might be competing for audiences with STV. The BBC would in Scotland, as is true anywhere in the UK, welcome competition for audiences. We welcome new players, we often think we learn creatively from new players, and we think the public should have the widest choice of services that they can. You will never find us saying there are competitive reasons why we would not want a new player. Working out quite hard how such a channel would impact on the rest of the Scottish media scene, the commercial Scottish media scene, is quite important. Again, just as you do at a UK level, you want a sustainable media scene in Scotland. We recently launched BBC ALBA, the Gaelic television channel, which is doing very well and is well ahead of its audience targets, but BBC ALBA did not present overwhelming market impact issues. I think the market impact issues of a new English language Scottish channel would have to be thought about quite carefully.

**Q48 Lord Hastings of Scarisbrick:** If I can take you back to the Channel 4 dilemma, there is a sense in your comments in your article of, in a way, “Nothing to do with us”—kind of “Go away Channel 4”. If you were both, yourself Mark and Caroline, back at Channel 4 now, knowing what you know about it, what argument would you be making?

**Mr Thompson:** I would ask Caroline to answer that first. In a way, because I am the last Chief Executive, I feel slightly constrained from this. My views were very clear when I was Chief Executive. The direction of my views has not changed in the slightest. It was my view that the issue of scale of Channel 4 and the issue of how you migrate Channel 4 from being an analogue UK broadcaster into a multimedia, multiplatform digital player, with access to international markets as well as domestic markets, are critical issues. Those are the issues which need to be addressed. I believed that passionately while I was there and I continue to believe directionally that that is the case, but I just do not think it is appropriate for me and I have not formulated precise alternative plans because I have my hands full where I currently operate.

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**Q49 Lord Hastings of Scarisbrick:** Does Caroline have a view?

**Ms Thomson:** Perhaps I am allowed to. One hesitates to go in there but I think that the model for Channel 4 is probably something along the mix of total clarity about how it is running its current operations, which bits are intended to be commercial and really making money to support the public service bits, and how you construct that and formulate that making sure that there is total rigour on efficiencies and self help, including questions about whether they are right to continue to be based in Central London. I would start off with that basis, to be honest. I think it is a source of some regret at the BBC that Channel 4 chose to say there was nothing much in our partnership proposals while we were still doing the press conference launching them, to be honest. I would have hoped that we would have had a more constructive debate around that because I think working out Channel 4's digital future is key to making it work. None of this is to say that it is easy. I think the Channel 4 problems are very tough and very significant. I can understand why there has been a struggle with it. But I would look at a mix of that. As long ago as I was in Channel 4 as the Director of Corporate Affairs, so that was a long time ago, we had a model which showed that Channel 4 was possibly sub-sized and was going to have a problem surviving, so, having done those things, I would then look at whether more was needed by way of consolidation.

**Mr Thompson:** It is also worth adding—and Claire Enders came up with the report on this topic over the Christmas period—that in many ways Channel 4 is in the financially strongest position currently of the other PSBs, with the best part of £200 million in the bank—which position the BBC would quite like to have, by the way—a £250 million unused debt facility. In terms of weathering the next couple of years, in many ways Channel 4, although we would accept these serious long-term structural questions, is very well placed and probably best placed of PSBs to weather the next couple of years.

**Q50 Lord Inglewood:** Doing nothing is not an option for public service broadcasting in this country. Something has to change.

**Mr Thompson:** Yes. I believe that is right. The BBC, in its own services but also in its partnership proposals, recognises that. If these partnership proposals go ahead—and I believe it is certain now that at least one, the IPTV proposal, will go ahead—it is very likely that others will go ahead as well. Some of these proposals are transformational. The IPTV joint venture with ITV and British Telecom is potentially transformational of the viewing of television in every household in the country. We absolutely recognise the fundamental way in which media is changing and the challenge but also the

opportunity that represents for all the public service broadcasters.

**Q51 Lord Inglewood:** It is rather like *The Leopard*: for things to remain the same things must change. Is that correct?

**Mr Thompson:** Just so.

**Q52 Baroness Howe of Idlicote:** What you have been saying is very helpful in guiding us in the thinking that is going on and putting it all in context when we get to Ofcom's proposals. I have a query. I quite understand why you do not want to damage the market—and that seems to me quite an important stance to take—but why, for example, let us take Jam, which is something I was particularly disappointed you decided to remove, with all the expertise there is in helping the younger generation and the older generation to re-equip and to retrain why is that not something that could work with BBC Worldwide and with other organisations, to produce the best possible answer, and, indeed, no doubt to have a commercial value too? It would seem to me that that is something that you could have worked on, instead of, it seems to me, giving up entirely on the Jam thing.

**Mr Thompson:** It is worth saying two things. One, we still hope to be able to use some of the Jam material, especially those based, for example, in other indigenous languages in the UK, and get that out to children to use. Second, we are coming forward to the BBC Trust with fresh proposals in the area of multi-media formal learning to the BBC Trust. The educational mission of the BBC is very important and it is very important we pursue it and also look at what its future is. I believe it is absolutely the BBC Trust's view but it is my view as well that the issue of market impact is something the BBC has to take far more seriously than it did in the past. Clearly there is a balance to be struck. The BBC can potentially add a great deal of public value by what it does, socially, culturally, educationally and so forth; it can also sometimes build markets; it can involve positive market impact by driving the take-up of new services and so forth; but a balance has to be struck. Constitutionally, one of the things that the BBC Trust is set up to do with Ofcom is to strike that balance. Sometimes when they have done the analysis and the consultation, the equation will come out and they will believe that, despite potentially some risks, and possibly with some mitigations and conditions in place, a service like the iPlayer should go ahead and be launched. It also turns out they will sometimes—BBC Local is an example of this—decide that on balance, although they can see potential merits in the proposal, they believe that the total equation means that the merits do not outweigh the demerits and the service should not go ahead. I would hope that over time this will build confidence in a properly managed boundary

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which maximises the public value the BBC can deliver and allows the BBC to evolve and develop but also gives comfort to other media players that the BBC will not be a kind of unpredictable elephant where you may accidentally get sat upon without anyone noticing.

**Q53 Baroness McIntosh of Hudnall:** I am still puzzling about the relationship between the BBC and other providers. We seem to be looking at the BBC, for good reasons, wanting to keep the plurality going. Ofcom obviously supports that. The other providers are, on the whole, recognising that public service broadcasting is decreasingly easy for them to deliver, both in terms of the economics of it and all the rest of it. What is being presented in this discussion is the notion that somehow there is a win-win solution to all of this and everybody who is in the business of providing public service broadcasting can do well in the new world that is coming. But I still do not quite see what the model is that leaves the BBC with everything that it wishes to continue to do and allows all the other broadcasters to remain commercially viable and contribute to the public service environment willingly. At the moment I cannot quite see they are entirely keen to do that.

**Mr Thompson:** Perhaps I could take a kind of microcosmic example. If the BBC has brought a satellite truck outside of a town hall so that it can beam back pictures of a reporter with an interviewee, for some story on the BBC's regional 6.30 pm programme which is beamed out of Plymouth to the rest of South

West England, the idea that when our chap has finished doing his report and interview he should hand the microphone to the woman from ITV to do her interview and report, to be honest—although there are some operational questions—is essentially no skin off the nose of the BBC and nor is it in any way going to diminish, in my view, the quality of the BBC's output. But it might potentially transform the economics if you add that, and add the studio, and add other factors, of somebody else being able to provide a 6.30 pm news programme for which, although the facilities may be the same, the editorial content and direction can be quite different. To me, it is applied common sense actually.

**Q54 Chairman:** There is going to be a revolution in the views of some journalists.

**Mr Thompson:** As it happens, the BBC has a long and deep history of partnership which we do not often talk about. In technology, many of the technologies on which you all rely—PAL television, Nicam stereo sound, Ceefax—developed by the BBC and then offered freely to the entire industry. So there is a heritage of doing this. The idea that the BBC's scale gives it an obligation to help and support other broadcasters is not a new idea, but you are right, of course—and the reason a lot is going to change—is that this is culturally an absolute step change for us.

**Chairman:** I am going to draw it to an end because we are half-an-hour over. We are very, very grateful for the way, Mr Thompson, you and your colleagues have answered questions. There is a lot in there. Thank you very much indeed.

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 WEDNESDAY 21 JANUARY 2009
 

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Present	Corbett of Castle Vale, L Eccles of Moulton, B Fowler, L (Chairman) Hastings of Scarisbrick, L Howe of Idlicote, B King of Bridgwater, L	Macdonald of Tradeston, L Manchester, Bp Maxton, L McIntosh of Hudnall, B Scott of Needham Market, B
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**Examination of Witnesses**

Witnesses: MR ANDY DUNCAN, Chief Executive, and MS ANNE BULFORD, Group Finance Director, Channel 4, examined.

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**Q55 Chairman:** Welcome. You could not have come on a more appropriate day. The forward planning of this Committee is impeccable! Over the last few weeks, you could hardly open a newspaper without an article on the future of Channel 4 and of course this morning Ofcom put forward, if not solutions, options as far as the future is concerned. We will come in a moment to why these different options are necessary but I wonder if, for the record, you could tell us first what your preferred option is.

**Mr Duncan:** Yes, definitely. We are very encouraged by the very clear conclusion of the Ofcom report that first of all that the public want public service plurality, about which we have been arguing for some years now as this Committee knows, and secondly, in order to ensure delivery of that, you do need a second strong public service organisation with that ultimate objective. It is quite clear that commercially driven organisations for profit are increasingly doing less and less and I think that further decisions about ITV and Five today further confirm that. We are very pleased with that. I think that the preferred option Ofcom have put forward is very much what we have been arguing for. We have the idea of having a proper structural solution—Channel 4 at its heart—potentially giving you a stronger/bigger organisation that has the scale to compete in the interesting world we are heading into and increasingly a global world that we are heading into. Our very specific preference is to really build the potential partnership with BBC Worldwide. We think that there is very significant synergy around extra value that can be created by the two organisations working more closely together and for some time we have been working up that idea and indeed we were even involved in discussion with the BBC. We think that there is a very clear opportunity where the incentives of the two organisations are very aligned—ultimately both Channel 4 and BBC Worldwide try to maximise commercial income to then invest back in content for the public and that is in itself very good—and there is a strategic logic to that partnership. If we look at some of the criteria which Ofcom have laid down, the combination of brands,

channels and distribution is actually very powerful and can create extra value. So, that sort of strategic solution to a strategic problem and, very specifically, that is where we have a great deal of enthusiasm.

**Q56 Chairman:** I see in one of the numerous newspapers that I have that one of the BBC men describe that as the “Frankenstein merger” which does not indicate that it is going to be necessarily taken very kindly within the BBC.

**Mr Duncan:** I do not think you should believe everything you read in the newspapers because there has been a great deal of speculation and different points of view put forward by all sorts of people. The facts of the matter are that the BBC themselves have proposed a partnership around Worldwide. This was first mooted last summer and we had an initial project then really looking at a series of loose projects and that in itself definitely generates some synergy, and I think there was a figure at its peak of something like £40 million that it was believed could be generated from that and then that was somewhat scaled down in terms of the economic environment we are now in. What we are now engaged in is very constructive discussions around a much bigger partnership, more of a structural partnership, where you can really unlock bigger synergies and the sorts of prize that is available in terms of economic benefit and public benefit is actually much greater. That is in its early stages and, over the coming weeks, it is going to be very important to see just how much money might be available.

**Q57 Chairman:** We interviewed Mark Thompson of the BBC last week. You have referred to “very constructive discussions” but it was not entirely my overwhelming impression from that that they were going that way.

**Mr Duncan:** I think it is fair to say that we are at the more enthusiastic end of the spectrum in terms of what could be achieved and I think they are at frankly the more cautious end of the spectrum in terms of what could be achieved. We have agreed a scoping

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exercise in terms of what should be looked at, but we have yet to fully flesh out what sort of numbers might be there. Our own very clear view is that to unlock the synergy that could be achieved, you have to do something quite significant in terms of partnership and you have to actually have something that structurally gives you a real chance to get more money in revenue and in cost benefits.

**Q58 Chairman:** If you were the Chief Executive of the BBC and you had built up this organisation, would you actually be enthusiastic about it going away, given that it makes some contribution to keeping the licence fee down?

**Mr Duncan:** It is not a question of it going away. The key point is about what extra value can be generated. The key to our idea is, can you generate genuine additional money through those two publicly-owned organisations collaborating and working more effectively together to grow the total pie which in turn can help be reinvested in content? That is our idea. Our idea is not that the BBC transfer value or somehow lose value from the licence fee payer, quite the opposite. To put it into some sort of context—sometimes in terms of the press point you referred to, one gets straight into the detail of the nitty-gritty of vested interests—if you take a step back, what we have going on—and I made a speech last week where I tried to make this case more broadly—is a very big issue around content investment in Britain as I think this Committee well understands, but essentially it is funded from two pots of money. You have the licence fee pot of money which is now £3.5 billion and has never been relatively bigger compared to commercial investment and, for the first time ever now, it is more than the total TV advertising market in this country. The BBC did a great job with that and I think everyone is in agreement that the BBC should be there as the cornerstone of the system. You then have the TV advertising pot and, at its peak, that was also £3.5 billion; it is now down to less than £3 billion this year—and in fact some people think that it might decline as much as 10 per cent this year on top of six per cent decline last year—and the majority of that money has historically been re-invested back into TV content but, as it is going down so fast, that is putting massive pressure on the system. The two other pots of money that we have in the system do not really get spent on high-quality TV content. So, you have internet advertising which has gone from nowhere 10 years ago to some £3 billion today and the vast majority of that goes back to the American online companies—it flows out of the country and goes to the companies directly or indeed the banks that own them—and hardly any, really very, very little indeed, gets spent on content or even services in this country. Then you have the subscription money which is a big pot of money, over £4 billion, mainly going to Sky and

to Virgin, and most of that gets spent on technology, platform development, sports rights, film rights and indeed profits, and the entire multi-channel system in this country invests a very modest sum indeed, a couple of hundred million, in original programme investment excluding sport and film. So, the structural problem that we have is that if we want high-quality broadcasting in this country and we do not want just to rely on the BBC, we want plurality, it is not going to come from ITV and Five—and they are going to do a bit for the next few years and it is debatable whether they will do anything post-2014—and so this notion of a second strong public organisation that can be the source of that plurality is crucial, and our argument is, can we and the BBC work more effectively together to generate substantially more money which in turns flows back into content?

**Q59 Chairman:** We have your speech which is I think good and incidentally is something we will want to talk to you about on a later inquiry we are doing. Before I bring my colleagues in, let me ask you about the other option which is mentioned and that is the merger between Channel 4 and Channel 5. Why do you not support that?

**Mr Duncan:** If you take the criteria of the Ofcom document, I think that we have two concerns about the strategic logic. Firstly, the misalignment of incentives which I think is a very important point. One of the reasons the original notion of tying up with Channels 4 and 5 five years ago was rejected was that we could never resolve the fact that one organisation is trying to maximise profit for its shareholder and the other organisation is trying to maximise income to re-invest back in content for the benefit of the public. Operationally, that kind of oil and water of what those two organisations were trying to achieve is really difficult to synthesise. That is one point and Ofcom have certainly made that point in their report. The second is that the strategic logic is questionable as well. The whole problem is the pressure on the TV advertising market. So, the idea that by putting two organisations wholly dependent on TV advertising together solves the problem of the TV advertising market does not work and in fact some of the things that Ofcom have said in their document about diversification of income, actually having more of an organisation that is future facing in terms of where the world is headed in terms of digital and the strategic combination of brands and channels around Worldwide for example makes much more sense. The other thing is that some of the figures quoted in the newspapers and so on are wildly inaccurate. The absolute scale of opportunity around Five is quite modest. For example, we have just gone through a very significant cost-cutting exercise and around one third of the staff has gone over the last six months.

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Acquisitions, which is one of the areas first mooted as significant synergy years ago, we have now pulled out of quite significantly. Five will certainly be under very severe pressure this year, very severe pressure indeed, and they are likely to lose a big chunk of income through market decline and also share decline, so any kind of financial problems they have thrown into the mix with us could exacerbate the problem. I think that consolidation may have a role to play further down the line, but you have to get the structural solution in place first has been our argument.

**Q60 Chairman:** Would both the models we have talked about require legislation?

**Mr Duncan:** In the case of both, it depends heavily on how you did it. Obviously, the more structural a partnership would be with Worldwide, it may require certain legislation, and, similarly with Five, there might be legislative or competition issues in both cases, but it heavily depends on what nature of deal or partnership might be achieved.

**Q61 Chairman:** Just to sum up on where we are at the moment, you would like a merger with BBC Worldwide but, to be frank, the BBC are going to fight you on this one, and Channel 5 would like a merger with you but you will fight them on that one. That seems to be the position as we hear it this morning.

**Mr Duncan:** I would say it is slightly more nuanced than that! Regarding Five, there may or may not be consolidation further down the line. It is not a whole answer and it cannot be seen as the major structural way in which you achieve a second strong public service organisation to compete with the BBC. On the BBC conversation—and this is where I think some of the BBC opposition has come from—some people have characterised this idea as almost an equivalent of taking money from them, top slicing by the back door as I think some people called it. If it is simply profits being generated by Worldwide flowing in our direction instead of giving us a share of the licence fee for argument's sake, you can see why some people might be pretty opposed to that. What we have been trying to engage the BBC in is a much bigger idea which is to say, let us take a step back, let us not think about just the BBC world, let us think about the whole of digital Britain in the future. Can we, as the two publicly-owned organisations, really collaborate in a much bigger way than they have been previously thinking about and generate extra value? For example, I think that Worldwide is quite constrained in what it can do. It is constrained in capital—it does not have enough money—it is constrained politically—I think there are a number of things that it cannot do in the UK because the BBC is worried about what impacts it might have on the BBC's public service brand and the perceptions of the BBC—and it

is to some extent limited in terms of flow of IP. Equally, we are somewhat constrained in terms of what we can do. You can get the two organisations working together. We think that you can actually unlock some of those constraints and generate more money both within the UK and importantly from outside the UK, and it comes back to our argument that, if you can get the total pot bigger, that is a much better way of solving the problem than simply dividing up an inadequate pot. What we would like to see is the BBC engaged in those conversations with that bigger prize in mind and, back to your point, I think it is not yet clear. I am hoping that, over the coming weeks, they will seriously engage in that in a very proper way. The sort of scale and ambition thus far that we have had in the conversations has not been big enough. I am encouraged by the meeting we had with them for example earlier this week where it felt like there was a much bigger ambition entering into the conversation than we had had even since they spoke to you last week.

**Chairman:** Well, we will leave aside the nuances!

**Q62 Lord King of Bridgwater:** I would like to pursue this point. Presumably, the situation at the moment is that the BBC determine quite often what programmes they may back partly in the expectation of what sort of income it might bring into BBC Worldwide later for themselves. As I understand it under the merger, if there were one, they would be handing over the marketing responsibility of Worldwide to a Channel 4 operation, if it were a Channel 4 one, in which the resources and the funds generated would go to Channel 4 because the purpose of this exercise is that you certainly would appear to need substantial extra funds and, if your advertising budgets are anticipating some of the problems that may be emerging in the world, you may need much bigger funds than you presently are talking about. I found that rather difficult. Also, the second point to which you have just referred is that the BBC is somehow a little constrained about whether it is looking a little too commercial—and this may or may not be relevant—and whether it has too much power, and so there will be attempts to play down the BBC brand and it will become what, a sort of Channel 4 Worldwide selling BBC products?

**Mr Duncan:** No. First of all, I think that there are clearly a number of ways in which one could structure a partnership and I genuinely would say that we have an open mind in terms of the best way to optimise the partnership of both organisations. I think that people are jumping too quickly to “it will have to be done this way” or “it will have to be done that way”. Very specifically, if you took how it works at the moment, BBC Worldwide invest in BBC content in two ways. They directly invest in the programming, so quite a chunk of the value they put into the BBC is effective

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co-production money to top up commissioning budgets from within the BBC and, in addition, they then generate profits themselves from the rights they have secured, whether that is through DVD business or their UKTV JV or their international ventures for example, and then a dividend flows back to the BBC as well. With regards to areas of synergy, which they agree absolutely exist by the way, if you were to say that we could cross-promote some of things that they are not currently able to cross-promote . . . For example, they cannot cross-promote their DVD business; any of the DVDs for the BBC cannot be cross-promoted on BBC air time; it is not the public service part of the BBC. We have a very strong ad sales capability; we have grown our share of the advertising market from 20 to 24 per cent in the last five years and have a very formidable sales outfit. Again, those sorts of capabilities are created. Trail making—and I do not mean branding it for Channel 4, I mean making the marketing trail—which again will be of value for them. We are not proposing that for example we would promote the BBC in terms of BBC branded services because the way in which it works at the moment is that they have BBC public service which they promote themselves on the BBC public service channels and everything else they do not exploit under the BBC brand. So, UKTV quite specifically is not branded BBC. I think that the branding and marketing communication issues are relatively easy to resolve. It is all about whether you are creating more value in the system rather than seen to be transferring value. I think that we are in agreement that there is synergy there. What there is potential disagreement about is how good that synergy might be. There is no disagreement that there is synergy there and the more we really try to work together . . . I believe that if there is the right spirit of trying to really maximise what that opportunity could be, the prize is a very big one in terms of the absolute scale of money, which means that the BBC would not lose out in terms of what they are getting back in terms of money into content. If you can reach a point where they have not lost out and more value has been created which solves our ability to invest in content, I think that is a very good outcome.

**Q63 Lord King of Bridgwater:** Do you think that you have made progress because certainly when Mark Thompson was here last week, it was just seen as an alternative top slicing; it was just another way of taking money out of the BBC?

**Mr Duncan:** It got off to an unhelpful start because I think that was the perception. I think that it has been slow progress and that is back to what I said earlier on. I think that it has taken a long time to get not very far. For this to be a serious answer to the question, “how do you achieve a second strong public service organisation?”, I think that the BBC and us need to be

able to think big and really think about how we are going to try to maximise the synergy. I would say that the current rate of progress is not sufficiently fast, so it needs to be accelerated and be made bigger in its thinking, but the core principle of creating a value in a way that the BBC does not lose out from and creating significant extra value which helps this second strong organisation I think is a really, really worthwhile prize.

**Q64 Baroness McIntosh of Hudnall:** May I press you a little on the content issue because what you are talking about here is an arrangement which would protect the distinctiveness of two different kinds of public service broadcasting, the BBC on the one hand and Channel 4 on the other. Is that right?

**Mr Duncan:** Yes, that is right.

**Q65 Baroness McIntosh of Hudnall:** However, you are talking about quite a complicated partnership arrangement in order to, as you put it, create more value in order to generate funds to go back into content provision. If I am an end user five/10 years down the line and this arrangement which you have envisaged is in place, what could I expect to see by way of benefit in terms of a genuine (a) increase in high-value programming and (b) distinctiveness in programming as between Channel 4 and the BBC? Is there any danger in the arrangement about which you are talking that in some way the distinctiveness would be lost because there would have to be some element of cooperation in how the content is generated and by whom?

**Mr Duncan:** I think that you are putting forward a very important issue. The whole point of these discussions is in order to ensure that we keep plurality and in particular keep that alternative point of view, that distinctive tone, that plurality in the system, and, if it ended up with Channel 4 or the alternative organisation’s output being more similar to the BBC, that is not what we are trying to achieve here. I have to say that I do not think there is any real danger of that because effectively the commissioning decision making would not be in any way, shape or form working together or overlapping here. If we think about what happens at the moment, you have commissioning decision making made within BBC public service at arm’s length to Worldwide. So, the commissioners decide what is best for BBC 1 or BBC 2 or BBC 3 for example, make those decisions, Worldwide may or may not invest in those programmes at the time of commissioning or subsequently in securing the rights to exploit, but they do not have any input or say in the commissioning decision. Similarly, if you had works at Channel 4 at the moment, although it is all a hybrid within the one organisation, the same point applies: we have commissioning editors who are commissioning the

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content and we have other people who are selling the advertising or who are actually promoting the DVDs or the consumer products. So, what you would basically be saying here is, can you optimise the commercialisation of the content, get more money in total back in? Obviously there is a straightforward point to make sure that the value flows back fairly to the two organisations, but then they would continue to invest in the very distinctively different content they had to buy.

**Q66 Baroness McIntosh of Hudnall:** I see the point you are making and, in an ideal world, I can see that that is how it would be. However, a cynic might wonder whether for example even now the content of BBC programming is indeed influenced—I do not know whether it is but it could be—by the fact that some programming requires investment from BBC Worldwide which, as you describe it, has autonomy about whether or not it invests in BBC programming. If you inflate that kind of situation up into a world that you are now envisaging, the potential for the bit of the partnership that actually has funds to invest to influence the way that programming is developed, no matter how carefully the separation is maintained between commissioning and the exploitation of what is produced, there is surely some danger of influence being brought to bear.

**Mr Duncan:** I think it would be very important to make sure that that did not happen.

**Q67 Baroness McIntosh of Hudnall:** How do you prevent it happening?

**Mr Duncan:** Anne Bulford may want to contribute having also worked in both organisations but, from my time at the BBC and my time at Channel 4, both organisations guard very precious indeed their editorial distinctiveness and independence and the dominant driving influence in terms of BBC commissioning decisions is, what is the right programme for the audience for those BBC channels? And similarly Channel 4. I would say that even at times when you could argue it goes against our interests, there is not an attempt to say, which clearly does happen in commercially-driven organisations, “Let us not do the best programme here for the public or the best creative idea or the most interesting thing editorially. Let us do something that is going to be rather more populist and is going to earn more money”. That simply does not apply in the commissioning decision-making culture of either organisation. I think that there are very, very clear values, really clear values, as to what sort of content works well on Channel 4 and what sort of content works well on the BBC. I understand the point you are making, but I genuinely think that it is not a significant danger providing that you keep safeguards in place. For example, you make sure that there are Chinese

walls, which is effectively how it works at the moment, between the decision making and the commissioning and the commercialisation of that content.

**Ms Bulford:** I think that the Ofcom report is helpful in identifying that at heart both organisations have completely aligned objectives in that both of them are maximising profit for re-investment in content and that is exactly the culture, the DNA, at Channel 4, and I think that the objective would be of course to have processes in place to protect any Chinese walls but at heart the culture would be aligned and the job of the organisation is to provide and develop distinctive and innovative and new content and you have to maximise the commercial return that you can get out of that as a second step. This is a conflict and a balance that Channel 4 has successfully managed over its 25/26 years of existence in terms of that reliance on commercial return to fund that distinctive commercial content. We do that; it is part of our day-to-day job already. It is not always straightforward but I think that Andy is completely correct: providing that the objective of the organisation from everybody in ad sales through to the senior people in commissioning is clear that that is what we are seeking to do, it works very well.

**Q68 Lord Hastings of Scarisbrick:** You seem to have tied your wagon absolutely to the partnership plan of BBC Worldwide, and the BBC last week said that it is worth up to about £50 million a year at the top. Your funding gap is considerably bigger than that. I have two questions. First of all, does that mean that you think that the BBC is hiding something and that there is a lot more that you can get out of it and what would it be? Secondly, does that absolutely mean that you have completely and forever given up on the licence fee as being any source of funding at all to Channel 4 and it will never surface again?

**Mr Duncan:** We believe that the licence fee could still be an option and, whether the potential is a full option or part option, I think that it is clearly there on the table in the Ofcom report. I think that the way they have thought about it not in terms of the bit of the licence fee that is funding service and content for the BBC but the part that is currently being used for switchover, it is clearly a valid option and potentially an important option still. The fact that we know already that the switchover money is very likely to be significantly under spent pre-2012 on the take-up of the extra box scheme and the potential to keep that going post-2012 we think remains a very interesting option and we have actually said today that we believe some of the issues around how that would work from the concerns about creating independence, editorial independence and governance and accountability are important issues but could all be resolved. What we have also said is that the reason why the Worldwide

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route is the preferred route is that it is creating more money in terms of more money in the system. So, to pick up your point about the £50 million, I think that that is cautious and I think that is based on the previous work which was just on loose partnerships sort of scaled up a bit. If we are more radical in thinking about how we could maximise synergy, there is more to go for. Just to give an example, we have certainly talked to the BBC saying, from our point of view, we are up for discussing everything as long as we can protect the public service delivery of what we do as Channel 4. For example, we have built very profitable businesses with our digital channels; they made a good sum of money last year. We have some very strong brands: E4 for example is a very strong brand with young audiences; More 4 has done very well; 4 Music is the biggest music channel; Film 4, we are hoping, fingers crossed, for some Oscar nominations tomorrow—*Slumdog Millionaire* is a fantastic success. If we are actually prepared, which we are, to throw those things in the mix and ask, “What sort of synergy exists around film and music and using our brands and our connection with younger audiences and the digital channel potential” and be more radical—whereas previously when we had the conversation with them, it was much more at the level of, we have a bit of the DVD business, they have a bit of the DVD business, if we pool resources, can we create a bit more money, and obviously Kangaroo, the video-on-demand project, is well documented—and say, “Hang on, let us think much bigger about this in a more strategic way”, if we think that way, we think that the prize could be a great deal bigger.

**Q69 Lord Hastings of Scarisbrick:** Going back to the licence fee point, two assumptions are built into that: the amount of money that is in the reserve and not spent will be sufficient enough of value for you to have it, but it also implies that you would need it in perpetuity because that fund will run out once digital switchover has happened. Essentially, you are implying that you would become a long-term licence fee supplementary funded organisation.

**Mr Duncan:** What I think is really worth exploring is, can we get enough synergy for it to be a fully-sustained solution and we believe that that is possible. You need to get the transition to get there. You are not going to get there overnight but, if you could get there over a period of three or four years, that is a really exciting place to potentially get to. For example, collaborating in new areas like online is an obvious pairing where there might be new revenue that currently neither organisation is particularly optimising. Whether we will be able to get the whole way there or not is clearly the next thing we should be focusing on. To the extent that we did not or could not, then you either have to use another source of

revenue to fully deliver the public service ambition I think Ofcom are suggesting the public want, or you would have to accept that we are not able to provide that plurality as powerfully as we would like.

**Q70 Chairman:** Following up on what Lord Hastings was saying, you have not given up so far as the licence fee is concerned but have you given up as far as the merger with Channel 5 is concerned? Is that completely off the table?

**Mr Duncan:** The report came out this morning and it is 130 pages.

**Q71 Chairman:** Come on, it is not exactly news to you, is it?

**Mr Duncan:** No, it is not.

**Q72 Chairman:** It has been in every newspaper for the last month.

**Mr Duncan:** I think that we will have to have a proper look at what Ofcom have said. I have given you some initial views about the criteria they have suggested. It is hard to see how it could be a whole answer. Even if you park the misalignment of objectives issue and even if you park the rather inconvenient point about the fact that it is not a strategic solution anyway, just on the financial numbers, it is hard to see it as a complete answer. Our worry is that it is a distraction. Our worry is that somehow it takes a lot of the airtime and occupies a lot of the energy just when we need to be focusing on what really could be a very exciting way through this. As I said earlier on, there may be a role for consolidation further down the line more generally, but you have to have a structural solution in place in the first place.

**Q73 Chairman:** It sounds to me as though you are saying it is off the table.

**Mr Duncan:** We are trying very carefully not to rule anything being firmly in or out yet. I think we were right to make some of the points in the press. We effectively had the Chief Executives of two alternative organisations, the BBC and RTL, proposing a solution regarding our future and we thought that it was quite important that we needed to provide perspective in that. Being very blunt about it, I think it would be foolish of us to rule things out before the Government have ruled things out, so we have to in a sense be talking to them and seeing what comes through in their *Digital Britain* report. We have a very strong and very clear preference.

**Q74 Chairman:** Why do you think Channel 5 are so enthusiastic?

**Mr Duncan:** I think they are so enthusiastic because they are under enormous pressure. The reality is that Five is struggling this year. For example, they faced the market decline of some 10 per cent—it could be 10

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per cent but we do not know that; it might be better or it might be worse but there is clearly going to be a decline this year—and we think that they are the biggest loser in this year's advertising sales negotiations. So, potentially they are going to lose quite a significant chunk of their share of the market, possibly equivalent to the market loss as well. They are faced with very severe top line revenue pressure as things are. In our case, we are a much more robust organisation. We have spent a lot more on content, we have a strong brand and we have grown our share of the market. What we are currently doing, which is disappointing, is that, when not enough money is coming in, we are having to cut back programmes, but we are able to manage the organisation to break even, which is our objective. I think the problem Five face this year is very tough and I think that they could be heading into significant losses.

**Q75 Chairman:** So, they want to lean on you and you want to actually support them.

**Mr Duncan:** We have to be very careful that we do not end up with the situation that makes the problem bigger rather than solves the problem.

**Q76 Lord Maxton:** My whole problem with this area is the fact that of course, in three years' time, everybody in this country will have access to at least 50 channels. That means they will have access to what I would term public service broadcasting: four news channels, sports news channel, history channels and all the rest of it. Even if they do not subscribe to Sky or to Virgin, they will still have that. Why do we continue this debate on public service broadcasting about five channels?

**Mr Duncan:** To be fair, the majority of people today have access to 30 or 40 channels.

**Q77 Lord Maxton:** Yes, they do.

**Mr Duncan:** What you are describing is already currently reality for nine out of 10 homes. Ofcom have just been through a very rigorous thorough two-year process and massive consultation and a big part of that is discussion with the public. What has come through very strongly in their research—and I have to say that we found it equally strongly in our research and the *Next on 4* document we published in spring last year for example had a lot of this in it—is that very, very clearly the public value, the sorts of content that the market is not providing. So, they absolutely value high-quality news. I agree with you that there is more than one source for that. We still do one full hour and we go into depth on international issues and even some of the national issues in more depth than you can do in half an hour or you can do in a rolling news bulletin for example. Current affairs: we do one hour of current affairs every week—*Dispatches*. BBC only do half an hour now—*Panorama*. No one else does current

affairs to speak of really in a serious way. We do *Unreported World*, our foreign affairs strand, for half a year. Again, there is not another programme like that on television. Investment in comedy, investment in new talent and investment in drama. Film I have already spoken about. There are a number of areas. We still do a huge amount in peak of science, religion and art. We have a big series at the moment on Sunday nights—eight programmes in peak—about Christianity. It is a fantastic series rather brilliantly showing different perspectives around the world on Christianity: the Jewish perspective, the Islamic perspective, an Atheist perspective, a Christian perspective. You just do not find that on multi-channel or on commercial broadcasting. Look at the evidence. The evidence is that ITV have had 20 years of consolidation and we are effectively now ending up with ITV doing news and regional news and that is it. There will be nothing over and above that that the market does not incentivise them to make. We have had 20 years now of Virgin and Sky and building up multi-channel both in satellite and cable. They invest virtually nothing in the sort of high-quality programming I am talking about. They invest in sport and film and whatever commercially is in their interest. I think that the public could not have been clearer. They do not want only the BBC providing that. They really want a second strong source for that and that will only come if you have an organisation that has those public incentives and has an objective to achieve that. It not something Sky or ITV will do because you cannot earn money out of it.

**Q78 Lord Maxton:** You have how many channels—I can never remember—on the digital channels?

**Mr Duncan:** Five.

**Q79 Lord Maxton:** Do you consider them as part of your public service broadcasting commitment?

**Mr Duncan:** It is a very good point. If you take the legislation as it is currently laid down, it is rather out of date.

**Q80 Lord Maxton:** Not rather, very.

**Mr Duncan:** What it basically says is core Channel 4 is the way we deliver our public service and all the other channels and online is not. Already that is slightly artificial. For example, in the video-on-demand world, if somebody accesses a public service programme online rather than through the linear channel, does it make it less publicly valuable than it was online? It is daft. For example, education. We have very successfully moved our entire education spend online because, not surprisingly, we were running TV programmes in the morning when the target market was at school. We have now put it online and we have had much more success in getting to that target group. More 4 is a good example. We have a

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news programme on More 4; we have documentaries; it is an import but we have *The Daily Show* from Jon Stewart; we have had some original, very innovative, award-winning programme on E4, *Skins*.

**Q81 Lord Maxton:** Do you make programmes specifically for your digital channels?

**Mr Duncan:** We do and one of the tricky nuances in this whole debate is, if and when there is a change in legislation, does the legislation need to reflect the fact that we deliver our public service content through more than one channel or indeed more than one platform? I think that Ofcom very clearly today are saying that that is what the public want, they want to get their public service content through a range of channels and platforms, and we have been moving in that direction. At some point, I guess that the legislation will catch up with that.

**Q82 Baroness Howe of Idlicote:** Your answer to the question I want to ask will be very interesting. We have just come from an all-party media breakfast and one of the questions asked there of Ed Richards was in fact what is public service broadcasting. I can see the range that you have been describing here, but he did not seem very inclined to want to define, at that stage anyhow, what was public service broadcasting and how that differs given that there are a number of programmes now being covered by commercial broadcasters. Perhaps you could give us an indication of how we would recognise this very special animal. Quite clearly, the public knows it when it sees it and it has clearly shown that by the value it places on what we have in this country and which I have not seen when I have travelled abroad in other countries. Perhaps you can help.

**Mr Duncan:** If you take Ofcom—and maybe Ed did not answer it this morning—they laid out a good framework a couple of years ago and they said that the best way of defining public service broadcasting is through its purposes and its characteristics. They came up with four purposes: informing understanding of the world, stimulating knowledge and learning, reflecting the UK cultural identity and representing diversity and alternative viewpoints. The characteristics they spoke about are high quality, original, innovative, challenging, engaging and widely available, which really means universally available and you do not have to pay really. We in *Next on 4* laid out a much more specific framework that we felt was our unique contribution. For example, it did have alternative viewpoints and reflecting diversity and different perspectives which Channel 4 has always been extremely strong on and the key source of our plurality—back to the earlier point—of the BBC is that different perspective on the world that we will bring you. Another purpose that we think Channel 4 has always been very strong on—and it was part of

innovative experimental remit—is championing new talent. Very interestingly, whether it is the likes of Ricky Gervais and, although I know he is now very controversial, Jonathan Ross or Graham Norton. There is a history of entertainment names that come through from Channel 4. A huge number of film talent, both onscreen and behind the screen, has come through Film 4 for example and there are many other examples of people who have gone on to very successful careers who had their first break through Channel 4 or Film 4. So, championing talent and giving new people a chance. Just to give you an example, we still have *3 Minute Wonder* on every night and we have *Comedy Lab* in terms of comedy week and we have quite a number of spots in our schedule where talent gets a chance to be tried out and have its first break. That is at the conceptual level and, if you want more practical examples, the fact that we have an eight-part series on Christianity and the fact that we have very strong series on science or on the arts, the fact that we put so much emphasis on news and current affairs . . . Drama would be a good example. *The Devil's Whore* last autumn was a high-class piece of drama. That will never make money; it is the sort of thing that is disappearing from screens in terms of commercial investment. Some of the one-off dramas that we have had in the last two or three years that have tackled big, important, contemporary issues such as *Mark of Cain* looking at prisoner abuse and we had *Secret Life* looking at the issue of paedophilia and those sort of topical contemporary dramas that have each done very well tackling quite difficult issues. Those are the sorts of things that I think would be pretty against the Ofcom framework or our framework would deliver those purposes and have those sorts of characteristics and they are the very things that you are not getting on the purely-for-profit channels, I would say.

**Q83 Baroness Howe of Idlicote:** From what you are saying, that would include programmes that do not cost a great deal but also those that cost a great deal of money. Where would for example something like *Big Brother* fit into all this?

**Mr Duncan:** I have to say that when *Big Brother* first came along, in my view, it would have ticked the public service box mainly on the criteria of innovative. It was highly innovative and very experimental. It was a bold, exciting idea that no other channel would take. Certainly in its early series, I think it was genuinely innovative television. I think it would be probably wrong to claim now the exemplar of public service broadcasting because it plays a much more commercial role for us now. It is a popular programme; it is a little like *Eastenders* on BBC or *Coronation Street* on ITV; in a sense, it is like our soap. It generates profits for us which we re-invest back into the rest of the schedule. Having said that, I think it is

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only there for 13 weeks of the year in the summer, three weeks in January and two thirds of the year it is not on air at all, but it now plays more of a commercial role.

**Q84 Baroness Howe of Idlicote:** I would like to query that. Given that public service broadcasting has to cover all tastes, why suddenly does *Big Brother* slip off into the not public service broadcasting in your view?

**Mr Duncan:** My view is that it is a very good programme. It is not to everyone's taste. Some people really enjoy it and are thoroughly big fans of it and it remains their favourite programme. Other people do not like it at all. I think that it has a valid role to play. If you look at the mix of programmes which Channel 4 has always had, we have always had a mix of programmes that have been there generating money to some extent which we can re-invest in other parts of the schedule. Acquisitions is quite a good example of that. If you take the early days of Channel 4, about half the schedule was acquisitions. Some of them were quite innovative, German soap operas and various eclectic things, but some were frankly much more commercial in terms of that they were just a means of earning money which could then help fund the rest of the schedule, and I think that within the kind of mixed schedule that we have, I would not particularly put *Big Brother* forward now, 10 years on, as our best leading example of innovative public service content. I think that it is more of a commercial role that it is playing. I think that it is still a high-quality programme for its audience who enjoy it, if that makes sense.

**Q85 Baroness Scott of Needham Market:** I think that you have probably more or less answered the questions as I was interested in understanding how much you thought the current recession had played a part in where we are now or whether these were just such long-term structural problems with migration of advertising and changes to platform, but I think that you have covered that because you have said that you are looking for structural solutions, so you obviously see this as long term. What effect has the recession had and what are the dangers of making long-term decisions against the background of quite extraordinary and, we hope, short-term economic situations?

**Mr Duncan:** I think that it is predominantly structure. Anne Bulford could give you a perspective as to why we think that is the case and the cyclical downturn has made it worse.

**Ms Bulford:** We have been talking for some years about the structural decline that we face as a result of increased competition for advertising on channels, the increasing emergence of on-demand services and development of the internet. What we have seen

happen as a result of the recession is that structural trend has deepened and consequently we are facing some of the issues that we have been thinking about and trying to plan for in forecasting sooner and deeper than we were anticipating. At Channel 4, because we have set ourselves the task of working to break even until such time as we have a clear agreed future, that has resulted in us having to firstly speed up our efficiency programmes and cut deeper and take a more aggressive approach to driving out cost, and we have been very successful in doing that whilst still running the business. It is a much, much more complex operation than it was in the late 1990s in terms of the numbers of channels that we are running and the complexities of rights deals and the arrangements there are for acquiring windows and all the rest of it, and we run with our head count now, a staff complement, which is less than it was in the late 1990s. Over the last six months or so through a combination of outsourcing and restructuring, we have reduced the staff by about one third. We have also had to look hard at the programme budget and there is no question, going back to the earlier comments, that we have a scale of ambition and work that we would very much like to be putting on, but at the moment we simply cannot afford to do it. What we now have is a background to these decisions which make it very clear that the problems are serious and they are structural and they are here now and I think reinforce the need for urgency in solutions. I think that all of us fear that when we come round to planning—and we are already starting to think about programme budgets particularly for long-form documentaries and dramas 12 months/18 months out—we face similar sorts of very, very difficult decisions and trade-offs around our programme base. We spend much less than five per cent of our total cost base on overheads; it is probably somewhere around three-and-a-half to four per cent in terms of back office operations, financing, IS, HR and all those sorts of things. We spend the vast majority of our money on content distribution and marketing that content to audiences. Consequently, when we face these downturns, it flows straight through to the content budget and we have to make very, very difficult trade-offs between those more commercially successful programmes and those more interesting distinctive programmes that do not necessarily attract the most income but actually are at the core purpose of everything we are doing. That has a very significant multiplier effect out across the UK. We work with something like 300 independent production companies. Some are substantial but the vast majority are still comparatively small start-up businesses and, when we cut back on spend, it starts to affect them very quickly and that has a roll-out impact out across the whole of the UK. We are working very, very hard with our supplier base to mitigate the effects but it is not easy in these difficult circumstances.

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**Q86 Lord King of Bridgwater:** I would like to be very clear about what you said. You have taken one third of your staff out.

**Ms Bulford:** Yes.

**Q87 Lord King of Bridgwater:** Did you say that you have halved your programme budget?

**Ms Bulford:** No. The programme budget for 2009 that we are working to is equivalent probably to around 2002–03 levels. So, we have taken around £50 million out of our budgets.

**Q88 Lord King of Bridgwater:** Fifty million out of how much?

**Mr Duncan:** In total, its gone down by £90 million over two years, so £625 million at its peak in 2007 down to £553 million approximately this year and that is roughly £40 million last year and £50 million this year and counting.

**Q89 Lord King of Bridgwater:** Do you have any measure of how many independent companies have gone?

**Mr Duncan:** I have to say that this is a concern. We work with over 300 independent production companies in any one year and of course it tends to be some of those smaller companies that lose out when you have less money for some of the new talent schemes and the piloting and the early innovative programmes in a way.

**Q90 Chairman:** What do you say to the criticism of Sir Jeremy Isaacs, who was the first Chief Executive of Channel 4, who says that Channel 4 should be spending far less money on things that do not contribute to public service broadcasting?

**Mr Duncan:** I have had many conversations with Jeremy and he is coming into Channel 4 this evening for a memorial lecture. I think that where he and I are very much in agreement is that ultimately Channel 4 should be about its public purposes and public service content and I think that is absolutely crucial and he knows—and I completely agree with him—that that is the most important thing. In the time when Jeremy was running Channel 4, effectively it was a spending organisation. It was given money by ITV in the form of a cheque and Jeremy’s job was to spend that money. So, in a sense, he did not have to worry too much about the commercial issues and of course in reality you only had two commercial channels then: you had ITV and Channel 4 who between them shared the advertising fund. ITV sold the advertising and gave Channel 4 a cheque. The reality is that we are in a very different place now. We have to earn in a much more competitive world—there are many more channels out there—and we have to earn enough money off the free spectrum ourselves to then invest in that programming. I would say what is similar to the time

under Jeremy is the role that acquisitions play. Acquisitions disproportionately played a role in generating income which could then be invested and arguably, for most of our first 20 years, the huge profits made in acquisitions were the single, most important source of money for original British content investment. One of the problems is that acquisitions are nowhere near as profitable as they were; many more channels are out there buying American programming now. I understand the spirit of where Jeremy is coming from, but I have to say that I think he also agrees that we produce an awful lot of distinctive and remarkable programmes now as well. I think that he is quite right to challenge us and keep our feet to the fire in terms of are we still doing as much as we can, but it is a much tougher environment than it was then and it seems to me that this is part of why these discussions are happening now and we have to find a new sustainable model which works in this much more competitive modern world.

**Q91 Bishop of Manchester:** In your reply earlier to Lord King, you were indicating that because of the particular circumstances at the moment, your spending levels were back to, I think you said, 2002. You mentioned a moment ago *Next on 4* which I recall as being a rather energetic document with expansionist ideas, and indeed you have mentioned some of them already which you are clearly still committed to in terms of imaginative programming, and incidentally I have seen what you have broadcast up to now on the programme on Christianity which I think comes over very well indeed. You also referred to the developing digital online media but you did not mention the high definition plans. I would like to hear whether or not you are having to cut back on those plans that almost a year ago now you presented and, if you are not, presumably those then are still included within the estimates about the funding shortfall and, after you have responded to that, perhaps the Finance Director could give some precise figures on that funding shortfall. What I am interested in first is, do you have really to be very constrained over your global plans?

**Mr Duncan:** The short answer is “yes”. The Ofcom document is very strong on this. They are saying, “You have to provide public service content. How and where are audiences wanting to get it?” and they absolutely want to get it online as well as getting it through traditional linear channels. With the relative ambitions that we had and what we think is important to the audience, we have managed to move that forward to some extent. For example, the 4iP *Innovation for the Public* fund which is a big, new online public content fund, has begun. We have a number of partners around the country, in particular in Birmingham, Glasgow and Sheffield and there are some very exciting innovative projects online which

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we think are exactly the sorts of things that we were hoping we would be able to start on a year ago. However, we are somewhat constrained in terms of how much we have been able to put into that compared to what we originally had hoped and that will remain the case for the foreseeable future. Another example was children's. We believe and still believe that we can play a very strong role in providing public service plurality particularly for older children, which is where we have this very good connection with young audiences. We have three very good projects in development. One was a six-part series on the best TV moments in British history which is really exciting. There was one children's drama about transitioning from junior school to senior school, and one other idea. They have unfortunately gone on hold. So, while we have developed them, we are not in a position to finish them off and show them. There are yet other areas where we have not been able to move forward at all. Interestingly, one of the things Ofcom have said here is that one of the reasons that a second strong organisation, as they have outlined it here, will be very valuable is if it could not only just deliver the sorts of things we have been doing historically but could also do many of those things that I believe a second organisation should do going forward if it is to stay in touch with audiences and be relevant to what is going on.

**Q92 Bishop of Manchester:** What about the high definition impact?

**Mr Duncan:** We have moved forward with high definition. We actually did a commercial deal with Sky, so we were the first people to launch our channel in high definition on Sky and, because we did it commercially with Sky, that helped us with financial issues. I think that it is not an option for the future; I think that you have no choice to the extent that the industry is moving that way. This is one of our problems. You have more platforms and you have no choice but to move on to those platforms but they are adding more cost. That is part of our financial pressure going forward, but I think that Anne could explain that more fully.

**Ms Bulford:** Through the competitive process with Ofcom, we have been awarded a spot for HD and the digital switchover costs of the main channels and that has been built into all the financial projections and that is in partnership with S4C who would opt out on the same capacity and provide their service in Wales, which I think is very helpful. In terms of the gap, Ofcom are quite helpful in the way in which they talk about that today. We estimated the gap in September at around £150 million including the *Next on 4* commitments. Since September, going back to your question, the market conditions have worsened very considerably and the medium-term market has worsened very considerably. At that time, I think

people were anticipating some sort of recovery in 2010 and I recently read some analyses which suggested that we might not return to 2007 levels of total TV advertising until right out well beyond digital switchover and possibly even as late as 2017. All of that is putting more pressure on our gap. Against that, we have looked hard again at the cost and some of the restructuring has brought some of those savings forward which has helped a little. Across the piece, I think that the pressure on Channel 4 is greater than it was when Ofcom published their report last September.

**Q93 Bishop of Manchester:** Can I just make this absolutely clear because I think what I was hearing you saying is that the estimates that Ofcom have about the funding shortfall and the ones that you are presenting are now virtually the same.

**Ms Bulford:** I think it still remains the case that our view of the market is more conservative than Ofcom and, in terms of the level of spend that will be needed in *Next on 4*, there is much more detail to be worked through on that as those commitments work through. We certainly both agree that the gap is significant and substantial and argue that it is the wrong side of £150 million and there are a lot of pressures to hold it to that sort of range.

**Mr Duncan:** Ofcom in a sense have chosen not to give an updated estimate; I think they have taken the view that it is too difficult because there is such a state of flux structurally. I absolutely think that they think it has become a lot worse since their September report, but they have probably wisely not tried to quantify how much worse. From the conversations we have had with them, the order of magnitude of what we see as the financial pressure and they see I think we are in agreement on. The other more strategic point is what they have said very clearly in this document and what we have been pushing for is that we want to try and get to a solution that is going to be able to see you through the potential ups and downs of the next few years. You cannot predict with accuracy what is going to happen and one of the benefits of having a more strategic solution is that it gives you some greater ability to navigate through uncertainty, for want of a better phrase.

**Q94 Lord Corbett of Castle Vale:** Mr Duncan, you have partly answered this question about the funding shortfall but, in just over a year, you have gone from relative optimism to mournful pessimism. You have talked about substantial investment in radio which has been now put on hold. Did you just read the signs wrong when you were making those projections and did not anticipate what is going to happen—this is not a complaint but, if that is the case, you would want to know—and you got bits of that jigsaw not

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quite right at the time and then the economic downturn comes and makes it worse?

**Mr Duncan:** I was of optimistic view. We have been arguing for three or four years now that these big structural issues were very serious and were going to affect the whole industry and that is clearly what happened. I was not predicting a year ago that there was going to be on top of that a massive cyclical downturn, but the primary cause of the issue is structural and not cyclical. Radio in particular was what we saw as a new business opportunity to try and alleviate those pressures. We have actually invested both successfully in our digital channels over the last year; that has cost us money but now they are making a successful profit stream. When the opportunity came up when Ofcom effectively put out for tender the multiplex, we saw a commercial opportunity to bid for that multiplex in a consortium with partners and the core logic, the number one reason for doing that, was to generate some commercial income and then secondly we also thought it would be a contribution into the wider content plurality in radio as well. I think it is fair to say that we could have gone on to make money—there would have been two or three years of investment in the cycle—but we reached the point last autumn where it was increasingly clear that we could not afford that and in fact it is not just radio where we have had to take out our plans but any other new business investment that we had in the budget for this year has been taken out as well. We have taken a view that although it is obviously sensible to invest in new things that can generate more money for the future, it is even more important in the very short term to keep our content spend as high as we can, so we took the new business investment money out ahead of cutting content even more deeply than we otherwise would have had to. I think it was strategically logical but, had we known when we first made the bid that we were going to enter into a cyclical downturn like this, I think clearly we might have taken the view that it would have been too risky. At the time, it looked a very sensible commercial investment and it was more an affordability question than a question of strategy.

**Q95 Lord Hastings of Scarisbrick:** Going back to the partnership proposals from the BBC, if you were to spin forward beyond digital switchover in a couple of years' time and you could describe to us the services and programmes the BBC might be selling and the services and programmes that you might be selling alongside them, do you envisage Channel 4 then having some form of international brand presence? One of the comments the BBC made last week is that, as they have an international brand presence and you do not, they can therefore get asset value globally and you cannot.

**Mr Duncan:** Again, I think this is one of the issues that needs more discussion. If you take the next three to five years let us say, the majority of synergy that might be there is within the UK. We have a big existing business within the UK and so does the BBC and most of Worldwide's existing profits today come from the UK. So, in terms of where the obvious synergy sits, a lot of that is within the UK and some of the things I talked about earlier on regarding cross-promotion and advertising sales would clearly apply within the UK as indeed our brands. I think that longer term, if you take a five to 10-year timeframe and possibly earlier than that—and this is one of the arguments I made in my speech—Britain has a more serious problem altogether which is, are we organised properly and efficiently enough to get enough money from the rest of the world back into the content we are producing? It depends where you start from. If you start from compared to where we were a few years ago, we are doing quite a bit better and that is great. If you start from the world has fundamentally changed, there are billions going out of the country now to American-owned companies and although we are doing better than we were, if you think about the vast number of channels, both linear and online, that exist around the world and the expanding markets in digital media, are we punching properly our weight in terms of getting global investment back in the other way for British content? We have the advantage of English language and we have the advantage of high-quality, creative ideas coming from us and the BBC. The BBC currently have a number of our programmes on their channels in America; BBC America has several Channel 4 programmes on it. I make the broader point which sits above, for me, the BBC or Channel 4 or any other organisation: I do not think that Britain is punching anywhere near hard enough in terms of getting money back into the UK for our content, and this is back into a creative industries debate and a digital Britain debate, and anything that we are talking about around BBC and Channel 4 is, I also think, additionally a very helpful next step towards Britain itself organising itself more powerfully for monetising its creative industries around the world. There are similar industries in music and advertising and computer games and other industries as well, actually.

**Q96 Lord Hastings of Scarisbrick:** You know, given your time at the BBC, how difficult—and certainly the BBC says it was and is—it is to make that £100 million, how long it took to get to the point of making that return. Is the BBC to be believed that it really tried every twist and turn and it pushed every conceivable option in the market and it has been really tough and everything became so fast? What is it that you can add into that internationally that would be the added value of Channel 4? Forget the UK for a minute, just the additional global revenues.

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**Mr Duncan:** First of all, obviously in terms of the value show and this goes back to the independents and that is absolutely valid and we are comfortable with that. As I have already said, a number of programmes that are commissioned by Channel 4 are already exported internationally. Film is another area where I think we have had some good success: *The Last King of Scotland* for example made some good money for us and we are optimistic and cautious that *Slumdog Millionaire* will. We have the rights for *Lovely Bones*, the next Peter Jackson film. There is a model in film, albeit that it has much bigger issues in other ways, where we have learnt to get money back in from around the world. My observation is that if you start from, “I have £3.5 billion coming in the door through the licence fee, can I earn some extra money through my commercial operations?”, that is one way to think about it. If you start from, “Britain needs to generate a substantially bigger sum of money from abroad to come in on the back of British content, how do we best organise ourselves to achieve that?”, you might get to a different place.

**Q97 Lord Hastings of Scarisbrick:** There is a sort of implication in there that you are saying that the BBC’s approach to how it gets value from its assets is a little bit “public servicey”, whereas you could approach it from a very robust commercial proposition that, if you took it over, you could run it better.

**Mr Duncan:** I do not like language of taking over and running better; I think that is not right. There are two things. If you take the very short term just looking at the existing activities of the two organisations today, there is a huge amount of synergy and that is one way into the conversation. If you jump five to 10 years from now, do we need to be getting substantially more income—and I do not mean another £50 million, I mean hundreds of millions more back into the UK from abroad for our content—yes, we do and, if we do not, I genuinely fear that there will not be enough money to invest in the system in the first place. With regard to the Government report on the *Digital Britain* work for example—and I made some recommendations which they may or may not think are good ideas—I am very interested to see how seriously they take that on because I think there is an issue of economic importance to Britain as well as public importance to Britain around getting that right and I think that my general observation would be that people are not thinking about it in a big enough and radical enough way.

**Q98 Baroness Eccles of Moulton:** May I say to begin how much I enjoyed reading your speech; it was very helpful background to this session. If we could turn to the other two advertising funded PSB channels, the conversation so far has concentrated very much

on your relationship with the BBC and how important it is to have two strong PSB channels in the system. The discussion has previously stressed the fact that if Channel 4 gets more support, then it will inevitably be screening more commercially attractive programmes which will deflect advertising revenue away from Channels 3 and 5. We are talking about the possibility of BBC Worldwide becoming the extra source of funding to Channel 4 and that seems possibly to reduce that risk; I do not know whether it does or not. How important do you think it is that those two other PSB channels should be preserved at all costs and how can that be managed in light of the possibility that they are going to find it more difficult to get their share of a diminishing advertising market, or would you say that, at the end of the line, considering the acute economic situation we are in and probably not heading for any sort of recovery for a while—in fact we know that things are going to get worse—that possibly they could be dispensable?

**Mr Duncan:** There are a number of things in what you have raised. My starting point—and I think that Ofcom have this just about right—is that you cannot rely on a commercial organisation with a profit incentive to shareholders to be the reliable mechanism through which we are going to get public service plurality in the future. Recognising that certainly for a few more years ITV can deliver news and regional news—that is great, but you are pretty much saying that there is nothing else—and similarly Five make a more modest contribution anyway and, for the moment, they have the benefit of reaching position number five and access to spectrum, so the benefits to them outweigh their costs, but again long term you cannot rely on that. I think that the very modest contribution they continue to make on specific public service content is welcome and helpful but you cannot rely on that. Therefore, to have a guaranteed source of plurality in the system with the idea of this second strong public service organisation is vital. On your advertising point, rather bizarrely, I think that it is in ITV and Five’s commercial interests that there is a good solution for Channel 4 and a good solution to the second strong public service organisation because us funding *Dispatches* for one hour every week and us running an hour of news at seven o’clock and us running a big series on Christianity or arts or science or one-off dramas, very often these things do not rate that well although relatively they have a big reach and impact still. What would be a good example? The street and knife crime series that we did last summer I think was a really important campaigning week of programming. It played a very important role. It reached a big audience but it reached a smaller audience than a normal set of commercial programmes would have reached in that week. If ultimately in the final next few months there are not some final decisions regarding Channel 4 and nothing

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happens, I think that we will have to go the other way. We will have to cut more of those sorts of programmes out of the schedule and operate more commercially in order to get our books to balance which I think will hurt ITV and Five. I know that it sounds a little bizarre, but actually I think that it is in their interests to see a good solution to this issue and arguably we have to be seen to be more commercial. I think what Ofcom have painted is a rather worrying picture which is, if you do not come up with the big partnership or you do not use the licence fee, you are either managing decline, which is pretty sad and pathetic but that means us being more commercial, or you are effectively saying, cut our obligations, which also means us being more commercial. In both cases, that is bad news for our commercial competitors.

**Q99 Baroness Eccles of Moulton:** I hope that they can understand that point of view.

**Mr Duncan:** I am not sure that they would put it quite that way but that is how I would see it.

**Q100 Lord Macdonald of Tradeston:** You have obviously had a very productive partnership since 1982 with the independent production sector. With the commercial pressures that are coming on, do you see that there will have to be a change in the terms of trade that you have with them, particularly if you want to get the full value out of a partnership with BBC Worldwide?

**Ms Bulford:** I think that the relationship with the independent sector since 1982 has been absolutely fundamental to the success of Channel 4 and we value that relationship very highly and we value the special relationship that we have with the independent sector. The way in which we are structured gives us huge advantages in terms of being able to follow the best ideas and have a low cost base and actually we are very, very proud of that second purpose that we have had in terms of helping to develop some excellent globally successful new businesses in Britain and we are starting to see returns back into content from those successful independent companies bringing money back in. In terms of trade, we have had some very constructive and good conversations with PACT and with big independent companies over the last year or so recognising that the world is changing very quickly and that terms of trade need to evolve and develop, to recognise different digital windows and different ways of working, but we do not see a need for any fundamental change in terms of trade and in terms of ownership of intellectual property. Our very firm view is that spending a lot of time talking about how you can share out the cake is not helpful and altering the back-end share of international returns in some way would be tinkering around the edges insufficient to solve the funding problems and not helpful. Consequently, our view is that the terms of trade

should continue to evolve through negotiation, through commercial negotiation outside of terms of trade which is all allowed, but that there is likely to be some continuing need for protection of independents who merit that.

**Q101 Baroness McIntosh of Hudnall:** May I go back to a related point to the question that Lady Eccles asked to do with advertising revenue. It looks as if ITV may have been successful or may be successful in persuading the OFT to lift the restriction that currently operates through the contract about renewal undertakings. My first question to you is, how is that going to impact on your position? My second question, which I will just get in quickly because the Chairman will probably scowl at me, goes back to one question before. I wanted to ask you about something you said about *The Devil's Whore*. You held that up as an example of your programming that was high-quality drama, which I entirely agree with—slightly dodgy history but very high-quality drama—and you said, if I have not misquoted you, that it was never going to make money. In this brave new world that you anticipate, could you make that make money?

**Mr Duncan:** In terms of the CRR question, where the OFT are in terms of some relaxing of the CRR mechanism but not its complete removal is, I think, mixed news because there are two different points with CRR. ITV have about 45 per cent of the TV advertising market even now and, despite their loss of viewing share over the last few years, they have very successfully managed to persuade agencies to spend more money on the digital channels partly through growth but, if you look at it analytically, probably more than the simple viewing share growth that a digital channel would have justified. So, at some level, even with CRR, they have used their clout to persuade people to keep their spend with them because most advertisers cannot afford not to have some of their money on ITV. I think that the agencies and the advertisers will be very worried about the complete removal of CRR as would we because I think that the danger is that if ITV have too strong a position, it was a key part of the deal being allowed to go through in the first place and, if they can abuse that position, it is a zero sum game—you are helping ITV at the expense of everyone else and we would be the biggest losers because we are the next biggest players in the ad market. I think that an unintended consequence of CRR is that it has not given the market leader much pricing power, so at least one of the reasons why I think advertising market pricing has not moved on particularly over the last two or three years has been because ITV have been quite weak in being able to push that pricing on. Therefore, I think that Channel 4 has slightly mixed views. If we end up with a situation where it is modified—and it needs to be

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consulted on—and it simply helps the ITV share at our expense, that is a bad outcome. If we end up with it being reasonably neutral on share but giving ITV a bit more bite in terms of being able to not force prices artificially high but at least push them directionally in a fair way, that is probably a good outcome. I think that we are a little more open to that as a possibility than we might have been perhaps a couple of years ago, but I think that it has to be treated very carefully. I think that the idea of no constraints at all on ITV in such a dominant position would be worrying. *The Devil's Whore* took 10 years of development, huge script development time. Those sorts of things are really very difficult to make work. Unless you have something that could genuinely be a huge global export—and that probably will not be—those things do not make money. Having said that, they are massively publicly valuable. Particularly one-off dramas even more it is difficult to make a commercial return out of.

**Q102 Baroness McIntosh of Hudnall:** I do want to get this clear. I know that that was a very unusual example because it did take a very long time to develop—I am not very surprised by that—but, in some ways, that kind of work seems to map reasonably well on to the sort of work which the BBC for example makes and does make money out of through exploitation through BBC Worldwide. I am intrigued to know what it is about that kind of drama relative to, say, *Cranford* that you think, well, in a way, we have to regard that as a loss leader.

**Ms Bulford:** The independent production company responsible has the opportunity to seek international distribution of that title and try to get that sold. It is an interesting point—and I think Andy talked about it earlier—that, in some cases, the independent producer absolutely goes to BBC Worldwide because they are the best distributors for their titles and the rights potentially impact together with similar likeminded programming. I think that, in terms of international distribution, the way in which the market works ought to be able to result in the right title finding the right home in terms of the best distributor for it.

**Q103 Lord Corbett of Castle Vale:** I am always amazed when I hear the figure quoted that it takes £1 million to make an hour long drama. Given all the tremendous advantages in technology, how do you manage to spend that kind of money? Where does it go? Give me some kind of breakdown.

**Mr Duncan:** Drama and comedy, scripted comedy and scripted drama in particular, are genuinely very expensive to make. If you have a soap where you have a sort of machine that is making several episodes a week, you can absolutely get the costs right down. If it is a one-off in particular or a short series, it typically

is much more expensive and, when you have a cheap drama, you notice it and, when you have a quality drama, you notice it.

**Lord Corbett of Castle Vale:** Where does the money go? That is what I want to know?

**Q104 Baroness McIntosh of Hudnall:** See some of us afterwards!

**Ms Bulford:** It is all about how many minutes a day you can capture, how long you have to spend in the development phase before you start filming and how much time you spend on post-producing all the tape that you have.

**Q105 Chairman:** Perhaps we will have a teach-in in the next one!

**Ms Bulford:** In terms of lots of work to drive the cost of all production down taking advantage of technology, the sorts of efficiency objectives that we put through our programme budget absolutely takes that into account. We look to get something like five per cent a year out and we have been exceeding on that target.

**Q106 Chairman:** Would you just confirm these figures for me. In 2001, Channel 4's gross revenues amounted to £945 million on which you made a profit, I think, of something like £500,000.

**Ms Bulford:** Our consolidated revenues in 2001 were £730 million from the five-year record at the back of the annual report.

**Q107 Chairman:** I have been given figures of £945 million and a profit of £500,000.

**Ms Bulford:** £945 million was 2007.

**Q108 Chairman:** That is what I am talking about.

**Ms Bulford:** Yes and the profit was £500,000. I am sorry, I misheard you. I thought you said 2001.

**Q109 Chairman:** What figures were you giving?

**Ms Bulford:** I am very sorry, I thought you said 2001.

**Q110 Chairman:** No. When it comes to 2008, you obviously do not have the figures yet but what do you expect?

**Ms Bulford:** We have been working throughout the year to try to achieve a positive cash flow and at least a break-even result and we are still in the process of closing our books.

**Mr Duncan:** There is a very substantial drop in top-line revenue. We grew our share slightly last year of the market but the market declined by about five or six per cent and that equates to nearly £50 million for us. On top of that, other areas were hit somewhat. We have not published the numbers yet, but we will be looking at a substantial top-line reduction and, as Anne said, we have cut costs in order to break even.

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**Q111 Chairman:** When will you publish?

**Mr Duncan:** Usually at the end of April or May.

**Q112 Chairman:** So, from our point of view, probably after we have reported. Can you give some indication of how much you spend on United States imports.

**Mr Duncan:** Yes, we have the data here. Basically it is going down.

**Ms Bulford:** We spend on acquired programming. In 2007 on film and series we spent just under £150 million and we have made a commitment on both series and film to reduce that as a proportion of the schedule.

**Q113 Chairman:** So, £150 million being imported?

**Ms Bulford:** Film and series, yes.

**Mr Duncan:** Two points there. As Anne said, we are looking to reduce that and one of the ways we are looking to get more money to invest in British content including some of the new things was by reducing our position. Secondly, it remains a very profitable area for us. We have to be careful that we do not cut in an area that then further worsens the financial problem, if that makes sense.

**Q114 Chairman:** And you have net assets of £452 million.

**Ms Bulford:** Yes.

**Q115 Chairman:** And financial assets of almost £200 million or you did in 2007.

**Ms Bulford:** Yes. Cash reserves of about £200 million.

**Mr Duncan:** Typically on the cash reserves, it is worth saying that we need about £100 million of working capital to run the organisation. We pay programme makers and small companies as we go through the month and we collect the ad sales cheques at the end of the month and about half of that cash balance we have kept. At one stage, it was the sort of sum that we were thinking could be invested commercially to get a return, but at the moment we have said that until such time as we get more certainty from the Government and Parliament as to how our future can be secured, we want to keep that there as a potential transitional option.

**Q116 Chairman:** And your headquarters are valued at £58 million.

**Ms Bulford:** Yes. We expect the value of that to reduce.

**Q117 Chairman:** Why do you need to be in London?

**Mr Duncan:** We have always been in London.

**Q118 Chairman:** I am not sure that that is a very good reply!

**Mr Duncan:** It is not a very good reply. There are two points on the value. The value of the building has come down dramatically; it is in the Victoria area and property prices have dropped. There is this notion that I noted one or two of our competitors have suggested that somehow by moving building we could solve all the issues. We own the building and, by the time you have moving costs and start paying a rent somewhere, it does not actually give you any saving.

**Q119 Chairman:** You would have to have one heck of a moving cost to get through £58 million!

**Mr Duncan:** No, but you would have to pay rent. The net present value of paying a rent for the new property you go to. It is certainly not a substantial solution to the financial gap we have. On your London point, clearly in terms of where the centre of the UK media industry is in many ways, it is a very good base. I think that we are in a redevelopment area so, in terms of the benefits to the local area of having the head office there and one of the reasons why it was put in Horseferry Road in the first place—

**Q120 Chairman:** Westminster is a redevelopment area!

**Mr Duncan:** No but where we are is. Going forward, we are keen to try and get more of a shift of emphasis in terms of other parts of the UK. For example, we have a small commissioning presence which we have just announced in Glasgow. This 4iP fund is interesting because I think that we are starting to get an online presence in Sheffield, Birmingham, Scotland and so on and so forth. With regards to where our head office is based, crucially Channel 4 has always been about getting ideas from across the whole of the UK and I think that we very good at that. Particularly in the regions we have big areas of ideas—for example, drama: *Hollyoaks* and *Shameless* come from the north-west—and keeping that going is really, really important. The idea that somehow our property strategy could be the answer to our problems for organisation—

**Q121 Chairman:** It is not the answer but it could be a contribution.

**Mr Duncan:** A very, very modest contribution indeed.

**Q122 Lord King of Bridgwater:** Listening to this discussion which started off in some of the briefing papers, commonly named, with fairly precise figures of what the problem was, it seems to me that this could very quickly become quite out of date. Is there a Plan B?

**Mr Duncan:** Do you mean relative to what we expressed earlier on in terms of the third outcome?

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**Q123 Lord King of Bridgwater:** The figures could be very much more difficult. I listened to Anne Bulford and the Chairman did say 2001 and I may have misheard you but did I hear you say 2017?

**Ms Bulford:** In terms of the total market. The structural decline meeting the cyclical decline in order to return back to levels is proving very difficult.

**Mr Duncan:** To be fair, I think that a lot of this is structural and is reasonably predictable. If you accept that we are in a very deep cyclical downturn and for the next two years or a year or two it is going to be difficult. What you can model very precisely within that is the digital switch-over and a lot of what has put pressure on our system is the move from analogue to digital. You can make reasonably clear assumptions about how quickly viewing will move online and what the video-on-demand model is like relative to linear channels. I think it is quite important that people do not think that there is a huge black hole here that could grow into something unbelievable.

**Q124 Lord King of Bridgwater:** You are talking about the structural side, I am talking about the basic capacity of the advertising market and what may happen there. It would take a brave man to forecast what the level of that would be in one or two years' time.

**Mr Duncan:** I completely agree with that. None of us know quite how bad the downturn could get.

**Q125 Lord King of Bridgwater:** What could be Plan B in that circumstance if a real black hole opened up in your funding?

**Mr Duncan:** Do you mean as a short-term Plan B or as a long-term solution?

**Q126 Lord King of Bridgwater:** I do not know.

**Mr Duncan:** In terms of short term, I think that we would continue to do more of what we have done already, which is basically to cut cost as we go. It would be very difficult in terms of people. We were very aggressive last year with a view to saying, let us not have a destabilised organisation, let us get that done and move on. There is less to go for in other areas than there was, but you would be essentially cutting content budgets and to some extent online and marketing budgets in a way that would be directly damaging both the public service and creatively commercially. If you have a real emergency, we do have some reserves. So, you could effectively take the view that you have run into a deficit at least on a short-term basis and dip into reserves but, as a strategy, that clearly would not work.

**Q127 Lord King of Bridgwater:** You made a very good point which I would like you to enlarge on slightly which is that, in the current circumstances, the pound is coming right down which makes Britain

much more competitive and therefore our exports ought to go up. The problem is that we have a much smaller manufacturing base and the question is, what can we actually sell? Knowledge and content and the creative industries –and tourism as it happens—are the areas where we should certainly be able to work. Is there a real understanding in Government in your discussions with Government that this is one of the areas? There is no car production and a number of car factories are closing down at the moment, maybe on a temporary basis, and other areas may be cut off. Creative industries become a very important source of potential income which could be switched on.

**Mr Duncan:** I think that the jury is out. I think that the *Digital Britain* report is encouraging that that is happening. I think that there is an ambition to have some proper joined-up policy in this area. I agree completely with you. I think that even if you do not care about the public cultural and creative aspects of this, you are a hard-nosed prism of the economic arguments, it matters a lot and it is one of the reasons why I think that it is vital that the Government make some clear decisions in this area over the next few months and I think that it is vital that the BBC are under some pressure to engage in the bigger picture. I am a huge BBC fan and there is no reason why they should be damaged by this; I think it is the other way round. They need to be engaging in the bigger picture more than they have been. Government need to really put this up the agenda politically. I do not know yet whether that will happen, but clearly we are very worried that it does not come through as a top project.

**Q128 Lord King of Bridgwater:** Is that why Plan B has to keep you in business?

**Mr Duncan:** It is more important than the British car industry generally in terms of the unique contribution we make and I am not sure that that is how most people see it at the moment.

**Chairman:** That takes us on to our next inquiry as it happens, but we will question you again. The last question today is from Lord Macdonald.

**Q129 Lord Macdonald of Tradeston:** I would like to take you back to what you were saying about the regions and the nations and your relationship with them. As you know, the Scottish Broadcasting Commission has argued for a Scottish digital television channel to provide a “secure and sustainable source of competition for the BBC in high-quality public service content produced for Scottish audiences”. I would be interested first in your reaction to that proposal and also the proposal that you might relocate a commissioning department from London to Scotland. Bearing in mind the tense relationship you have always had with the nations and because you are judged to be the most metro-centric of all the channels, do you have any plans to

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spend more money in Scotland in a significant way given that 10 per cent of your audience used to come from Scotland but very little of your investment and production went back there? That is one question, and I believe that Ofcom have suggested that there might be a fund for Scotland though I have not seen the details of that. What are your future plans for Scotland to build a more productive relationship?

**Mr Duncan:** We are very keen to do more in Scotland and we have always had a base there. Stuart Cosgrove, our Director of Nations and Regions, is actually based in Glasgow and yesterday Kevin Lygo, our Director of Content and Television, announced moving more commissioning presence into Glasgow. We ourselves suggested in our *Next on 4* document last year that we have a strong story in the English regions. Outside of London, we do very well compared to some of the other broadcasters. We have never gone far enough potentially in the nations as you have described it and, in particular in Scotland, we have had great one-off projects, some of the films for example, but not necessarily returning series. We have absolutely put forward our ambition to do more. Ofcom have also suggested that in their document that they published today and very specifically we have announced a fund yesterday where we have a pilot fund to keep these returning series. Can we find more returning series that can be based for example in Scotland? Also, we have announced a commitment that a proportion of some of our long-running strands will be sourced from the nations. For example, *Cutting Edge* which is our documentary strand and *Dispatches* which is our current affairs strand and some of the *Comedy Lab* types of things. Some of those areas we have said that, going forward, we want to have a system where we guarantee a certain number of those slots. This is something that we think is a wholly good thing and we want to do more of it. Clearly, the more financially constrained we are, the potentially harder it is in the short term to make real progress, but it is something

that we have pushed forward, Ofcom are encouraging and I think that it will be a wholly good thing.

**Q130 Lord Macdonald of Tradeston:** Would that embrace Northern Ireland too, because of the other three nations, they have had the worst deal of all from all the UK channels?

**Mr Duncan:** I think that it would. Each of the nations has very different structural issues. In Wales, there is the S4C issue and I think that we have a very good relationship with S4C but the dynamic there is very different certainly now that Channel 4 is becoming available to all homes in Wales. Northern Ireland, you have the structural issue that with a number of the independent production companies, their centre of gravity is not so much the UK, it is more into Ireland itself and Dublin, and that is quite complicated. If you look at the cold numbers, beyond the BBC owned organisation in Northern Ireland, Northern Ireland does very poorly in terms of strengthening the new sectors. It is the same point, it is more returning series coming through. There are some good one-off projects but, without returning series, you do not get that infrastructure. I have to say that, in terms of industrial policy, I think that it is a very strong point. One of the things that I think a second strong public organisation does is, in any scenario we are looking at, that is spending all the money with the independent production sector, allow you, both on traditional TV and in online, to help build up infrastructure right the way across Britain. So, for the 4iP fund, you are really helping digital start-up companies. We are very enthusiastic about that side of the equation. One of the big prizes of what Ofcom have put forward here is the economic prize of better infrastructure across the whole of the UK including the nations.

**Chairman:** Thank you very much. You have both been exceptionally patient because we have gone on for over an hour and a half which is beyond the call of duty. Thank you very much indeed and we look forward to seeing you again on our next inquiry.

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THURSDAY 29 JANUARY 2009

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Present	Bonham-Carter of Yarnbury, B Eccles of Moulton, B Fowler, L (Chairman) Howe of Idlicote, B Inglewood, L	King of Bridgwater, L Macdonald of Tradeston, L McIntosh of Hudnall, B Maxton, L
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**Examination of Witnesses**

Witnesses: MR MICHAEL GRADE, Executive Chairman, and MR JOHN CRESSWELL, Chief Operating Officer, ITV plc, gave evidence.

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**Q131 Chairman:** Welcome, both of you. Thank you very much for coming. At the moment we are looking at the public service broadcasting debate and also bringing ourselves up to date with what is happening with the various television companies, including the BBC, but obviously including your own. Could I begin by asking you what the current financial state of commercial television is?

**Mr Grade:** It is about the same as that of the country as a whole—severely challenged. Advertising revenue, because the profitability of our advertisers is challenged by the consumer downturn, which is reflected in cuts in advertising revenue, and we are facing a very serious reduction in advertising spend. That is common to all the commercial free-to-air advertiser-supported businesses. The impact of that is not the reason for the debate about the fundamentals of the business, but the kind of projections about when we are going to hit problems because of the fundamental changes in the business, are all being brought forward, they have been accelerated. The issues that we have on PSB are not driven by the downturn, they are just accelerated; the date of the problems just comes forward.

**Q132 Chairman:** You have been in television for some time and have had experience with many companies, is this the worst you can remember?

**Mr Grade:** By a long way. I have seen the cycle come and go over the years; I have never seen anything quite as dramatic or quite as profound as this in terms of the effect on advertising revenues.

**Q133 Chairman:** Does that mean—not necessarily your own company—that there are serious questions about the financial future of some companies?

**Mr Grade:** I sincerely hope not. We try to operate in a market, so far as we are allowed to under the regulatory constrictions, but there is a lot of self-help that we can implement ourselves. Obviously, we are a dynamic company and we are making a number of cost savings. We are hoping to get some benefit from the regulatory relief, which appears to be moving forward. We will survive, and will be in a fitter state

when the economy eventually turns. We should have a thriving business when the economy turns.

**Q134 Chairman:** But other things being equal, you would like ITV to remain a public service broadcaster?

**Mr Grade:** We would. We believe there are advantages for us, but there is conditionality attached to that statement and that conditionality is really in two simple headline sections. One is that we pay no more for the spectrum that we would occupy as a PSB than that spectrum is worth—it is not what we say it is worth, but what Ofcom says it is worth. And we will provide in kind or in cash, or a mix of both, in value to the value of that spectrum. The second issue is the conditionality that we need in order to continue as a PSB is that many of the regulatory constraints and burdens that we carry, which are a hangover either from the merger of Carlton-Granada, the CRR advertising mechanism and many other pieces of statutory and regulatory impositions, prohibit us from responding in a true market fashion to the downturn.

**Q135 Chairman:** Obviously, we will come on to the controls and what you want to do, but could I just get it clear in my mind, according to Ofcom, one of their four top priorities is to have Channel 3 services' commercial networks with "a limited public service commitment"—a *limited* public service commitment. I assume that means not a full commitment. Therefore, I wonder what that limited public service commitment is or, putting it another way, what are your priorities?

**Mr Grade:** My priorities are simple: not to pay more for the spectrum, the PSB status, than it is worth to us. It is a matter of public policy; it is for the regulators and parliament to decide if the agreed value of the spectrum, let us say, is £35 million—which is about the right figure—we will deliver £35 million of PSB value of whatever kind, either in cash or in kind, whatever the policy makers decide they would like in return for that money.

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**Q136 Chairman:** Have you got any views on what comes top of that list? Would news come top?

**Mr Grade:** To be honest, we would want to do news anyway. We could not guarantee it indefinitely, but we would want to do impartial, independent national and international news if we are to remain a major broadcaster and a major part of the British public's life. We would want to continue to provide the ITN service as a business priority.

**Q137 Chairman:** What about regional news?

**Mr Grade:** Regional news, as Ofcom has said in its PSB review, Part 2, is severely challenged from 2011. We can provide the airtime, the Ofcom proposal, which we hope this Committee will take very seriously and maybe endorse it, is for ITV, as a PSB, to guarantee the air time and the reach for regional news through our licences. Bear in mind, that we do not own all the licences, there is Scottish, Ulster and Channel as well. We would provide the air time, but the money would have to come from somewhere to pay for that; we could not afford to do that.

**Q138 Chairman:** Just to summarise, your position at this point is that you do not want State funding, but you do want a bonfire of controls?

**Mr Grade:** We do not want direct State funding, no. If it is the desire of the Government that there should be guaranteed provision of regional news in the English regions and the nations, as a matter of public policy to provide plurality of supply with the BBC, so that the BBC does not end up with a monopoly. We are happy to be the agents of that; we cannot afford to pay for it. In other words, we cannot afford to guarantee it going forward.

**Q139 Baroness McIntosh of Hudnall:** I wanted to press you a little on something you said earlier on—more or less verbatim, you said, “We regard being a public service broadcaster as having benefits for us”. It is not clear to me from what you said today or, indeed, from what we have read of what you have said recently elsewhere, what those benefits to you are. If I were going to be provocative, which I will be for the sake of the argument, I would say that there is a sense in what you have put forward recently that you feel that ITV, in retaining public service broadcasting status, is doing the nation a favour, and the nation, in return for that, needs to lighten up a bit. I am deliberately characterising that rather unfairly, but can you tell us, what are the specific benefits to ITV of remaining within the public service broadcasting fold?

**Mr Grade:** There are two elements to that, one more important than the other. One is the coverage we get through the use of the PSB spectrum; technically, D3 and 4 are the multiplexes through which we broadcast, which give us a reach to people's homes of

about 98.5 per cent. If we were to give up our PSB status and not be allowed to buy that spectrum and just took a digital licence and became one of the digital channels, our coverage would be reduced. Many parts of the UK would be deprived of *Coronation Street* and some of the programmes that millions of people enjoy on ITV would not reach some parts of the UK, which I think would be a shame. We would lose financially, because we would lose some coverage. The other benefit is the protection we have on the important Sky platform, where there is regulatory protection for our electronic programme guide position on the front page of the EPG, which is a benefit that will diminish over time, but presently, it is important. There are so many channels now that, in due course, we will have a revamp of the EPG.

**Q140 Baroness McIntosh of Hudnall:** But you have said, fairly clearly, that there are circumstances in which the acquisition of those licences, or the continued holding of those licences would not be worth it to you and that you would walk away, which is implied in some of what you said recently. I wonder what ITV would look like if you did not get the concessions that you feel you need in order to continue and had to take yourself out of the mix.

**Mr Grade:** If I could re-phrase that, it sounds like we are threatening to take our bat and ball away. It was Ofcom that identified the option for ITV. Our licence is due for renewal in 2014; that is a decision point when we can decide whether to stay a PSB or whether we want to take our chance in the digital world. It is not threatening anybody; we have said very clearly that our stated preference is to remain a PSB. In the event that deal is not workable, then obviously the option to give up that status is one that Ofcom has identified as being available to us. We are not in the business of threatening anybody; we want to get to a satisfactory conclusion for viewers and for our advertisers and shareholders. If ITV were to give up its PSB licence, what you would lose is guarantees. You would have no guarantee of investment in UK production. There might be cheaper ways of running the service and making a profit. You would have no guarantee of news provision of any kind—national, international or regional—and many viewers would lose programmes that they value, because we would lose that reconfiguration of the analogue spectrum which gives us 98.5 per cent coverage. We would be an out-and-out commercial service and would be free to run it as a business. It does have its attractions, but it has its risks as well.

**Q141 Lord Macdonald of Tradeston:** Obviously, one of the results, if you were impelled to walk away from your present status and hand the licence back, is that the licences in the nations in Northern Ireland, Grampian, STV in Scotland, and the Channel

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Islands, would become unviable immediately, which would have a great political and social outcry attached to it. You have half a dozen proposals, that Ofcom have echoed, of the sort of conditions that you think should be met to keep you viable and keep you in the public service area, but I notice that point 3 is “A radical reform of the networking arrangements to put the relationship among the Channel 3 licences onto a purely commercial footing”. That means that you could stay as a public service broadcaster, preserve the present system but you might be seen to be bleeding dry the companies and the nations. Before it gets to any of those options, is there an accommodation that you can reach in creating a unified ITV through a deal that keeps everybody happy?

**Mr Cresswell:** We would hope so. Any commercial arrangement that we may enter into with, principally, STV and UTV, may have flows going both ways. They are very keen to have STV and UTV as their national brands; we obviously trade on ITV and there are many different relationships. In terms of the sustainability, the system works at the moment with contributions to the network programme budget from Ulster and STV. We need to clean up what those contributions are, and if those licencees decide to opt out of paying for network programming then it puts pressure on our ability to invest in UK-originated content for the UK viewer. So, all those things interlink but, ultimately, having a strong ITV in all licences is very important to be able to fund that originated investment, so we would be very keen to establish a commercial arrangement as quickly as possible to give stability to the system.

**Q142 Lord Macdonald of Tradeston:** Do you think you would need a broker to help you reach that deal and who might that be?

**Mr Cresswell:** I think Ofcom are well placed to do that, but any arrangement comes to the issue of how much PSB ITV’s licencees can afford to commit to going forward; I would say it is the same for STV and UTV. It comes back to the issue of how regional and national news is sustainable in very challenging economic times.

**Mr Grade:** I would like to add to that. Ofcom has said, on their economic modelling and on their research and analysis that even with the subsidies that Scottish are getting from London at the moment—I know that is contentious with STV and they will no doubt have a chance to put their side of the story, but we believe that there is clearly a subsidy that flows from ITV to the Scottish licencees—the Scottish licence will go negative. In other words, the value that STV puts in is much greater than the value of the licence that they hold in 2010, and I suspect that is true this year. It is not an issue for us, other than it is clear that ITV can no longer afford to subsidise and sustain national

licencees outside our existing licencees; it is just not sustainable; it is not a basis for guaranteed services in those licencees.

**Q143 Lord Macdonald of Tradeston:** Do you not think that inside the discussion on the conditions or proposals that you have put, based on what you said, you could reach an accommodation that ensured the viability of the present national broadcasters?

**Mr Grade:** The problem is bigger than that. We can help by having a fully commercial, market-driven set of relationships with the non-ITV licencees, which means money flows both ways; they pay us for programmes, we pay them for the use of our brand on their air time—the ITV brand, ITV.com, etc.—and money will flow both ways with proper commercial arrangements, then you will find out how viable those businesses are or are not. I suspect they are going to be severely challenged with or without the subsidy from ITV.

**Q144 Lord King of Bridgwater:** We have anticipated for some time that the changes—the impact of digital, the growth of channels—pose great problems for the continued funding of public service broadcasting on the commercial side. That is known, perhaps, as the structural changes. Galloping along, and this relates to your very first answer to My Lord Chairman, is the other impact, which is the recession, depression, whatever it may be, and looking at the Ofcom report, which has only just come out, they put a figure that they needed replacement funding of between £145 million and £235 million per year by 2012. In the light of what you have said about bringing forward the likely date when these challenges are going to become acute, would you say that figure is already out of date and, in view of the most recent news yesterday about the impact of the recession on the UK and its likely impact on advertising, what assessment are you making about the impact of this on the sort of figures that might be involved?

**Mr Grade:** The deficit that Ofcom have calculated includes Channel 4. Our deficit is very clear, we do not have a deficit; we just want to get what we put in, get it in line with what we take out, namely, the licence. We just want to balance those two things. We do not feel there is a deficit; we are putting in a surplus. We are still paying cash to the Treasury for our licence, which comes off the screen; that is not helpful to viewers. I do not know what the deficit is because we do not do our own modelling on Channel 4, that is their problem, not ours. We know what our problem is; we know that the problem exists with or without the recession. We know that the recession is bringing the problem forward and we have no time to delay in coming to conclusions about how we want to reorganise ourselves. Our position is quite clear: we

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are happy to give £35 million of value, tell us what you want us to do for £35 million.

**Q145 Lord King of Bridgwater:** Because of your involvement in advertising revenue, you have a very good picture of what is happening in advertising, and you have made your forecasts as to what the advertising revenue is likely to be.

**Mr Grade:** There are industry forecasts, which talk about total TV advertising spend in 2009—bearing in mind that 2008 was not a great year—and we are looking at the latest calculation of between –5 per cent and –10 per cent. We only have visibility on cash five or six weeks ahead, in terms of what cash is coming in, so we rely on industry forecasts. We model and forecast and we cut our cloth accordingly, but it is a pretty gloomy picture out there at the moment.

**Q146 Lord King of Bridgwater:** What is that compared to 2007?

**Mr Cresswell:** Well, 2008 is down 5 per cent roughly. The market is about £3.3 billion, so we have been over that in 2007 and below that in 2008. There is a consensus view of between 5 per cent and 10 per cent, if it is –10 per cent, that means that the total TV advertising market would be below £3 billion in 2009; so, you have lost £350 million out of the system over a couple of years, which obviously puts tremendous pressure on those commercial broadcasters and their investment plans.

**Q147 Lord Maxton:** What would that have been without the recession?

**Mr Grade:** When we announced our strategic plan in September 2007, we took a conservative forward look at advertising forecasts at between +1 per cent and +2 per cent going forward, and we were at the conservative end of forecasts at that point.

**Q148 Lord Inglewood:** As part of the turbulence in the wider market place, the BBC has offered you and other public service broadcasters a series of partnership proposals. We know that you are already in partnership with the BBC to provide TV via the internet, but now that you have had a bit more time and a wider look, what do you feel? Are you cautious about Greeks bearing gifts?

**Mr Grade:** We have had a very deep and lengthy detailed, line-by-line discussion—I would not call it a negotiation—but an attempt to reach some kind of efficiency saving by sharing facilities. There is a very clear line drawn between facilities and editorial, because the whole object of this on regional news is to protect plurality of supply. I am bound by a confidentiality agreement with the BBC, but I am very happy, if they will agree, to let the Committee have privately the results of that negotiation. I do not think I am breaking a confidence to say that there are some

savings to be made through partnership with the BBC, but they are marginal and those savings do not really reach maturity until 2015, and the number is sub-£10 million, which does not really solve the problem. The Ofcom solution proposed in their Part 2 review, the deal with the BBC very clearly does not replace, it is helpful to the Ofcom solution but it does not replace, it is not a substitute for the Ofcom solution.

**Q149 Lord Inglewood:** Do you think there may be other things that you, not the BBC, have thought up which, by various partnerships or possibly with other public service broadcasters, could materially alleviate the predicament that you are all in?

**Mr Grade:** No, frankly, but what is attractive about the Ofcom solution is that it opens up the very challenged regional news delivery to a new vehicle, which could be funded through the excess digital piece of the licence fee to bring in local newspapers, to bring in online and to create an entity that would create efficiencies for all of us who are providing regional news and information of one kind or another. That is a very attractive and very exciting opportunity that could bring efficiencies and compared with the gross of the licence fees, a very small amount of money would be needed to create this entity. The regional newspapers could be brought in, if they wanted to be part of it, there are good synergies there.

**Q150 Lord Inglewood:** I want to declare an interest in respect of local newspapers. At the beginning of your remarks you talked about pluralism and yet you are beginning to create a monolithic monopoly structure through which conduit perhaps all news might come. Is that desirable?

**Mr Grade:** For the purposes of the PSB discussion, plurality of supply of news, which is at the heart, is really defined as an alternative to the BBC. There is Sky News, which is a wonderful service and a great choice for consumers, but it is not guaranteed. Sky could decide one day that it is too expensive or they have better use for that spectrum, so they will use it for something else. There is no guarantee that Sky News is always going to be there. Our news is guaranteed; BBC's news is guaranteed. Plurality is defined as an alternative to the BBC. If the only way to sustain that is consolidation of some newspaper interests, ITN may be involved, the ITV licences, etc., I think that is a good proposition. It is too fragmented at the moment.

**Q151 Chairman:** On the point that you regarded as a very exciting proposition: the bit of the licence fee that has been taken to one side and is for digital switchover where we think there is going to be underpayment, do you visualise that as going on as an extraction from the licence fee?

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**Mr Grade:** If I may, My Lord Chairman, I think we have got to come back one stage. The principle of the Ofcom proposal is that ITV has PSB-light obligations—news and original production quotas—and makes available, air time for regional news. We make our air time available for another provider, another entity. They are suggesting that there should be some kind of competition for who should run that and how it should be structured. Their idea for funding it is that there is some cash available if, beyond the present licence fee settlement, that piece of the licence fee that is ring-fenced for digital switchover continues—that could be used for other purposes, of which a small chunk of it could be used to guarantee the plurality of supply of regional news.

**Q152 Chairman:** But that will not help you in the short term.

**Mr Grade:** Ofcom's proposal is to bring that forward to 2011, which we would find extremely helpful.

**Q153 Baroness Bonham-Carter of Yarnbury:** I have become increasingly wary about this excess digital money. It seems to be the answer to too many things. Can I press you on the idea that you provide the air time, but somewhere out there is someone willing to provide the money. If you find it impossible to provide the money, where is this pot of gold going to come from? It seems a very fine idea but does not sound very practical.

**Mr Grade:** It is for the policy makers to decide whether it is a sufficiently important piece of public policy that there is plurality of supply of regional news, that the market cannot provide it, it cannot sustain it and it cannot guarantee to provide it. So, it is a matter of public policy, it is not for us to decide. If it is decided that there is no public money, or there is no other pot of money to provide it, and nobody is willing to take it on and guarantee it—the key thing is the guarantee of supply, that is what PSB is about—then the nation is making a decision that it is happy for the BBC to have the monopoly of regional news broadcasting.

**Q154 Baroness Bonham-Carter of Yarnbury:** If that were the outcome, what effect would that have on ITN and your national news coverage?

**Mr Grade:** None at all.

**Q155 Baroness Howe of Idlicote:** I have been listening to what you have been saying and I am confused about one thing. Leaving aside news, I am intrigued as to how you would define public service broadcasting. What is going to be different about the content of public service broadcasting that you are going to qualify for if you have an extension, compared with the rest of your programming?

**Mr Grade:** It is for policy makers to define how they see ITV going forward as a PSB—what is it, as a matter of policy, you want us to do, what is it going to cost? If it is in excess of what the licence is worth, we cannot do it. We have an alternative, which Ofcom has clearly pointed out, which is to give up our PSB status and take our chance in the market. In the event that we are asked to make public service guarantee commitments to types of programmes and genre of programmes and quotas, etc., if it is not sustainable from a business point of view, it is not sustainable. But we will deliver £35 million worth of public service broadcasting, guaranteed in return for the spectrum. It is for the policy makers to tell us what they want us to do for that. After that, we must be free to run our business in the market place and compete.

**Q156 Baroness Howe of Idlicote:** When I switch on, I am still unsure about what bit of what I am looking at will be different from what is happening now. You are a commercial broadcaster, with quite a strong public service broadcasting remit.

**Mr Grade:** You will continue to see international and national news. After that, we will deliver whatever the policy makers want us to deliver up to the value of £35 million and after that we will do whatever gets us a return for our investment. If you go through our present licence from Ofcom, there is a whole raft of regulatory requirements on us, which are costly and for which we get no return; they will all go. We are very happy to provide the Committee, separately, with a schedule of the regulations and the quotas, etc., under which we labour, to be honest, where we are trying to compete in a very dynamic and expanding market. We have competitors today that are 10 times our size, which did not exist five years ago. That is the business we are in. Now, if you give us back a monopoly of advertising revenue, we will deliver anything you want, which is ludicrous and is a denial of choice for the consumer; we are not going there. Naturally, we all want it both ways. They want us to keep doing the things we used to, but they want us to compete in the market. We are happy to compete in the market and stand on our own abilities and run our businesses in as efficient a way as we can and provide value for the licence; beyond that we cannot go.

**Q157 Baroness McIntosh of Hudnall:** It has just occurred to me that this £35 million of value that you deliver, the way it is talked about seems to equate, in effect, with £35 million worth of broadcast material that is going to appear on the screen. Are there any other aspects of what you do that you regard as part of your public service remit? I am thinking particularly of the commitments that you have to the long-term health of the industry through the way that people are trained and encouraged into it and supported in it. In a world in which you had no public

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service obligations, would you see your commitment to training as something that you would still continue with, or would it fall away along with the other things? And do you see it anyway as something on which you would want to stay focused?

**Mr Grade:** If we believe that our business model of huge investment in UK production is the best way of getting a return for our shareholders, it is in our interest at that point to invest in training to ensure that we do not get caught by a skill shortage in five or 10 years' time, and we would continue to invest. If we find that model is unsustainable and that we can get a better return for our shareholders by running programmes from the archives, importing material from America and other countries and that is the best way forward and that we are going to withdraw from UK production, then we would feel no obligation whatsoever to invest in training, as we are not going to get a return from it.

**Q158 Baroness McIntosh of Hudnall:** So, just to be clear; there is a direct correlation for you between UK-generated output, which to some extent overlaps onto your public service obligations and your commitment to training. Would I be right in thinking that for as long as you continue to generate content in the UK as part of your public service obligation, you will continue to support training?

**Mr Grade:** Absolutely. We invest between £800 million and £1 billion a year, if you include all the licensees in content, of which 80 per cent to 90 per cent is in UK production, very happily, as the market stands at the moment, that is where the shareholder interest and the public interest overlaps and we believe that is our future. The future strategy that I have laid out for our shareholders and for the markets for ITV is absolutely UK content-led. We see our future as investing in UK content and if we are right—and I am sure we are right because of value of new platforms and other things coming on is only increasing—then we feel that we would get a very good return for investment in training.

**Q159 Chairman:** Are you giving a commitment to organisations like Skillset? I rather thought you were actually withdrawing.

**Mr Grade:** We are making cuts at the moment, which are very painful and we are trying to save as many jobs as we can. We hope this is a temporary situation, pending the recovery. Our job is to maintain as high a level of investment on screen as we possibly can, so that we emerge from this downturn in as strong a position as possible, maintain the support of our advertising customers and so on, and there are some painful decisions being made. Hopefully, we will be able to return to investment in due course.

**Q160 Chairman:** Does the same apply to the National Film and Television School?

**Mr Grade:** Yes.

**Q161 Chairman:** I understand that you have temporarily stopped both of those.

**Mr Cresswell:** We have stopped at the moment because we have decided that there is more benefit in training our own staff, given the tough economic circumstances. I wrote to all those people saying that, given the current financial challenges, the priority has to be jobs within ITV, training within ITV, and product on screen to serve our advertisers during this period. Each letter said that hopefully when we are through the recession and have a clearer view of the revenue, we can start to re-engage and support those organisations again, in cash. Obviously, we support all of them in kind, with our staff, and have a very keen engagement with all of them and will continue to do so over this year, but the cash has been cut back this year.

**Q162 Chairman:** What impact will it have on the organisations?

**Mr Cresswell:** Hopefully, they will all continue to provide their services, maybe at a reduced level, but I do not think we have put any of them in danger of not being able to meet their obligations.

**Q163 Baroness Eccles of Moulton:** To continue what you have been saying about regulatory constraints and not paying more for spectrum than it is worth to you, this brings us on to the question under review at the minute, which concerns the Contract Rights Renewal Undertakings. There are two sides to this question: one point of view is that it is a carry-over, now out of date, of the Granada-Carlton merger and that, therefore, the OFT is possibly going to recommend to the Competition Commission that these are relaxed, which would obviously give you more freedom within the advertising market, but the other side to the question is what effect that would have on the other advertising-funded channels. What is your view on that?

**Mr Cresswell:** The OFT said they were looking at an easing of the restrictions on CRR. The world has changed significantly over the past four or five years. ITVI's share of commercial impacts has fallen over that period. Now that most people understand that ITV air time is substitutable, ITV1 has 30 per cent of commercial impacts; there is 70 per cent out there and advertisers have significant choice—Channel 4, Channel 5 and Sky and the multitude of digital channels—so one is able to substitute the audiences that ITV provides in the marketplace. That is now becoming understood in the market. We obviously believe that investing in UK-originated content makes us a premium brand in that market place but, given the changes, it would be very difficult for ITV

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universally to put up its prices with advertisers not having choice. They have plenty of choice nowadays.  
**Mr Grade:** I would like to add that nobody knows what the final arrangement will be and therefore what the effect on the market is going to be, but a liberalisation of the CRR mechanism would be neutral for our competitors.

**Q164 Baroness Eccles of Moulton:** That is not the way they see it.

**Mr Grade:** No, of course not.

**Mr Cresswell:** One of the reasons that we believe CRR is a negative mechanism and an inappropriate remedy nowadays is that it stifles innovation on ITV. To give you an example, we had a drama in the autumn called *Lost in Austen*, which in pure volume of ratings was not a huge success—it got about 3 million—but the quality of that audience was very good with many BBC viewers, and AB1 profile, which in another world would be very valuable to advertisers. Under CRR we get penalised for having a show of that quality that we cannot monetise as it is judged by the volume of impact; it does not value reach or quality. So, we believe, that given an easing of restrictions and a different type of measure, it would enable us to invest in a broader range of product.

**Q165 Chairman:** There is a legitimate interest, is there not, in trying to ensure that there is United Kingdom innovation and production? You do not deny that?

**Mr Grade:** Absolutely. The CRR mechanism means that we are chasing volumes and ratings, otherwise there is a severe financial penalty, the following year, if we do not hit our ratings numbers. So, what do you do? You just carry on with shows that are perhaps past their sell-by date because they are certain to deliver six or seven million, whereas if you do something new, there is a risk that it might flop. The risks are very high in broadcasting.

**Q166 Lord Inglewood:** In the hypothetical “brave new world”, where you cease to be a public service broadcaster, do you think the viewers will get a better or worse programme, or do you think it will make no difference?

**Mr Grade:** The business model will change. The range of programming that we delivery might reduce, certainly the coverage will reduce, so there are people who will not be able to get *Coronation Street*—I use *Coronation Street* as a symbol of many other programmes that people enjoy, *X Factor*, *Britain’s Got Talent*, etc.—so there is a price paid. The principle of universality for PSB goes because we have got a limited reach—it would be about 93 per cent—so that people will lose the signal. In terms of what we deliver, we will deliver a service for us and our shareholders giving the best return, whatever that may be; the consumer will be in charge at that point.

**Q167 Lord Inglewood:** Do you have any ideas in your mind what changes that might impact on?

**Mr Grade:** No, not at the moment.

**Mr Cresswell:** Could I just add that if you do not change it, the one fundamental is that there will be less investment in the UK-originated product. When Ofcom did the first report in their Phase 2 study, they showed that despite the huge growth in digital channels, the level of UK origination coming from those channels was very small, so the market is not providing in that sense. ITV spends two-thirds of the amount of money invested by the commercial sector in UK-originated product. If ITV still has the legacy regulation which holds it back from investing then there is only one way it would go because most digital channels are full of repeats or acquired material.

**Mr Grade:** The Ofcom figures showed that the existing PSBs—BBC, 3, 4 and 5—still provide 90 per cent of the investment in UK production, whereas, there are now many hundreds of digital channels, and we are still investing 90 per cent of the total investment in UK production.

**Q168 Baroness Bonham-Carter of Yarnbury:** Returning briefly to CRR, when did the Office of Fair Trading start looking into this?

**Mr Cresswell:** They started at the back end of last year. They have just launched their first public consultation, which is a six-week consultation.

**Q169 Baroness Bonham-Carter of Yarnbury:** And then it goes to the Competition Commission?

**Mr Cresswell:** Yes, in the spring, they will refer it to the Competition Commission.

**Q170 Baroness Bonham-Carter of Yarnbury:** It strikes me that in this fast-moving world, if the conclusion is that this is necessary, the wheels of change grind very slowly.

**Mr Grade:** For us, because of the way the market operates, so long as this issue is resolved in time for our negotiations with the advertisers at the end of 2009 for the 2010 calendar year, that is fine; we have got until November, which is when the negotiations start. It is crucial that they stick to the timetable, which they have understood and acknowledged, to get this done in time for what is known vulgarly in the trade as the “up fronts” in November and December, for next year.

**Q171 Baroness Bonham-Carter of Yarnbury:** On a point you make, which I noted in your article, about the BBC, ITV, Channel 4 and Five supplying 90 per cent of British content, do you think there is a place, with the expanding number of digital channels, for a levy on broadcasters who are not investing in British content but are getting money out of British viewers?

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**Mr Grade:** I am not sure about that. I am more worried about copyright protection on line. I am hoping that Lord Carter's reports, which I have not seen, are going to deal with the issue of copyright because you start from the point of view at the moment that it is a bit of a Wild West on the internet and there is a lack of policing of intellectual property rights. We pay for music that we use; there are industry-wide collection systems for all the music we use, the same thing should apply to moving pictures on the web. As long as the people who created the intellectual properties are properly rewarded and their intellectual property—much of it is ours—is not stolen and pirated and promulgated on the web, then that would be a big step forward to maintaining our ability to go on investing.

**Q172 Chairman:** Very briefly, could you tell us in terms of priority, the controls that you want off—trying to keep it jargon-free.

**Mr Cresswell:** There are two things: outputs—what we sell—obviously CRR using restrictions on how we sell our air time is a top priority for any business to be able to monetise its product—that is the first one. We have a joint venture with BBC and Channel 4 going through, Kangaroo, which is online sales, getting that through would help us to monetise the content online. Our broadcast licence, then: it is a solution to the funding of regional news; it is a reduction in our out-of-London quota, which has been recommended by the second phase of the Ofcom PSB review; reduction in our other quotas, in terms of independent access to our schedules to European levels. So: out-of-London, independent quota, sorting out the networking arrangements that we have with the other licencees, and the terms of trade we have with our suppliers. Much of our inputs as well as our outputs are regulated. If we could just act as a commercial organisation and have commercial arrangements with the people we sell to and the people we buy from, that would be a very happy place.

**Mr Grade:** The regulator also retains considerable regulatory controls over our inventory and air time, which seems to me, in a dynamic market, an anachronism. We are told that we are required to sell out our entire inventory every day irrespective of price. Well, we are not like a newspaper, where the newspaper will reduce its pagination to try and match supply and demand and get a commercial return. We are denied that. We are told that the rules over where we place our minutes are arcane; we are waiting for the Government to endorse produce placement, brand recognition, which advertisers will pay for in programmes, it exists on the screens at the moment, it is all over the screens in American material. I do not notice any civil unrest or marches in the streets to stop Bond films being shown on television because they are full of product placement. It is a nonsense and we have

to get real about these things. We are operating in a market; we have got Google and the rest of them utterly unregulated. I am not arguing for the regulation of Google, but we are in competition with them and we must be free to compete. We have a set of rules and regulations that belong to the long-lost days of ITV monopoly.

**Q173 Lord Macdonald of Tradeston:** Assuming that you are still on Channel 3 in 2014, the licence expires then and Parliament would have to take a view on what happens subsequently. Ofcom proposes that they might advertise the licence for Channel 3, as a single UK-wide licence, or four national licences. The importance of the national licences—I do not have to explain it to Michael Grade because he was on the board of Scottish Television—is that the nations with their parliaments and assemblies think that they need a different degree of programming from an English region. How do you see that going forward? Do you think that if the Ofcom proposals are accepted, including GMTV's Breakfast television slot which you are taking over, there would have to be competitive tendering? If it were to be one franchise, you would presumably want to go for that; were it to be four, could you bid for all four excepting the different specifications in each nation?

**Mr Grade:** I see no reason to change the present configuration of licences. That being the case, there is a provision in the present arrangements whereby we have the right to renew our licences. I do not see the need for a huge reconfiguration. The last thing this industry needs now is to be convulsed in a tender process for new licences; that would be an absolute disaster for ITV.

**Q174 Lord Macdonald of Tradeston:** But if they had to redefine the licences?

**Mr Grade:** Then they would have to tender. If that is the decision, then we will make our own choice at that point whether we want to participate in that or not.

**Q175 Lord Macdonald of Tradeston:** Would it not be worth it to get an extra 25 per cent of GMTV?

**Mr Grade:** We own 75 per cent of GMTV—separate licence—it is really not going to move the dial in any direction to consolidate that licence; it is an irrelevance really. It is a bit of tidying up but I cannot see that it will change anything. Tendering for these licences was absolutely appropriate in the days when they were worth a fortune. They were very valuable pieces of paper. We know what the value of the licences is today; there is no reason to put the industry through that kind of upheaval, it is a waste of money.

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**Q176 Chairman:** Was your reason for saying that bidding would be a disaster because times are very troubled at the moment and very uncertain, or is that not part of the consideration?

**Mr Grade:** It is very costly and very destabilising for a business. I have lived through these things in the past. I was Chairman of Camelot, which was put through a licence renewal process for a monopoly licence so I suppose that has to be done, but it has a destabilising effect on the business.

**Q177 Chairman:** Quite apart from that, at the present time, it would be very difficult to forecast. If the recession is building, people are very uncertain what the future economic position is going to be, you would want a bit of time and a slightly more stable situation in which to make a sensible bid, would you not?

**Mr Grade:** There is no question about that.

**Mr Cresswell:** Also, the last time the licences were tendered in the 1990s, there was a significant amount of public value being pledged by the licencees—£300 million or £400 million, I would guess. Ofcom now says that the public value of the licences is £35 million to £40 million, so there is a huge process to go through to get back to that commitment. I would also come back to Lord Macdonald's point about the relationship with the other nations' broadcasters, having a tender where we could potentially compete against them—at the moment we are working in harmony, buying rights that go out for a certain period—would cause complete consternation and force the cracks in the system even deeper earlier on. I do not think there is any benefit to it.

**Q178 Lord Maxton:** I am slightly confused by this argument about your spectrum and switching 5 per cent of the population. In 2012, everybody is going to have to have digital television so, therefore, that 5 per cent will then come back, so you are talking about three years, maybe, of 5 per cent. I am not sure what public service broadcasting is. If I go on to Freeview, Sky or Virgin Media—which by the way, with three houses I have got all three in different forms, all of which were paid for before I became a Member of the House of Lords—I can get many more of your own channels, I can get BBC 3, BBC 4 as well as a range of other channels—the History Channel, Teacher TV and a whole range of other things, which are arguably public service broadcasting, are they not? Sky, I would accept is different, I am paying for more channels, but on the Freeview box, I get 58 channels, many of which can be classified as public service broadcasting.

**Mr Cresswell:** With the Freeview coverage, there are six multiplexes all having varying degrees of coverage of the UK. The multiplex we are on, which is owned by D3 and 4, of which we get 50 per cent, has very

high coverage. If we traded off that multiplex and bought spectrum elsewhere, we would have less coverage of the UK market because there are some black spots that cannot receive DTT coverage. We have launched Freesat to try and fill in those holes, but you are left with the position that some customers would have to pay via cable, perhaps, or more likely via satellite, to receive something that is free to the rest of the UK. That would be the issue; you are right, they could probably access it but they would have to pay to access it. So, maybe the risk to us is not as great, but there is the benefit of stabilising business and the EPG positions that we get through that spectrum. If we are able to balance the equation in terms of the cost benefit by supplying the public service value, whether that is national, international, impartial news or something else, we could do it.

**Mr Grade:** My Lord Chairman, in some of the nations there is as much as 20 per cent of the population who cannot access Freeview.

**Q179 Chairman:** At the moment.

**Mr Grade:** That is not going to change.

**Q180 Lord Maxton:** That is not going to change at all?

**Mr Grade:** Not at all.

**Q181 Lord Maxton:** Can I move on to your advertising revenue. The suggestion has been that the advertising take for television has been spread over other channels. Surely the greatest loss of advertising revenue has been to the internet rather than to other channels. That is something, particularly as I expect in this statement we will get a commitment to broadband to every household over the next few years, which surely is going to increase, rather than reduce.

**Mr Cresswell:** There has been a huge increase in the supply of impacts, which is what we sell, through the penetration of digital television that is now up in the 90 per cent region, and the number of channels launched. That has meant that the price of air time has deflated significantly. An advertiser can probably buy the same amount of air time on ITV in 2009 for 7 per cent or 8 per cent less than they could in 2008, without a deflation in the overall market. The price of air time in the UK is now cheaper than most of Europe, previously it was more expensive, so there has been a huge increase in supply.

**Mr Grade:** We are excited about the web; we think that the web being an opportunity for advertisers is a massive opportunity for us. We have demonstrated, and the BBC has demonstrated through the iPlayer, and ITV through ITV.com, that there is huge traffic to be drawn to the internet driven by our content and our investment in the UK content. The numbers are quite staggering. We believe that if advertisers want to

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move to the web, we should be there; we have the content that will offer them the opportunity. It is a big business opportunity for us, so we are excited by the opportunity that the web presents in terms of advertising revenue.

**Q182 Chairman:** We have taken a lot of evidence. You have a lot of experience. You have worked for BBC, ITV, Channel 4, what is your solution to the Channel 4 problem?

**Mr Grade:** I am happy to say that it is not my problem.

**Q183 Chairman:** I realise that, but just as a friendly advice.

**Mr Grade:** One of the options on the table at the moment is a shotgun wedding with Five, which would produce considerable synergies, but which meets with considerable opposition from the bride, namely, Channel 4. They have come out publicly against it.

**Q184 Chairman:** Would you be happy about that?

**Mr Grade:** We do not have a problem with that. Whatever the arrangements are with Channel 4, our only issue is to see that there is a proper governance arrangement with Channel 4 and that there is fair competition. That is all we care about. We do not mind what the solution is.

**Q185 Chairman:** What do you think about BBC Worldwide coming together with Channel 4?

**Mr Grade:** Again, it is hard to imagine that in the boardroom of BBC Worldwide for the past five years, as they discussed strategy, have been sitting there saying that the one thing they really want is to get their hands on Channel 4, that would transform their

business. I cannot imagine that is a conversation they have ever had. I would not imagine that Channel 4 is on their target list of strategic acquisitions. Again, it looks like a shotgun wedding. We wait to see what the detail of that is.

**Q186 Chairman:** So, you have no “third way”?

**Mr Grade:** No, My Lord Chairman.

**Q187 Lord King of Bridgwater:** You mentioned fair competition in relation to Channel 4, so if there were a Government subsidy to Channel 4, would that be fair competition?

**Mr Grade:** It would depend on what the subsidy was used for. If it was used to pay for American material and Celebrity Big Brother, we would be quite concerned about it. It is the issue of how closely you define the remit and how closely you ensure that if there is public money going in, that it is used on the Channel 4 network and that Channel 4 is not freed up from its public service obligations and can lay off public service obligations on Channel 4 Online or E4 or More4, it should be for the main channel and there have to be governance arrangements that ensure that is how the money is used.

**Q188 Chairman:** You wanted to make your last point.

**Mr Grade:** I am aware that we have not adequately explained the spectrum issue. We would like to send you a note explaining precisely what the difference is between PSB spectrum and non-PSB spectrum so that it is absolutely clear. Spectrum is my specialist subject.  
**Chairman:** Thank you for the offer. Your organisation tries to keep us up to date with developments and we are grateful for that. Thank you, above all, for coming this morning.

### Supplementary letter from Michael Grade, ITV

Further to ITV's appearance at the House of Lords Communications Committee meeting last week, there were two matters on which I promised to follow up with the Committee.

The first concerned the regulatory obligations that apply to ITV, many of which were relevant to the old analogue, monopoly era, but are simply unsustainable today, with digital switchover 90% complete and multi-channel television in almost every home. The relevant issues, which we have raised with Ofcom in the course of its Public Service Broadcasting Review, are set out in an annex to this letter. Without relief from these legacy regulatory burdens, the costs to ITV of being a Public Service Broadcaster will start to outweigh the benefits from this year onwards, progressively reducing our capacity to invest in original UK production, which is critical to ITV's viewers and to its future success. The proposals we have put to Ofcom are essential to ensure that the costs and benefits to ITV of remaining a Public Service Broadcaster are brought back into equilibrium.

The second issue concerned Digital Terrestrial Television (DTT) spectrum. At the Committee meeting I mentioned that if ITV ceased to be a PSB, ITV channels in future would most likely be carried on commercial DTT capacity. In which case, our channels would be received by fewer people on Freeview post-DSO in 2012 than would be the case if we remained on our current PSB spectrum.

This issue arises from the difference in coverage of the UK between the three public service DTT multiplexes (which will reach 98.5% of the UK population post-DSO) and the three commercial multiplexes, which will reach between 90% and 93% of the UK population post-DSO. Both the Government and Ofcom have recognised that it is not economically viable for the commercial multiplexes to pay the infrastructure costs to

build out the DTT network to 98.5% coverage—requiring expenditure on over 1,150 masts—when expenditure at 80 or so existing masts will deliver between 90% and 93% coverage.

The result of ITV services moving across to the commercial multiplexes would be that a proportion of UK viewers (with particularly high percentages in the Scottish and Welsh nations of the UK) would lose the opportunity of receiving ITV programmes such as Coronation Street via Freeview and would, as a result, have to subscribe to satellite/cable or take advantage of the subscription free ITV/BBC backed Freesat offering if they wished to continue to receive those ITV programmes.

I hope this additional information is helpful. If you or the Committee have any further questions on either of these points please do not hesitate to contact me or our Director of Public Affairs, Nigel Warner.

6 February 2009

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### Examination of Witnesses

Witnesses: Ms DAWN AIREY, Chairman and Chief Executive, and Ms SUE ROBERTSON, Director, Corporate Affairs, Five, gave evidence.

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**Q189 Chairman:** Thank you very much. Welcome. We are looking at public service broadcasting and obviously Five has an important part there. I will start in the same way that I started with Michael Grade of ITV, which is to ask, what in your view is the current financial state of commercial television?

**Ms Airey:** I think you will hear much the same answer as you had from Michael. I do not want to sound like a one-note Samba or follow what he said, but there are two issues going on at the moment. One is a cyclical change to the business and one is a structural change. At the moment, the recession is hurting every business. We only heard yesterday that 46 per cent of businesses are going to be making redundancies, and the entertainment industries are not immune to what is happening. What we are seeing is a tightening of horns by all our suppliers and our advertisers, and they are spending significantly less money on television this year than they did last year. We are anticipating a decline of around 10 per cent of the ad market for 2009, which is compounded on a market that was down 5 per cent the year before. Those are very significant reductions in revenue. You compound that with the structural changes that are happening to the industry, which is a shift of value to other sources. There are plenty of ways that you can interact with audiences, that you can get your commercials away, so we are seeing movement away, particularly to online. Broadcasters are responding to that, it is not all one way. It is not as if we are not involved in that business as well, because we are, but it is a double pinch point; it is unpleasant and everybody is looking at both their cost base and their own expenditure.

**Q190 Chairman:** You say you have had a 5 per cent fall and looking forward to another 10 per cent fall in terms of advertising revenue, what does that do to the bottom line of your business?

**Ms Airey:** It gives it a tough time, I would not say we are looking forward to it. We are looking at it with a degree of anxiety, but it means that you have to review your business. It hits everybody's bottom line unless efficiencies can be made, which Five is looking to do,

as has every other broadcaster, whether that is a reduction in its overheads or a reduction in its commitment to programme spend, it affects all broadcasters—and nobody is immune to what is happening.

**Q191 Chairman:** How many staff have you laid off?

**Ms Airey:** At the moment, we have not laid off anybody. We have the *de rigueur* consultants in with us at the moment—as they are with other broadcasters. There will be staff losses and our staff are aware of that; how can they not be? They only have to look at what is going on in the wider economy to know that television is not immune and they certainly know that year on year the reductions in our revenue mean that it is impacting on our bottom line.

**Q192 Chairman:** So, that is fairly dire. But in spite of all that, you still want to be a public service broadcaster?

**Ms Airey:** Yes, we have always been consistent in that. We started as a public service broadcaster 11 years ago and we have no intention not to continue with the additionality that we provide for the public.

**Q193 Chairman:** A number of solutions are being put forward as to your future as a public service broadcaster, one of which is that you should merge with Channel 4. You rather support that do you not?

**Ms Airey:** It is certainly an option that we are not immune to engaging with Channel 4, if they want to talk to us.

**Q194 Chairman:** I thought you were rather enthusiastic about it.

**Ms Airey:** We think it is a really interesting option in so far as it puts together two broadcasters that are in exactly the same business. We are both public service broadcasters; there is a huge amount of synergies that can be effected as a result of that merger and, importantly, we believe it solves, in a stroke, Channel 4's funding deficit in the short to medium term. At the moment, Channel 4 have not shown any curiosity

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about engaging with us in that conversation and we hope that they will.

**Q195 Chairman:** Have you had any talks with Channel 4?

**Ms Airey:** RTL, who are driving this initiative and are our parent shareholder, our Chief Executive, Gerhard Zeiler, has spoken to Luke Johnson who said that he would listen to anything, because that is his obligation as Chairman of Channel 4. But he has publicly said that he would regard his chairmanship of Channel 4 as a failure if it ended up with a merger with Five.

**Q196 Chairman:** That does not sound like the most promising start does it?

**Ms Airey:** It is a reluctant marriage; it is potentially a shotgun marriage if it happened. But, who knows, whether Channel 4 want to engage with us or not.

**Q197 Chairman:** No one can force you into a marriage can they?

**Ms Airey:** No, they cannot be forced into a marriage. The interesting question is that if we solve their funding problems without recourse to the public purse, or moving funds from one State organisation, the BBC, to another, why would you not look at that as a very serious option?

**Q198 Chairman:** When Channel 4 came here, they were indicating that you wanted to come to them because of their financial strength. You seem to be saying rather the opposite.

**Ms Airey:** I think it would be a very good solution for both of us. The arrangement is not oil and water, which is what it has been described as by Channel 4. There are so many benefits: we both commission programming; we both sell commercial advertising, the businesses are the same. In any other industry, if you put two businesses together that are in exactly the same business, there are significant synergies that come out of that. The synergies we believe are so significant that we can enhance the public service content that Channel 4 already has.

**Q199 Lord King of Bridgwater:** You referred to bringing in consultants—which is an unusual approach to how you cut your costs—I do not know if this is your briefing, it is a story that appeared in *The Times*, which said that revenue is predicted to fall by 20 per cent and the turnover in 2008 tumbled by nearly £70 million. If I ask you the same question that I asked Michael Grade, Ofcom has just produced their report which puts a figure of £145 million per year by 2012. If Channel 5 is £70 million down on its own and there are the bigger issues of Channel 4 as well, are those figures a bit out of date and going to be worse?

**Ms Airey:** I cannot predict how the economy is going to develop beyond this year. There is no visibility, but we are very good at managing our bottom line. Last year we made a profit, this year we are aiming to have a very robust performance. Of course, in these situations you reduce your expenditure and you try to maximise your income. Five is a young broadcaster, we are only 11 years old. We were born into a very dynamic market that has not seen substantial year-on-year growth and yet we have still done rather well fiscally. We are smaller, leaner and more nimble, so I cannot look beyond this next year to say what our business is going to look like in 2011, 2012 or 2013, but what I can say is that we will respond to that market as we always have done and be an effective public service broadcaster and a good business investment for our shareholder RTL.

**Q200 Lord King of Bridgwater:** Was this a proper, on-the-record briefing?

**Ms Airey:** No, I have no idea. I would like to find out where Dan Sabbagh got that from. We have not briefed anybody about what is going on internally. I was quite appalled to read it because it gives a figure, which would not be appropriate to confirm here, but our staff do not even know about it and they suddenly read that it looks as if a third of the staff are going to go, and there is to be an £8 million saving; I do not know where that has come from, it was not from us.

**Q201 Chairman:** So, it is wrong?

**Ms Airey:** Yes, it is wrong.

**Q202 Lord Macdonald of Tradeston:** I want to follow up on the discussion about Channel 4 and Channel 5. If that is seen as a forced marriage of incompatibles, there is an easier route, which is the one of the market place where there has been speculation in the past that RTL, owner of Channel 5, might bid for ITV. If that were to happen, would there be any regulatory barrier to stop that happening, and would it deliver the benefits that you look for in your merger with 4 to an even greater degree.

**Ms Airey:** That is an interesting question, Lord Macdonald. Unfortunately, I cannot answer on behalf of RTL and cannot comment about their strategy for this market. What I would say is that 4 and Five does have real industrial logic and out of that industrial logic also comes an enhancement in performance and revenues that would be reinvested back into public service content. That has to be a really good thing. Clearly, there has to be governance around 4 and the very particular remit that it has and the great things that it provides in terms of plurality of public service content. We are not in any way suggesting that Channel 4 should be deconstructed.

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**Q203 Lord Macdonald of Tradeston:** I understand that. I just wondered if you thought there might be any regulatory hindrance were a bid to be made in the market and an agreement reached between RTL and Channel 3. There is nothing to stop that happening in the future?

**Ms Airey:** Not that I am aware of. From a regulatory perspective, I do not think there is.

**Q204 Baroness Bonham-Carter of Yarnbury:** Why is it that you are so hostile to the proposal of Channel 4 and BBC Worldwide coming together in some way?

**Ms Airey:** We are not hostile to the proposal at all. We just do not think that it solves the funding gap. BBC Worldwide is rapaciously commercial, and rightly so, that is what it is there to do, to exploit the IP that it has, to deliver as much revenue back into the organisation. Channel 4 is a company that does not own any IP. We can see some benefits, some synergies, but not of the quantum that are necessary to solve Channel 4's very openly publicised £150 million deficit. It certainly could be part of the solution but in and of itself it is not the solution.

**Q205 Baroness Bonham-Carter of Yarnbury:** So, you do not think it meets the sum required?

**Ms Airey:** We are pretty good fiscally and we just cannot work it out.

**Q206 Chairman:** To pick up a point that Lord Macdonald made. You said you could not answer on behalf of RTL. Does that mean that if we ever want to find out the corporate policy of RTL relating to Five, we have to have the head of RTL here?

**Ms Airey:** Not necessarily.

**Q207 Chairman:** You have just exposed one part where it is necessary, have you not? If this became an issue, you would not be able to answer for it. I am just trying to get your structure right.

**Ms Airey:** It is a good point. The question was, from a regulatory perspective, could this come to pass? We are pretty confident that it could happen. In the past, RTL has expressed a possible interest in ITV, but it has not happened for whatever reason. I cannot honestly speak on behalf of my shareholder, I am not being difficult or obstructive and I will certainly refer it back and see if they can answer the question.

**Q208 Chairman:** That is not really my point. If we actually want to find out about the overall policy that relates to Five, we actually need the chief executive of RTL as well as yourself?

**Ms Airey:** No. If you want to know the policy in relation to Five, it is me. I am here to address Five's response to the Ofcom report and I can speak on behalf of that. What I cannot do, with respect, is speak on behalf of my shareholder on other issues and

aspirations they might have to this or to any other market. In the same way, I suspect that Michael Grade cannot speak on behalf of the investors that he has in ITV and what their aspirations might be for this market.

**Q209 Chairman:** There is some difference is there not between your position and that of Michael Grade's?

**Ms Airey:** We have one shareholder and he has a variety of shareholders.

**Q210 Baroness McIntosh of Hudnall:** It is pretty clear from what I have heard that you share Ofcom's view that public service broadcasting environment is now such that it is pretty difficult for the BBC 3, 4 and 5 between them to maintain present levels of public service provision without there being some intervention of some kind, whether it is with additional money or partnerships. I take it that you agree with that analysis?

**Ms Airey:** Yes, in part. We are not asking for intervention.

**Q211 Baroness McIntosh of Hudnall:** I am using intervention in a fairly broad sense.

**Ms Airey:** Yes, as far as a lightening of public service broadcasting obligations, Ofcom have taken that on board and have said that in relation to Five, for example, there can be a lightening of origination quotas—still 50 per cent of the schedule will be originated from this country. We continue to have obligations for news and children's programming but it is slightly lighter in terms of absolute maps, which we welcome. To be a public service broadcaster with Channel 5 brings real benefits, the real benefits being gifted spectrum at a reduced cost—that is a very important benefit of being a public service broadcaster—and due prominence in the EPG, and the universal prominence that goes with that, is important.

**Q212 Baroness McIntosh of Hudnall:** Yes, and I think we have understood that. However, Michael Grade has made quite a big feature of the necessity for the regulatory environment to change; you have just mentioned that yourself. He has been quite specific about exactly what regulatory changes he would like to see. Can you tell us what you would like to see that would make the environment viable for you?

**Ms Airey:** We would certainly like a revisiting of the terms of trade with the independents, not a wholesale revisit, but at the moment there needs to be a correction of the value chain. At the moment, I would suggest it is slightly too biased in favour of the creator of IP. There just needs to be a balancing of the terms of trade so that the broadcasters can acquire and exploit more rights in a time period, while still acknowledging who created the IP and giving them due recognition

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for that in whatever contract is struck. The other thing that we would like and this is not self-serving, but it is at the other end of the spectrum from Michael, which is that we would not like an alleviation of CRR—I am sure you will have heard this from other broadcasters who are not ITV, not surprisingly; ITV represents 46 per cent of the market; that is market dominance in any shape or form. We would like CRR to be maintained whilst you have a broadcaster with that sheer volume of commercial impact. So, those are the two key things: CRR and terms of trade.

**Q213 Lord Inglewood:** I have listened very carefully to what you said about your commitment to public service broadcasting and your determination and belief that you have got the resources to do that. I think I have understood that right.

**Ms Airey:** Yes, that is correct.

**Q214 Lord Inglewood:** Yet my understanding of your financial information as derived from the RTL accounts is that your EBITA is really not very much. How difficult is it for you?

**Ms Airey:** It is difficult. It is difficult for every broadcaster.

**Q215 Lord Inglewood:** Yes, but you are on quite a tight margin.

**Ms Airey:** It is a tight margin and it always has been. That, in itself, raises some interesting questions about RTL's commitment in the UK. They have been a consistent investor in Five right from the beginning; they were one of the founder shareholders and now own the company in its entirety. Throughout those 12 years, margins have been quite modest. There have been profits, but they continue to invest in the company and will continue to want a broadcast presence in the UK. Yes, things are tight but we have always been a broadcaster that cuts our cloth according to our means; we are not constantly having the begging bowl out asking for more. Yes, of course, we would like more profits, which is why we are diversifying our businesses outside the broadcasting stream, like every broadcaster, having a broadband proposition, an online proposition, to bring in an alternative revenue stream. Every shareholder always wants more money.

**Q216 Lord Inglewood:** I do not dissent from that. But the question I would like to ask and I think it is one for Gerhard Zeiler and not to you because, bearing in mind what you said earlier. Does RTL see Channel 5 as a bridgehead to something much bigger in this country? What market share are you aiming for? Do you want to get as big as Channel 3?

**Ms Airey:** If we wanted to get as big as Channel 3, we would have to invest a vast sum of money into the programming content. If we did that and the channel

was successful, then you would see the other broadcasters having a tougher time because there is a finite amount of money in the advertising market.

**Q217 Lord Inglewood:** That is not your principal concern.

**Ms Airey:** No, but the aim of RTL is to run a profitable business that has a good audience share—which we do; we have around 6 per cent of the market—and we are the most operationally efficient terrestrial broadcaster, for every pound of spend on screen related to profitability. Our profits are modest because we are a modest broadcaster. We are only 11 years old and we have some of the lightest PSB obligations because we were born into the late 20th century when the regulators saw that we could provide a form of additionality of public service broadcasting; saw a lightness of touch to our news and current affairs; could do additionality in terms of new content for young children—we are the only channel, aside from the BBC, which provides pre-school content. We provide real additionality and plurality into the market place, but we are a small broadcaster. Certainly, RTL would always like us to be bigger but it is always a cost benefit analysis in terms of investment.

**Q218 Chairman:** What was your profit in 2008?

**Ms Robertson:** We are in a closed period.

**Q219 Chairman:** In that case, what was your last published profit?

**Ms Robertson:** £7 million.

**Q220 Chairman:** £7 million, on how much revenue?

**Ms Robertson:** Probably £300 million<sup>1</sup>.

**Q221 Lord King of Bridgwater:** You say you are small broadcaster. That cannot be RTL's intention. What is your mission? Do you have a mission statement of any kind?

**Ms Airey:** Our mission is to continue to fulfil our obligations as a public service broadcaster and, of course, maximise profits where we can for RTL. We are a commercial broadcaster.

**Q222 Lord King of Bridgwater:** What are your targets? You must have a long-term plan.

**Ms Airey:** I have a three-year business plan, which, with respect, is not something I can share with you because obviously it is fiscally sensitive because RTL are a public company. Let us be very clear, if Gerhard Zeiler were here, he would give you the same answer. It is not because I do not know what those figures are.

<sup>1</sup> Revenue for 2007 was actually £341m

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**Q223 Lord King of Bridgwater:** Without putting specific figures on it, presumably you have a clear brief from RTL—you are controlled by RTL—with instructions as to what you are expected to do. Are they going to invest in you to really grow you as a major business, are they recognising that this is a recession period where you are likely to face great difficulties on your own? Are they prepared to fund you so that you can improve the range of your programmes and extend the range of your attractiveness to advertisers? What is the plan?

**Ms Airey:** The plan has consistently been, they have gone from a 25 per cent shareholder to a 100 per cent shareholder, which shows their commitment in investment in this company. They have bought out the other shareholders.

**Q224 Lord King of Bridgwater:** They own 100 per cent? Our brief has them down as 90 per cent, but they are now 100 per cent?

**Ms Airey:** They are 100 per cent. They have literally spent hundreds of millions of pounds to get control of this business. In terms of their commitment to the business, we have launched two new channels in the last 18 months—Five USA and Fiver—that to me demonstrates a shareholder who is prepared to continue to invest in this business for the long term, not for short-term gains. If you look at what RTL do from a European perspective, they run Luxembourg, the oldest public service broadcaster in Europe, which is older than the BBC. They are very good partners throughout Europe in a number of other broadcasting markets. They are an exemplary shareholder; they are in it for the long term and believe in broadcasting as a good business, just as they believe in content creation as a good business.

**Q225 Lord Macdonald of Tradeston:** In the event that ITV were to benefit from all the issues on which Ofcom might be accommodating, they would clearly become a much stronger competitor against you, and were Channel 4 to benefit from an arrangement with BBC Worldwide, they too would become stronger. That does not seem terribly fair from your perspective. What would you look to out of any kind of settlement that was being discussed that would help you in the future?

**Ms Airey:** The settlement that we have at the moment is pretty good for Five. Always alleviation of quotas would be useful. But for us it continues to be, changes in terms of trade so that we can exploit the content that we commission slightly more effectively, that would certainly be a priority, as well as safeguards around CRR, because if you have ITV getting stronger because of the alleviation that is being given and a 4/BBC Worldwide combination, which could potentially raise issues of state aid, depending on how that was constructed. We do not

have the begging bowl out; we are not making a bid to be Oliver in Lionel Bart's next production, thank you. We are pretty self-sufficient. Of course, we would like to be bigger, which is why the 4/Five combination works for 4, in our view, of course it works for us as well, we are not doing it out of a sense of altruism, it is two public service broadcasters together and you get more than just combining the two, which you can put back to the public in terms of an increased investment in public service content.

**Q226 Baroness Bonham-Carter of Yarnbury:** In your response to Ofcom, you also mentioned that you would like a reduction in origination quotas. Can you explain that?

**Ms Airey:** Ofcom have responded to that. We had a 53 per cent origination quota and it has been reduced to 50 per cent, a modest reduction, which allows us to use our inventory, our content, and that we commission more effectively and help balance our books. It is still a 50 per cent origination quota, which is pretty high.

**Q227 Baroness Bonham-Carter of Yarnbury:** That means British-made content?

**Ms Airey:** Yes.

**Q228 Baroness Bonham-Carter of Yarnbury:** So what can the 3 per cent be used for?

**Ms Airey:** We invariably exceed our quotas, we just want the flexibility to do it.

**Ms Robertson:** Last year, we did 59 per cent UK-originated content.

**Q229 Baroness Bonham-Carter of Yarnbury:** What is your response to an idea that we have not talked about yet, which is the BBC's partnership proposals?

**Ms Airey:** We welcome them. The BBC, with its £3.5 billion, is clearly in a position to do a whole host of things that the other PSBs simply cannot, as it is beyond their scope. We were one of the very few broadcasters who were quite enthusiastic about it. We are particularly interested in piggy-backing on the back of their technological developments, whether that is the iPlayer or their new PVRs or the new on-demand services.

**Q230 Baroness Bonham-Carter of Yarnbury:** You suggested that the BBC should cross-promote and advertise your programmes. Would you be willing to advertise BBC programmes or would you prefer it to be one way?

**Ms Airey:** That suggestion was not accepted by Ofcom and we were a little disappointed about that. We were talking about the pure public service content—which would be one way simply because of the size and scale of the BBC—so, for example, the

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BBC outside its pre-school programmes might make reference to *Milkshake*; where you have *Panorama*, there might be reference to *Dispatches* on Channel 4. I am afraid that Ofcom have not taken up that suggestion and I do not think that the BBC is going to offer their air time to cross-promote public service content on other public service broadcasters.

**Q231 Baroness Howe of Idlicote:** Listening to what you have said, your enthusiasm for public service broadcasting, plus the fact that in 11 years you have moved quite fast and far, is to be complemented. Thinking about the future—we know that Channel 4 is not keen, regardless of your wish to be associated with them—supposing that one of the answers that is arrived at is that Channel 4 is granted more public money, to what extent would that sort of funding, given that you and all the commercial groups are competitors for advertising revenue, be a serious disadvantage to Channel 5?

**Ms Airey:** If they are given State aid to solve their funding gap, where does that money go? If it impacted on the other commercial businesses, there would be some serious legal questions arising from that. If, however, the money is very clearly directed to public service content on the main channel and is accountable, then possibly that is a route to go down. But, if they were given £150 million and told to go get the next *Desperate Housewives* and you can pay £1 million an episode for it, that would be market distorting for the rest of the businesses in that commercial market place. We would certainly have something to say about that.

**Q232 Baroness Howe of Idlicote:** Nevertheless, if it went to good quality material, surely that would attract more advertising and you would be disadvantaged.

**Ms Airey:** Channel 4 has always made the case that the funding gap is also in part about them maintaining their high-end public service remit content that they have, so it would be money for that. They have said that it is hard to maintain because it does not attract the audiences and therefore does not attract the revenue.

**Ms Robertson:** You would need to have a different system of governance to ensure that the money went to the right place. Also, one would need to be pretty careful that it was not just displacing spend that they would be doing anyway on public service output in order to spend more on the extremely commercial outputs, such as *Big Brother*, etc., where they do seriously compete with us for advertising.

**Q233 Baroness Howe of Idlicote:** So, you do not see that as a major threat to your public service business.

**Ms Robertson:** The governance would have to have very strict provisos. It would be a threat if they were given another £150 million a year to compete with our programme budget with absolutely no strings attached. Of course, that would be serious.

**Q234 Lord Inglewood:** Do you see your public service broadcasting obligations as an albatross around your neck, or do you see it as something through which you can leverage profit?

**Ms Airey:** It is certainly not an albatross, far from it.

**Q235 Lord Inglewood:** Is that partly because it is less extensive than some of the others?

**Ms Airey:** Yes. It is also the way we approach public service content, whether it is our serious factual programmes, which do spectacularly well for us, or our pre-school programming where nobody else apart from the BBC does it in a free-to-air environment, or it is our more accessible approach to news and current affairs. Those are all eminently public service genres that we are very happy to do. They are not an albatross; they are part and parcel of the defining nature of Five.

**Q236 Lord Inglewood:** Would you do them anyway, even if you did not have the obligation?

**Ms Airey:** Yes, we would do some of them anyway. We certainly would not do all of them and to the same extent. Being a public service broadcaster is absolutely part of our DNA.

**Q237 Chairman:** What do you want out of the review to maintain your public service broadcasting role?

**Ms Airey:** The Ofcom paper has given us what we have requested. There are caveats around—I am sorry to sound like a one-note samba—CRR, and around terms of trade that we would like to be considered.

**Q238 Baroness Eccles of Moulton:** Continuing your quite understandable interest in Channel 4, in a statement you made to Ofcom, you stated: “Our own summary analysis suggests that in 2012 the annual value of Channel 4’s public status and regulatory assets will be well in excess of £100 million, and could be nearer £150 million—which would allow it still to deliver considerable public value”. What are the grounds for your analysis of that situation?

**Ms Airey:** Channel 4 is a not-for-profit organisation. If it were, around 5 per cent of its revenue would probably be profit, which would be around £47 million—£47 million from 4 as it currently exists—its balance sheet would go up. The other issue, which you have heard much about this morning, is the value of gifted spectrum, the DTT capacity. If it did

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not have gifted spectrum, it would have to pay the market rate, which, as determined by Ofcom, is pretty high. That is how we get to that figure.

**Q239 Baroness Eccles of Moulton:** Surely, the situation with regard to spectrum in 2012 has dramatically changed. We must be talking about digital spectrum in 2012.

**Ms Airey:** Yes, I should have clarified that, it is digital.

**Q240 Baroness Eccles of Moulton:** The situation regarding digital spectrum for Channel 4 in 2012 is already quite clearly defined.

**Ms Airey:** But is the value if they were not a public service broadcaster and had to go out and pay the market rate for that spectrum; it is a lot more than at the moment because it is gifted. That is the differential.

**Q241 Baroness Eccles of Moulton:** Has it been possible to assess what the market rate for digital spectrum will be in 2012?

**Ms Airey:** That is a very good question. What you can do is to base it on the value today. The last channel went for around £10 million.

**Q242 Baroness Eccles of Moulton:** What form of spectrum are we basing that value on today; a mixture of analogue and digital, or purely analogue?

**Ms Airey:** Purely digital.

**Ms Robertson:** As wide a coverage as possible—universality.

**Q243 Baroness Eccles of Moulton:** You can see that for the amateur, trying to comprehend what is meant by spectrum and how you can project your analysis from now to 2012 is quite difficult to grasp.

**Ms Airey:** Can we follow this up with a short paper which, hopefully, makes it crystal clear?

**Q244 Baroness Eccles of Moulton:** That would be very helpful.

**Ms Airey:** We will do that.

**Q245 Lord Macdonald of Tradeston:** You are aware of the problems and options that might be available for broadcasting in the three nations of Wales, Scotland and Northern Ireland. Would any of that impact on the way that Channel 5 does its business? Do you have a view on how those problems might be resolved?

**Ms Airey:** I do not think it will impact on the way Five does its business in so far as historically we commission little from Scotland, little from the nations. That does not prevent us, if there were nations broadcasters, being able to co-produce work with them. Our doors are open to everybody. We do

not have a view on whether that should or should not come to pass. If they were commercial entities that were taking advertising, that would impact on all the broadcasters that were reliant on advertising as their primary source of income, which is ourselves, ITV and 4; so it would impact, but that is assuming they are commercial channels and are not funded, like the BBC, through a different mechanism.

**Q246 Lord Maxton:** What is your percentage coverage now in the UK? Michael Grade was saying 98.5 per cent; you are not as high as that are you?

**Ms Airey:** No, but because we are carried on digital satellite, it is 96 per cent. We are a little less than ITV. But, 96 per cent is much better than where we started, which was 70 per cent—we have climbed a mountain.

**Q247 Lord Maxton:** Do you have an audience grouping, in social terms—ABC1, etc?

**Ms Airey:** Yes, we do. We are pretty much representative of the UK population as a whole; we are middle-aged and mid-market so we are very much mainstream, in the sweet spot of the market—as defined by BARB, these are not my definitions!

**Q248 Lord Maxton:** You do digital channels besides your main terrestrial Five, and you are online. Have you got a player yet?

**Ms Airey:** No, we do not, but you can go online and download a piece of software that will allow you to catch up with our anytime video on-demand service.

**Q249 Lord Maxton:** Do you consider those as part of your public service broadcasting commitment?

**Ms Airey:** We do not have to do it; it is certainly not as defined and laid down in statutes that you have to do this. We feel that if you have this content, you should liberate it for audiences. It is one of the interesting things that we are all grappling with and what increasingly viewers and consumers expect is, yes, it is nice to have it broadcast, but we want it online, on demand, whenever we want it on whatever the device, you should give to us. That is expected. Where we have the rights to do that, we do make it available to our viewers. It is not specifically part of our PSB obligations but is certainly something that we want to do because it is expected, but also, it is a source of revenue.

**Q250 Lord Maxton:** Something you said there leads me to a point that has not so far been raised, or with ITV, is what I would term the changing nature of watching television. To be honest, why would I advertise on television when increasing numbers of the population, particularly those who advertise as A map, which is the better off—the AB, C1 categories—when nearly all of them now have

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PVRs, delayed television or watch it on the internet, and therefore have the ability always to skip through the advertisements, to fast forward and say “I do not want to watch that, I want to watch the programme I am watching”. If that is the case, why would anybody advertise on television?

**Ms Airey:** Because it is still the most effective medium at getting mass coverage and reach and launching a brand. Have you ever heard of a brand that has been launched online successfully? I have not. It is still the singular most effective medium. There are some interesting figures that only came out this week that said that television viewing is not dying, it is actually growing; television viewing is up 3 per cent. What you are seeing, particularly online, it is not substitutional, it is additionality.

**Q251 Lord Maxton:** When you say that it is up, you are probably quite right, but it is how? The question is asked, “Did you watch *Coronation Street* this week?” You are not asked “How did you watch *Coronation Street* this week?” are you?

**Ms Airey:** I clearly have not answered your question quite as helpfully as you would like. There is a challenge because you are right that vast numbers of people watch on playback and fast forward through commercials. It is a challenge for the advertising industry as to how can they make that advertising more salient. Having worked at Sky, where I had quite a lot of information as to what happens in the homes that have Sky Plus, there is still a very high recall of commercials and people still quite like them; the best commercials are part of the viewing experience. There needs to be a slightly more innovative and lighter touch regulation around the whole of product integration and product placement. It is something we have been lobbying Ofcom, as has every commercial broadcaster.

**Q252 Lord Maxton:** Many of the advertisements that people like and admire, they cannot tell you what the product is. The famous gorilla drummer—who knows what it is for?

**Ms Airey:** Cadbury’s chocolate!

**Q253 Chairman:** How much do you spend each year on imports?

**Ms Airey:** Around £100 million a year, just less than half the programme budget.

**Q254 Chairman:** And most of that from the United States?

**Ms Airey:** A significant majority, yes.

**Q255 Chairman:** Do you buy anything from RTL itself?

**Ms Airey:** Yes, we do. We buy *Neighbours* from them, which is Australian. They own the production company in Australia that makes it. There is quite a lot of origination that we do with Talkback Thames, which is a big supplier and is owned by RTL. We do not buy RTL European programming, so we do not buy German content that runs on the RTL stations, for example, for our market and, indeed, there is no pressure for us to do that. We have to commission the right content from whatever supplier that we think is appropriate for our audience.

**Q256 Chairman:** So, you are totally independent in what you commission?

**Ms Airey:** Yes.

**Q257 Chairman:** No one leans on you?

**Ms Airey:** No. It is a nice position to be in, I have to say.

**Q258 Lord Inglewood:** Do you sell back to them?

**Ms Airey:** That is a good question. Because we do not own any of the rights, I cannot honestly answer that question. I do not think so.

**Q259 Chairman:** But do you remain committed to UK originated programmes?

**Ms Airey:** Absolutely, yes. Our origination is some of the most defining elements of the schedule—whether it is *Milkshake*, Channel 5 News, or *Revealed*, our history strand—they are central planks to our audience proposition, and origination is the most salient content to the domestic audience.

**Q260 Baroness Howe of Idlicote:** I would like to ask a supplementary question about the amount that is originated as far as children’s programmes are concerned. How much of that is originated in this country?

**Ms Robertson:** We do about 22 hours a week of children’s programmes, of which about three quarters is UK originated—three-quarters of our 22 hours a week.

**Q261 Lord Macdonald of Tradeston:** Would you like to produce more yourself, are you more interested in changing the terms of trade with the independents?

**Ms Airey:** We are more interested in changing the terms of trade. It is not a wholesale change, it is just slightly more equitable distribution.

**Q262 Lord Maxton:** You do not do your own news, obviously; do you take it from ITN or from Sky?

**Ms Airey:** No, it is Sky. ITN used to provide our news service, but we changed news providers and we are really pleased with the quality of service that Sky News provides that is completely and utterly bespoke for our audience.

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**Q263 Lord Maxton:** But obviously you cannot provide a regional input to news.

**Ms Airey:** No, we do not. We do not have the ability to provide regional news because we have not got the spectrum to be able to do that.

**Q264 Chairman:** My impression is that after this questioning, which has been very interesting, this merger between Channel 4 and Five is something that is very high up your list of priorities.

**Ms Airey:** Yes, I would like it to come to pass. It is not oil and water, it is gin and tonic as far as we are concerned; a lovely combo which maybe you will be having at your lunch.

**Q265 Chairman:** So, you will have the small problem of persuading your would-be partners that it is gin and tonic?

**Ms Airey:** Exactly.

**Chairman:** We looking forward to receiving the information on the spectrum that you

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#### **Supplementary letter from Dawn Airey, Five**

I am writing to follow up the evidence session on Thursday 29 January at which Sue Robertson and I appeared on behalf of Five before the Lords Communications Committee.

That day also saw the publication of Lord Carter's *Digital Britain Report*, which set out a roadmap for tackling many of the difficult issues confronting Britain's creative issues. Prominent among these is the future of public service broadcasting, the subject of the Committee's current inquiry.

As I hope we made clear, Five's history as a public service broadcaster shows a strong track record in the delivery of news, factual and children's programming. We are committed to playing our part in securing a sustainable new broadcasting landscape in the UK.

Both *Digital Britain* and Ofcom's recent Public Service Broadcasting Review considered the future of Channel 4 as a provider of public service content, in light of the estimated £150m per annum funding gap it is facing. Both publications set out the desirability of creating a strong second public broadcasting organisation providing competition to the BBC, while not settling on any single way of achieving it and stating that a range of options and solutions were worth considering.

As I outlined to the Committee, our shareholder RTL believes there is a compelling case for combining Channel 4 and Five. An amalgamation of two similar organisations would release serious synergies and allow greater investment in public service content. A combined Channel 4 and Five would not only safeguard public service broadcasting but enhance it. It would be a sustainable, market based solution that would not call on public money or other public assets.

I would be very happy to talk to you further about this should you wish.

10 February 2009

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 WEDNESDAY 4 FEBRUARY 2009
 

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Present	Bonham-Carter of Yarnbury, B	Manchester, Bp
	Eccles of Moulton, B	Maxton, L
	Fowler, L (Chairman)	Macdonald of Tradeston, L
	Howe of Idlicote, B	McIntosh of Hudnall, B
	Inglewood, L	Scott of Needham Market, B

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**Examination of Witnesses**

Witnesses: MR GRAHAM McWILLIAM, Group Director of Corporate Affairs, Ms SOPHIE TURNER-LAING, Managing Director of Entertainment, and MR DAVID WHEELDON, Director of Public Affairs, BSkyB, gave evidence.

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**Q266 Chairman:** Good morning, Mr McWilliam, and welcome to your two colleagues as well. We are looking at public service broadcasting and its limits and where we are going in terms of the debate which seems to be raging at the moment. In your response to Ofcom's consultation you said: "... there is no evidence of an impending crisis in the general availability of public service content." I think your view there is that channels such as Sky Arts and Discovery provide public service content and you do not see any particular reason for any special additional measures in this area. Would that be correct?

*Mr McWilliam:* I think that would be more or less correct, yes. Our perspective on this is that we start, as we do with all aspects of our business, looking at it from the point of view of the viewer or the customer. If you look at it from their perspective, there has never been a greater range of high quality, distinctive content available from a wide range of different sources, not just on TV but online increasingly as well. Much of that content fits very closely with the purposes and characteristics of public service broadcasting that Ofcom set out in its review. From the viewers' perspective, there is more and more public service content available today than there ever has been and it is increasing all the time. It is worth asking why that is. The answer is quite simple. It is because that is what viewers want and expect. As a result, businesses such as our own, but not just our own, are responding to that demand and creating more of that sort of content. I think it is also important to note that the vast majority of what ITV and Channel 4, for example, produce is produced because of market forces. It is produced because that is the sort of programming that advertisers and viewers expect and want. That is why ITV and Channel 4 produce it; it is not because they are forced to as a result of some form of regulation, on the whole. In those areas where there may be gaps in provision, where the market is not delivering, then the obvious starting point for that is the BBC. Everybody agrees, as part of the debate—and Ofcom

have used the words themselves—that the BBC is the cornerstone of public service provision. They have a licence fee settlement of some £3.5 billion a year to spend on public service content. It seems to us that the starting point for any intervention beyond what the market is delivering is the BBC and that we should be looking, as part of this debate, at what the BBC does and whether the BBC is prioritising its own activities and expenditure in the areas where there is the greatest need, where gaps have been identified, or whether it in some cases is spending too much time duplicating what it is that the market is already providing.

**Q267 Chairman:** You would love the BBC to be a minority programme?

*Mr McWilliam:* I do not think it is about minority programming at all. I think it is about being distinctive, though. To give you an example: the BBC spends something like £100 million a year on the American programming it buys in from the Hollywood Studios. It competes against us, ITV, Channel 4 for that content. It would otherwise be shown to the British public on one of the channels; it does not need the BBC to do it. The BBC is adding nothing to that.

**Q268 Chairman:** Of the public service broadcasting that Sky does, which programmes would you claim to be your stars?

*Mr McWilliam:* Perhaps I could hand over to my colleague, Sophie. She can talk to you about that.

**Q269 Chairman:** Good morning.

*Ms Turner-Laing:* Good morning, My Lord Chairman. We offer a variety of programmes and channels. It is not just our own channels, which are Sky branded, but also our joint ventures, in the shape of the History Channel, National Geographic, Nickelodeon, and equally those channels we represent as a third party, Discovery. I am not sure how familiar everybody is with the wealth of programming that is available in the pay world, but

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there are hundreds of channels. To use as an example Sky Arts, we now have three channels, soon to be four, all in HD—which obviously is a greatly enhanced viewer experience that we have pioneered in this country. Tonight, for example—unfortunately it was snowed off on Monday—we have the live transmission of Jonathan Miller’s *La Bohème* with the ENO. As you know, we are sponsors of not only the English National Opera but also the English National Ballet, the Hay Festival—

**Q270 Chairman:** How many viewers will you get for *La Bohème*?

*Ms Turner-Laing:* With a live transmission it is always very difficult to say how many we will get, but the great advantage is that we have something called Sky +—a way in which you can watch what you want to watch, when you want to watch it—and so we tend to look at cumulative viewing, and whether our audience watch it on Monday, Wednesday or Friday does not really matter. We would hope to have several hundred thousand watching opera—which, quite frankly, is a lot more than go to see opera.

**Q271 Chairman:** That is quite interesting. What about Sky News, which most of us would associate with public service broadcasting?

*Ms Turner-Laing:* News is obviously one iteration. We do not use ratings as a particular measure. In the pay world, for us, it is about customer satisfaction and value. We are looking at offering a huge range of programming and content, of which news is one, factual is another, and drama is something else that we are just moving into in Sky 1. I am not sure if you are familiar with our new drama strategy, primarily book-based drama, where we are bringing to life things like David Almond’s *Skellig* for this Easter; Chris Ryan’s *Strike Back*; Martina Cole’s *The Take*. These are only Sky channels. There is the History channel. National Geographic are producing 140 hours of natural history programming for the coming year, and that is a phenomenal amount that no terrestrial broadcaster is even getting close to.

**Q272 Chairman:** How do you reach this conclusion that nothing really needs to be done, when there is obviously a limit on the number of UK TV households which subscribe to pay television in any event? Do you not think that public service broadcasting has something to do with making it available for everybody?

*Mr McWilliam:* There is a vast amount of public service content available, obviously from the BBC, and from ITV and Channel 4 and Five, that is available free to air and is going to continue in the future. There is no prospect of that going away. We are trying to argue that we should be looking more at what can be done alongside that, particularly from

the pay TV sector. So it is not a substitute for what is available to free to air, it is in addition.

**Q273 Chairman:** If I do not subscribe to Sky, I do not get it, do I?

*Mr McWilliam:* You do not, but I think we would reject very strongly the notion that something only has public service value if it is free to air. It is not the case in any other form of media and cultural life. People do not think that cinema, theatre, live performance should be free at the point of use. With newspapers and books, people choose to buy what they want to consume, and that is considered to be a good thing. We think that the accountability and responsiveness that goes with a direct customer relationship, such as in our business, is a very good thing. It makes us a better business as a result, and it is something that I think should be celebrated and embraced more widely within the industry. We think that pay TV has a very valuable role to play alongside the core free-to-air offer. Absolutely, it is up to the choice of the individual viewer or household whether they want to subscribe to that, but that is a good thing. They should have that choice.

**Q274 Baroness Bonham-Carter of Yarnbury:** Mr McWilliam and Ms Turner-Laing you both worked at the BBC and so will understand the term “inheritance”. One of the things about the channels that you provide—providing wonderful content, and it is great that you do support the arts in the way you do—is that you are preaching to the converted, are you not? Your channels are for people who love the opera. On what are now the terrestrial channels someone who is watching *EastEnders* will then fall into watching opera or art or vice versa? Is that not something that is as valuable as the amount of public service content that you are supplying?

*Ms Turner-Laing:* My Lord Chairman, inheritance is possibly a term that we used to use. As we move into predominantly homes that are dominated with Sky + or a form of PVR, the fact of assuming that one audience will automatically flow from one programme to another becomes less and less. One has seen the uptake of video-on-demand on platforms such as Virgin and BT. The control of what the audience want to watch is in their hands now, so one would be suspicious that the role of the scheduler is now slightly downgraded from what it once was. One has to market and promote that wealth of programming, but in a pay world you are able to say, “If you love natural history programming, go to National Geographic. If you want to watch *Ross Kemp in Afghanistan*” – which is one of our leading factual programmes on Sky 1 at the moment—“it is there for you.” You are giving the audience choice, which for us is the Sky mantra.

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**Q275 Baroness Bonham-Carter of Yarnbury:** It still seems to me you have to go and find these channels. *Ms Turner-Laing:* Since we re-launched Sky Arts in October, the reach of those channels has increased by 1.5 million, so people are finding it. On Sky Arts 1 we offer things which we call “dad rock”—which is basically classical music concerts—and we get quite a young audience into that. Opera, ballet, more traditional classical art, tends to skew towards the older audience. I think you are giving an experience for people to go and find stuff. Probably the domain of the BBC, saying “You need to watch this,” has a very different attitude from pay, where it is: “Here it is, come visit.”

**Q276 Baroness McIntosh of Hudnall:** Mr McWilliam, you said at the beginning of your remarks that there was an established public service broadcasting definition, as it were, within the Act and that your view was that a lot of your programming fell within the confines of what that definition prescribes. Can you give us a rough estimate of what proportion of your total output you think falls within the public service broadcasting remit as described?

*Mr McWilliam:* The remit, at least as defined by Ofcom, is a very broad one and I think you would find that the vast majority of programming to some extent could be argued to exhibit one or more of the characteristics of PSB. In aggregate we spend £1.3 billion a year on programming. That is more than any other UK broadcaster apart from the BBC. Of that, around £1 billion—so the vast majority—is on content produced in the UK. A large amount of that is on sport and news, which are two of our biggest areas of expenditure. On sport, in terms of the hours we produce, I think it is about 40,000 hours.

*Mr Wheeldon:* 40,000 hours of sport a year. Across sport and news, 20,000 hours approximately is UK programming.

*Mr McWilliam:* As well as the things you would imagine we would have on Sky Sport—Premier League Football and Test Cricket and those big events—about half the hours are more minority sports. We do a lot of women’s sport, we do a lot of the smaller events within the major sports, and we show a wide range of the sports that otherwise would not get any exposure on TV. I think we have 100 sports in total.

**Q277 Baroness McIntosh of Hudnall:** So that I am clear about what you are saying, you are saying that all of that falls within the kind of definition of public service broadcasting that we have to accept is what Ofcom and the Act define for us.

*Mr McWilliam:* I am not so sure about how it is defined in the Act, but in terms of what Ofcom has defined in its PSB review, we would argue, I think convincingly, that the vast majority—

**Q278 Baroness McIntosh of Hudnall:** That being the case, would it be unfair to characterise your position as one in which you say the market is working very effectively, and there is no particular reason why any sort of programming should have special status? Do you regard public service broadcasting as, in effect, a redundant definition?

*Mr McWilliam:* I certainly think it is fair to say that we think the market is working very well and delivering lots of content. From our own perspective, we are not a public service broadcaster. We have never sought to portray ourselves in that way. The term public service broadcasting is not one that we think is particularly relevant to the audience of the viewing public at large. We think the public want engaging, high quality programmes from a diverse range of different providers, and that is what we seek to bring through our service. That definition, though, fits quite neatly with the one Ofcom has defined as being public service broadcasting, but it is their definition, not ours.

**Q279 Baroness McIntosh of Hudnall:** You did also say that you thought there was a role for the BBC. You described it as the cornerstone of public service broadcasting—which I do not think anyone would disagree with at present—but what is the BBC doing, therefore? What is it doing that is public service broadcasting in a different sense from what you are doing?

*Mr McWilliam:* The primary role of the BBC should be addressing those areas where the market is not delivering for one reason or another. Two of the most obvious examples would be not in TV but in radio: Radio 4 and Radio 3, which are services which it would be very, very difficult, if not impossible, to replicate commercially. The BBC provides those services, which are incredibly valued by the audience and do a good job. Those are the sorts of things the BBC should be doing. I think that is true in a lot of areas of television as well. The issue we have with the BBC is not the fact that it exists or that it does this at all or that it is funded by the licence fee, but that it prioritises its activities in the area where there is greatest need from the perspective of looking at the market as a whole and one of the things they need to take into account in that is that it is a very dynamic market-place. The gaps in provision that were there five/ten years ago may not be there now. If you take the arts, that is an area in which we have become very heavily involved, really in the last couple of years, in a very serious sort of way. The amount of arts programming now available provided by the market is very different from what it was two years ago.

**Q280 Baroness McIntosh of Hudnall:** You would like to see the BBC get out of the way where there is a market that you can supply. Would that be right?

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*Mr McWilliam:* The BBC in the end always has to make choices about where it decides to invest its money. I think the BBC should be investing in those areas where there is least provision by the market and there is the greatest need for publicly funded, publicly supported—

**Q281 Chairman:** It does not do the licence fee very much good, does it? That is going to undermine the licence fee itself, is it not? People are going to say, “All you do is invest in vaguely minority areas, areas where there is some gap” and almost by definition the number of people who are watching is going to go down. That might suit you but it does not seem to be a very good deal for the BBC.

*Ms Turner-Laing:* My Lord Chairman, I think there are various areas that the BBC does incredibly well and one of the areas is drama. We all want competition because competition makes us all raise our standards higher. It is incredibly expensive to provide and I think the BBC should be applauded and continue to provide in genres like that. We are seeking to illustrate that the pay market does offer these programmes as well.

**Q282 Baroness McIntosh of Hudnall:** In relation to natural history programming—and I have now forgotten what the number you gave us was, but it was a very large number of hours—

*Ms Turner-Laing:* 140 hours.

**Q283 Baroness McIntosh of Hudnall:** —can you clarify what you mean by producing in that situation? Are you talking about Sky or its associates originating that content, putting the packages together, making the programmes, or are you talking about providing it because you are buying it in from other sources?

*Ms Turner-Laing:* The 140 hours is what National Geographic will be producing, which will be made in conjunction with their channels here and round the world. But that is no different from the BBC producing their natural history programmes, which, again, are very expensive and so are produced with the likes of Discovery.

**Q284 Baroness McIntosh of Hudnall:** Yes. I just want to be clear about where it is really producing, as I understand the term, and where it is in fact providing.

*Ms Turner-Laing:* No, it is producing, not buying in.

**Baroness McIntosh of Hudnall:** Thank you.

**Q285 Lord Maxton:** EastEnders, the most popular BBC programme. Would you say they should not be doing it because it could be done by you or by someone else commercially?

*Mr McWilliam:* No, I am not saying the BBC should not be doing *EastEnders*. It is an established programme that I think is a high quality drama. I think the BBC uses it as a vehicle from time to time to tackle some quite difficult social and cultural issues. I think that is a programme that we would applaud. I have no concern about *EastEnders*.

**Q286 Lord Maxton:** Could I change tack a little bit and throw in that the BBC have been much criticised for refusing to show the charitable appeal on behalf of the people of Gaza. You too refused to show that. Could you explain why? The BBC have tried to explain why—not very successfully, maybe. I do not think you have been asked to explain why.

*Mr McWilliam:* I would be very happy. As you know, reporting the ongoing conflict on the Middle East is a challenging job for any news organisation. It is something that we try our best to do in a way that is objective and impartial and tells the story of people affected on all sides of the conflict. I think that Sky News does a very good job at that. The overarching thing about Sky News that makes it special and which we think is the reason that it is so important and so highly valued by its audiences, is its impartiality and its independence. When we were asked whether we would be willing to show the DEC appeal we talked it through at great length and we thought very hard about it, but, in the end, the editorial leaders of Sky News, John Ryley who is the head of Sky News and his senior editorial team, felt that it was not something that was appropriate to show on a news channel alongside the reporting of the conflict. They talked to ourselves, B Sky B management, and to our chief executive about it, and we supported and endorsed that decision, but it was a decision made by the editorial people responsible for Sky News. It was their view, which, as I say, we supported, that an appeal that is designed specifically to get people to make donations and so on sits quite uneasily alongside the objectivity and context and reporting of all sides of the issue that Sky News feels is so important for its viewers, both in the UK and also around the world and in the Middle East. That is why we took that decision.

**Q287 Lord Maxton:** You can assure us categorically that the decision had nothing to do with Mr Murdoch’s other commercial interests?

*Mr McWilliam:* I can absolutely, categorically assure you of that.

**Lord Maxton:** Thank you very much.

**Q288 Chairman:** Does that apply, therefore, to any sort of conflict in the world? We have had other conflicts as well.

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*Mr McWilliam:* It is an interesting question, My Lord Chairman, and one about which we in broadcasting probably need to think again.

**Q289 Chairman:** That is why I am asking it.

*Mr McWilliam:* The history of these things is that, traditionally, the consensus has been that all the broadcasters run it or none at all. DEC's tend to go to the BBC first, so the BBC has effectively made the decision on behalf of the industry. For example, in the conflict in Lebanon a couple of years ago the BBC decided not to show it and it did not therefore become an issue for Sky News. This time around, the BBC decided not to show it; ITV and Channel 4 then decided that they would show it—they sort of broke ranks with the consensus; and then we had to make our decision, which was similarly with the BBC not to show it. That has put us in a whole different territory about how this works going forward. One of the things we will need to do with the DEC is to talk and agree the kind of protocols going forward on it. I cannot give you a definitive answer about what it means in future conflicts, because I do not think we have had those discussions yet.

**Q290 Chairman:** It is funny that this should be the one. You obviously do not have a general rule on this. This is a one-off in a sense as far as you are concerned. This is the first time you have done it this way, I suspect.

*Mr McWilliam:* Yes, although I absolutely think we would have made the same decision about the Lebanon War if that had come to us. As I say, it did not, because the BBC had already decided.

**Q291 Chairman:** You do not think there was anything in the argument that really the appeal was around relieving suffering and had nothing to do with making political statements?

*Mr McWilliam:* No, I do not think we are in any way passing judgment on the appeal or suggesting that we do not think there is a humanitarian issue that the appeal was trying to address. All we are saying is that in the context of Sky News, a news channel available around the world, including in the Middle East, we did not think it fitted on that channel in that way. It is not a broader statement about what we think about the DEC or the appeal situation in Gaza.

**Q292 Lord Inglewood:** One of the themes that has come through your collective replies, which I am not criticising, is that you keep on talking about the world of pay TV, and yet public service broadcasting as we know it in this country was devised in an era prior to pay TV, and one of the underlying ideas behind it was that there should be something for everybody out there for which they did not have to pay anything above and beyond the levy, the licence

fee. Are we not at risk of getting too excited and aspects of this muddled up? I think you did say that there was no suggestion that free to air was going to go away, and it seems to me that one of the characteristics of public service broadcasting is that people can see it without paying any more. You are saying, "We are producing material that if it was free to air would undoubtedly meet the tests of the public service broadcasting," but there is a fundamental difference, and that is, as Ms Turner-Laing said, that you are giving the audience choice but, at the same time, the audience is giving you money. Are we not talking about two slightly parallel things, therefore?

*Mr Wheeldon:* First of all, nobody is disputing that policymaking around public service broadcasting is predominantly focused on free to air. After all, the BBC has £3.5 billion to spend annually on free-to-air programming. It is not as if that is not an important element. But we would dispute the fact that because you have to pay for something it is intrinsically less valuable.

**Q293 Lord Inglewood:** I do not think anybody is suggesting that.

*Mr Wheeldon:* It is not a concept that applies in newspapers, for instance, where people pay for news. It does not apply to going to the theatre. It does not apply in a wide variety of cultural opportunities in the lives of people. One slightly jarring thing is coming through in government policy at the moment. If you look at the *Digital Britain* report, universal access to broadband is being described as a public good and something that should be enabled, and yet nobody is suggesting that you should not have to pay for that. I am not sure there is a material difference between paying for access to broadband and paying for content.

**Q294 Lord Inglewood:** I understand the argument you are making and I am now teasing you and leading you on. Are you saying that the way in which free-to-air television should be developed in this country would be through some sort of voucher system, as has been advocated by some for education, so that if people wanted your public service type material, they would not have to pay extra? Are you thinking along those lines, or do you still think there is going to have to be a chunk of dedicated free-to-air material which will be running in parallel, possibly or possibly not in competition with you?

*Mr McWilliam:* I would go back to something I said earlier, which is that the vast majority of programming that channels like ITV and Channel 4 put out is as a result of market forces. They are in the business of selling eyeballs to advertisers, as it were, and they generate a lot of money from doing so. It is our belief that the free-to-air, advertising-funded model of commercial television has a long and

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healthy future, and that, as a result of that, those broadcasters will continue to produce high quality programming and make it available free to air. I do not think there is a need to introduce vouchers or some sort of new system. That system that we have now has a long life ahead of it. I think all that we are trying to argue in the case of pay TV is that that can be a valuable addition to what is available free to air.

**Q295 Lord Inglewood:** A lot of the evidence we have received is that the prospects for advertising-funded, free-to-air television are very far from rosy and therein lies a lot of the problems. That is a point that Ofcom has taken up and the Government. That being the case, you have nothing to complain about.

*Mr McWilliam:* I do not think we agree that that is the case. Advertising, and television advertising in particular, is a cyclical business. It is one of the first things that drops off when the economy slows and it is one of the first things to pick up at the time of recovery. That has been the case for many, many years. Right now it is true that anyone who is reliant principally on advertising to fund their business—and that applies to television but it is also true in newspapers and other areas of business—are having a tough time. We are ourselves: advertising is a revenue stream that is important to Sky as well. But it will come back. Television remains an incredibly powerful medium for advertisers. We are also one of the top five, largest advertisers in the UK, as well as having a big media business of our own, so we see the value of television. Tomorrow we are going to be breaking a new campaign for high definition television. We will launch it on ITV in prime time because that is the best way to reach a large audience. We do not agree that the television advertising funding model is fundamentally broken. It is true that there are structural changes going on as well, with advertisers shifting money online, and there are new ways of reaching audiences. I think that any business that is relying principally on television advertising, such as Channel 4 and ITV, clearly should be looking at diversifying their revenue streams, building online businesses as well, and looking at, we would suggest, subscription models alongside their core free-to-air channels, so that they have not so many eggs in one basket. But none of that leads us to believe that television advertising is a fundamentally broken model.

**Q296 Baroness Howe of Idlicote:** This one is interesting because it seems to me that you are saying that it is not just cyclical problems and a current reshaping of what advertising is, but that it will be around for quite some time. But are you really saying that advertising, as such, rather than different ways of promoting particular programmes, will be here in ten years? How do you see the picture of advertising in ten

years? Are you really saying that it is going to exist as it does today?

*Mr McWilliam:* If I were to say anything with certainty about what it would be like in ten years, I would probably be foolish or very, very rich. As far as we can see, that is absolutely what we are saying. We think television advertising in the traditional sense will continue to be a very important vehicle for advertisers and therefore an important way of funding television. But it will have to change.

**Q297 Baroness Howe of Idlicote:** Are you talking two years, three years, one year?

*Mr McWilliam:* There is a cyclical effect right now and it really depends on how quickly the economy recovers. Past experience is that advertising is one of the first things to pick up as the green shoots, as it were, start to come through. Whether that is this year/next year I do not know, but I do know that when the economy recovers, as it surely will do, TV advertising will recover with it. I am not suggesting that there is not a structural effect going on in parallel, but we do absolutely believe that TV advertising has a long-term future. It is certainly an important part of our own plans, alongside growing our online advertising business and other aspects. It is certainly something we are backing ourselves.

**Q298 Chairman:** Have you noticed any green shoots of advertising recovery in 2009?

*Mr McWilliam:* Speaking of our own business, we reported our results last week for the half year up until the end of December and we were growing faster in that period than we were in the year before. Our profits were up about 25% and we were attracting more customers.

**Q299 Chairman:** Was your advertising revenue growing?

*Mr McWilliam:* Our advertising revenue was pretty much flat year on year. The market itself was down quite heavily, but because we had increased the reach of our channels, our share of the market was up. Of our revenue lines—and advertising for Sky is less than 10% of our total revenue—it is one of the most challenged lines, and I think going into the calendar year we are in now we would certainly expect that to be one of the areas of our business that declined. However, we think that overall the business will continue to grow strongly.

**Q300 Chairman:** You have a very good business model—which is part subscription/part advertising, is it not?

*Mr McWilliam:* Yes, it is.

**Q301 Chairman:** —which we saw in the United States as well.

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*Mr McWilliam:* Yes. But absolutely, advertising is challenging this year.

**Q302 Lord Maxton:** I heard Ms Turner-Laing's great paean of praise for the Sky + Box—and Virgin have their own, BT have their own, in fact some of the Freeview boxes now have this PVR capacity—but does that not make the long-term advertising revenue doubtful? If you can press the fastforward button every time you come to the adverts, who would bother advertising?

*Mr McWilliam:* Certainly that effect goes on, and people do fastforward through some of the adverts, but there are also some other effects that go the other way. People with Sky + watch more TV in total because they can watch it to fit in around their own lives, they can watch the things they want to, so they are watching more television in aggregate. The opportunities that PVRs, like Sky +, bring are the opportunity to do more targeted advertising. You can essentially insert into the programme an advert that is more relevant to the particular household in which that programme is being watched. It is obviously the way that online advertising is going. That technology, although it is not in the market-place right now, is something that Sky has been pushing very hard. We think that can help to make television a more attractive advertising medium going forward. That is available precisely because of the technology in the Sky + Box.

*Ms Turner-Laing:* We are very much dominated at the moment by spot advertising. We need to look at how other forms of advertising can take place, whether that is advertising-supported programming, or product placement—which is obviously the great debate at the moment.

**Q303 Chairman:** Product placement? Where do you go on that?

*Ms Turner-Laing:* My Lord Chairman, I think the most important thing is to protect the integrity of the show, the programme, so product placement has to be handled in a very careful way, but obviously it has existed for years and years in the American market. We watch extremely excellent US dramas that come in, whether it is 24 or whatever. That has an enormous amount of product placement and I do not think you notice that at all.

**Q304 Chairman:** Therefore you would like it in UK films as well?

*Ms Turner-Laing:* I think a form of product placement should be experimented with in the UK.

**Q305 Baroness Howe of Idlicote:** I was curious about your use of the words when describing public service broadcasting. You used the words “viewer” and “customer”, whereas I am sure you will recall the

quite complex debate that went on when Ofcom was being set up, when “citizen” and “consumer” were the two words used, and whether the citizen was going to be represented enough on Ofcom's deliberations which were mainly commercial, economic and customer-based. I am really asking you why you have chosen those two words and do the two equate, as far as public service broadcasting is concerned, with quality and so on, with the two words you used in the Bill?

*Mr McWilliam:* Without wishing to be too simplistic about it, I think in the end we think that people are people. We tend to call them customers in our business because that is the sort of business that we have, but I think if you run a free-to-air broadcast you are more likely to call them viewers than customers. But customers, viewers, consumers and citizens are all the same people. That tends to be how we think about them. We do not think about them in distinct ways.

**Q306 Baroness Howe of Idlicote:** Perhaps I could ask you, why use two words in the way you do? The distinction was quite clear when the argument was going on in 2003.

*Mr McWilliam:* Why did I use two words, “viewer” and “customer”?

**Q307 Baroness Howe of Idlicote:** Yes.

*Mr McWilliam:* It was not meant with any great significance. I could have just used one or the other. You probably read more into it than I intended.

**Q308 Lord Inglewood:** Citizens, though, include a lot of people who are not your viewers and are not your customers. If you are regulating the media world from the perspective of where we are, they have a part in all this which I can understand in the pay market they may not have to you. Is that fair?

*Mr Wheeldon:* I have never fully understood the distinction between citizen and customer. The overlap is so great that it is difficult—

**Q309 Lord Inglewood:** All customers are citizens but not all citizens are customers.

*Mr Wheeldon:* In developing policy it seems to be quite difficult not to develop policy that does not ultimately impact both in very similar ways. There are lots of people out there who are not our customers. That is very true. We would like them to be our customers. In terms of devising policy, we just have to keep on going back to the fact that there is already a huge intervention in the market-place. There is already the BBC, there are 17 channels that are somehow provided by and supported by the state on Freeview. It is not as if this is not being catered for. Our point is that, before you decide to increase the amount of intervention, should you not be looking at

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making sure that what is already being delivered as a result of intervention is delivering public purposes? There is a thriving market-place out there and there is a risk that if you intervene further you will damage that market-place.

**Q310 Bishop of Manchester:** Could we go back to the BBC and the points that Mr McWilliam was making at the beginning. If I may say so, I thought you were quite sweeping in your remarks, which, if I may put it a bit simplistically, were to say, “If there is a problem, the BBC has £3.5 billion so let it sort it out.” In the official response that you made to Ofcom you made the points which you have repeated this morning in general terms, about the need for the BBC to be more distinctive, prioritising, et cetera. When you were pressed this morning by Lord Fowler, it seemed to me that the only response you were able to come up with in terms of specific things that the BBC might be able to do was in terms of minority interest broadcasting—which, as Lord Fowler then said, although you did not respond to it, is not very helpful when the BBC has to keep in mind its very large number of licence-fee payers. I was wondering, really, if you found yourself in the next stage of your career as the Director General of the BBC—  
*Mr McWilliam:* God forbid, but . . .

**Q311 Bishop of Manchester:** —what would be the kind of creative proposals that you would be putting forward to ensure that as a public service broadcaster the BBC was doing the things that in general terms you have been talking about now? Because my suspicion is that you would be quite hard-pressed to come up with any.

*Mr McWilliam:* I would not presume to put myself in the shoes of the Director General, but I think we are trying to say that in the end the BBC is all about prioritisation. Any business that has a fixed income is making choices about where it invests in programming and which areas are most important. It seems to us that, as part of this whole debate, both the Ofcom PSB Review and the Government’s Digital Britain Review, the one thing that does not really seem to be a factor is a debate about what the BBC is or should be doing and how those prioritisation decisions should be made. I am not suggesting that Sky either has all the answers to that or should be the body providing the answers. I think it is a curious omission from the debate, which seems to have all been about Channel 4 and the future of ITV and so on and not about what is the largest part of the public service infrastructure and intervention, the BBC. I apologise for not answering Lord Fowler’s question earlier. I do not agree that the programming that the BBC should be doing, if it focuses in this area, is only of minority appeal and will therefore undermine support for the licence fee, but quite the reverse. I

think the general public, the licence-fee payers, understand that if they are paying a licence fee to the BBC—which is a form of compulsory taxation—then they should be expecting it to provide something that is different from what they can get in the market-place, and that is what they want the BBC to do. Drama, which Sophie talked about, but, also, British comedy. Comedy is a very interesting area. It is a difficult thing to make work commercially because there is such a high hit-or-miss rate. The number of things you have to develop in order to get a hit makes it very difficult for channels like us to do that. The BBC has a great track record in that. When they get it right, those are the programmes, when we all look back at the history of the BBC, with which we have the greatest affinity, whether it is *Fawlty Towers*, *Blackadder* or *Men Behaving Badly* and so on. Those programmes are probably the things that generate the most support for the BBC and yet they are distinctive from what the market is doing and are addressing an area of market failure. I do not think it is all about the BBC doing minority stuff at all. The one area that we can see very clearly, because it is perhaps the one that impacts us most closely and where we most closely compete with them, is that the BBC, as I say, spends a vast amount of money on American programming which, it seems to me, cannot be a priority for them. You can extend it out beyond that to other areas: they purport to spend something like £35 million a year or more acquiring the rights to Formula 1, which is a very commercial sporting event and does not seem to me necessarily to be the thing that is closest to the BBC’s remit. Our overwhelming point, however, is not that we have the answers but more that the debate should be about that and it has not been so far.

**Q312 Bishop of Manchester:** One of the reasons the debate has not been so much on the BBC in relation to these particular recommendations from Ofcom is surely because Ofcom has made it very clear that it feels the future of public service broadcasting in this country must not be left simply to the BBC, and that ITV, Channel 4, Five and so on are key to a healthy provision within this country. Briefly, if you are able to do this, do you agree with that and how do you see the picture in the future? The way I am hearing you at the moment is that you are almost saying, “Leave it all to the BBC.”

*Mr McWilliam:* I do not disagree with the analysis that ITV and Channel 4 have an important part and it should not all be left to the BBC. If we look at public service broadcasting in the round, from the viewers’ perspective I think there are four elements to where it is coming from. One—I think our most important point we would like to make—is that there is a large and growing amount coming from the market itself, whether that is for providers like Sky or

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other free-to-air broadcasters, as a result of market forces. We think that is the most important thing. That seems to be absent from a lot of the debate. If that is growing, what does that say about what else you need to intervene to deliver? The second thing is that we have the BBC. We think it can and should prioritise differently and particularly focus on the areas which the market is not delivering. Beyond that, you have ITV and Five, I guess, which are commercial businesses that (a) are delivering a lot of public service content as a result of their own commercial imperatives, and (b), as Ofcom itself concludes, have enduring value in the licences that they hold—maybe less than it once was but it is clearly still an opportunity for them to provide programming in return for the privileges they get. Finally you have Channel 4. The essential model of Channel 4 is that because it is a public corporation and does not pay dividends to shareholders it can reinvest its profits in programming that would not otherwise be commercially viable. Channel 4 can do things that you would not expect ITV or Sky to do. We believe that Channel 4 as a business model and as a business has a bright future. It has a very strong brand, it has a good line of programmes that people respond to and it has a strong position in the advertising market. We do not believe that the Channel 4 model is fundamentally broken. We also would caution that some of the more exotic proposals for how to fix the problem with Channel 4—which we do not necessarily agree exists—would fundamentally alter what it is that has made Channel 4 successful over the past 25 years, which is independence from government whilst being commercially funded and not-for-profit.

**Q313 Chairman:** That is very interesting. To follow up on what the Bishop of Manchester was asking, you have lifted the veil a bit on specifically the kind of programmes that you do not want the BBC to be covering. You have mentioned American imports and you have mentioned Formula 1. Are there others?

*Mr McWilliam:* I am sure there would be as part of the debate if we had the time and analysis to do that. I do not have a list of what the BBC should and should not be doing, because I do not think that is our position.

**Q314 Chairman:** If you do not have American imports and the BBC are excluded from Formula 1 that is quite likely to benefit companies like yourself, is it not? You do have an interest in this.

*Mr McWilliam:* We have an interest and I am not hiding it. In the case of Formula 1, by the way, that is a property which, the way it is funded, which is all about sponsorship, I do not think has ever been an issue for a pay-TV broadcaster. On American

imports, it is not just us who is competing with the BBC, it is Channel 4, it is ITV, it is Channel Five. To the extent that those broadcasters are finding it challenging in the current environment to make ends meet, that is partly as a result of the BBC bidding up the price of these imports. It seems to me it is a broader issue than just one for Sky.

**Q315 Lord Inglewood:** You touched briefly on content. Particularly bearing in mind the discussion we have just been having, a lot of your spending on programming is on sport. You were talking about bidding up the price of things. With soccer, professional football, a lot of it is UK-generated content. There is the most massive bidding war that goes on in there to get the rights. Were you right then to have outbid the BBC?

*Mr McWilliam:* Outbid the BBC for what, sorry?

**Q316 Lord Inglewood:** This UK-generated content, which seems to be one of the things that you think the BBC is for.

*Mr McWilliam:* I am not aware of the BBC bidding for live Premier League Football.

**Q317 Lord Inglewood:** You probably burnt them off.

*Mr McWilliam:* I have no idea. You would have to ask them whether they bid for that or not.

**Q318 Lord Inglewood:** This distinction you are making about different forms of content, is it really real in the world we are in? Everybody is competing for eyeballs, are they not?

*Mr McWilliam:* Yes, they are. The point we were making about the BBC is specific to the BBC. The issue is that the BBC is funded by the taxpayer essentially; it is using public money, where should it be prioritising its use of that? There is always a trade-off. If the BBC is spending £100 million a year on American programming, that is £100 million a year that it is not spending on something else. The question for the BBC—and it is a question for the BBC and the BBC Trust—is: Is that the best use of that £100 million or should it be spent on more children's programming, more regional programming, more natural history programming? That is the decision that needs to be had. It is always a trade-off. From our point of view, sure, we compete day to day in the market-place with other broadcasters for eyeballs, we compete for rights, we compete for talent. That is the market-place in which we operate and the competition is what makes it deliver such great outcomes for viewers. Our concern is a different one when we are competing with somebody funded by public money.

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**Q319 Lord Maxton:** In sporting terms, of course, you have lost quite a lot of your rights to Setanta, both in terms of Premier League Football, Scottish Premier League, US golf, have you not? You have lost that. Just to give you the chance to, if you like, sing your own praises, what do you think is your contribution in terms of money towards the fostering of sport in this country?

*Mr Wheeldon:* We are very proud of the contribution we make, not just in terms of the contribution we make in contractual relationships with the sports governing bodies, but also the investment that that affords into the grassroots of sport and the programmes which we ourselves run. For instance, with the England Cricket Board, £12 million from the money that we pay to the ECB goes every year into fostering grassroots. We run a Coaching the Coaches Programme with the ECB which has coached 5,500 coaches in the first year. It has got to 74,000 primary school children. We have used sports in a holistic way. Grassroots sport is critical to our entire offer. We have a programme called Sky Living for Sports which takes the power of the Sky brand, the power of sportsmen to be role models for children, and helps to engage with disaffected youngsters who would otherwise drop out of education. That has been incredibly successful. It has targeted 17,000 young people. We are rolling out into every single secondary school and the research we have done has shown that it has a huge benefit.

**Q320 Lord Maxton:** Would you not perhaps be slightly concerned that without your money going into Premier League Football, for instance, the wages of £150,000 a week which are now being paid to some of the top stars in football would not be paid?

*Mr Wheeldon:* There is a bit of an obsession with Premier League Football. As Graham said earlier, we show over 100 sports on Sky. The vast majority of those, in terms of numbers of sports, are what would be classified as minority interest sports, which would not otherwise get a chance to be aired, which would not otherwise attract money from broadcasters to pay for the rights which then gets invested into developing the game. Whether that is women's cricket, women's rugby, tennis, the Solheim Cup in golf, sailing, there is a whole range of sports. The whole point about Sky Sports is that it offers people choice. I do not think we have anything to apologise for.

**Q321 Chairman:** Do you have an estimate of what proportion of content broadcast by you is of UK origin?

*Mr McWilliam:* In terms of the amount of money we spend, we spend about £1.3 billion in total a year on programming for our own channels. We also spend some more supporting our third-party, joint-venture

partners. Of that £1.3 billion spent on our own channels, around £1 billion is spent on content produced in the UK.

**Q322 Baroness Bonham-Carter of Yarnbury:** Does that include sport?

*Mr McWilliam:* That includes sports, news.

**Q323 Baroness Bonham-Carter of Yarnbury:** What about programmes made by UK production companies?

*Ms Turner-Laing:* On our own channels, for example Sky 1, 40% of our programming is originated and commissioned.

**Q324 Baroness Bonham-Carter of Yarnbury:** On Sky 1?

*Ms Turner-Laing:* On Sky 1. One needs to be conscious, as you will well know, that a lot of programming now is co-produced. It is very hard for one broadcaster to say, "I put up 100% of the money" because we put seed money in too. We fund, and have funded in the past, a lot of ITV regional programming where we co-fund with them. For example, Peter Ackroyd's programme on the Thames was co-funded with us. Justifying exactly the percentages is quite a difficult thing across the board and third parties. The advantage for us is that our investment in original commissions is going up, not down, so we are not taking money off drama, we are adding money into drama. As we get more confident in establishing our channels—Arts, Sky 1, Sky Real Lives—we will continue to invest.

**Q325 Chairman:** How much do you spend on US imports?

*Ms Turner-Laing:* I do not have that figure off the top of my head.

**Q326 Chairman:** Would you be able to get it?

*Mr McWilliam:* We spend about £300 million a year on movies for our movie service which predominantly come from the US, and then we spend a little bit more on top of that on American dramas for Sky 1.

**Q327 Chairman:** Perhaps we could come back to you on some of these factual questions.

*Mr McWilliam:* We would be very happy for that.

**Q328 Baroness Eccles of Moulton:** Could we turn for a moment to the funding question of the advertising-funded PSB channels. I want to particularly ask you about your view of the enduring value of regulatory assets, but before doing that I would like to be a little bit clearer about your views about the cyclical or long-term effect of television advertising on the advertising-funded PSBs. My understanding is that,

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long before the credit crunch, television was being very seriously affected by the prospect and already the reality of a falling off of revenue generated from advertising because it was beginning to and had already quite substantially migrated to other media, like the internet, mobile, et cetera. I rather gathered from what you have said that you viewed the effect on television advertising as a short-term cyclical matter, and I wondered if you had taken into account this rather dramatic migration that everybody else seems to be very concerned about which obviously would not be cyclical. That is long term. Could you clarify that?

*Mr McWilliam:* I would be happy to. You are absolutely right, there is of course a longer-term structural shift going on in advertising alongside the current cyclical downturn, so I am not suggesting that it is all cyclical. I am saying that both factors are going on in parallel, and right now, this year in particular, there is a very sharp cyclical contraction. I think that is exacerbating the problems that advertising-funded broadcasters have, but, over the longer term, television advertising as a whole has, broadly speaking, with the exception of last year, continued to grow. Obviously, within that pool, there has been a shift of money from the traditional free-to-air broadcasters to digital channels as more and more people have taken up digital. As you would expect, advertising largely follows the viewer. Of course, ITV and Channel 4 have quite large portfolios of digital channels of their own, and so some of it has been moving from their analogue terrestrial channel to their digital channels as well. When you look at those broadcasters, you need to look at their channel portfolios in the round and not just their main channel. The other big trend that you have identified, which is absolutely going on, is that advertising is shifting online. That has affected newspaper businesses as well as television. We have certainly seen ourselves that that is a big growth opportunity and we have invested a lot of time, effort and money in building our own online presence in order to capture that. Building a web presence is something that the BBC, although they do not rely on advertising, have clearly done a good job of. I would submit that ITV and Channel 4 have been rather less successful in that and that is an area that they will probably want to focus on more going forward.

**Q329 Baroness Eccles of Moulton:** Against that background could you say a bit about how you see the enduring value of regulatory assets?

*Mr McWilliam:* Broadly speaking we would agree with the analysis that Ofcom carried out. Beyond digital switchover the ITV licences will still have value in a couple of ways: one is that they are gifted spectrum on the Freeview platform which is quite valuable. The most recent time a slot on Freeview

came into the market I believe it sold for about £10 million a year, so there is some value in the spectrum that they are gifted. In addition, as PSBs they are guaranteed a prominent position on electronic programme guides such as our own, so if you are familiar with Sky you will know that ITV is number 103 at the top of our programme guide. That again has some value as well, and Ofcom estimated that cumulatively that was around £40 million a year for ITV. I do not have any different information or access to the same information that Ofcom has to be able to question that but it seems plausible.

*Chairman:* The last two questions please. Lady Scott and then Lord Macdonald.

**Q330 Baroness Scott of Needham Market:** Thank you. The Ofcom report has talked about competition for funding for news to the English regions, to Scotland and Wales and possibly children's programmes. I guess the issues are slightly separate for the two but, in terms of news and given that ITV have struggled to make this viable now, how do you think it could be structured to make it attractive to you? Would it have to be subscription, for example?

*Mr McWilliam:* I will talk about news and maybe Sophie could then talk about children's television. There is no doubt there is an audience demand for regional news; the programmes on the BBC and ITV attract good audiences and Sky News, over the years that I have been involved, has looked at whether it is possible to develop regional or local news services alongside the core channel. What we tend to conclude from that is that the locality people want their news in is actually smaller than the traditional TV regions, which are based on transmitter topography rather than geographic convenience at city level or local communities. We have found that very, very difficult to do on television economically with the model that we have. It seems to me that that is one of those areas that is much better suited to broadband and internet-delivered services and you are seeing a growing amount of that there—local newspapers and radio companies kind of move beyond their traditional media, they are looking at building on-line presence. One should look at it in the round and not just television and one should consider whether television is the most effective way to provide regional news at a level which the audience most wants to engage with. It is an opportunity we would keep looking at ourselves but I suspect we will not do it via the television service; we will look to do it on-line if we can find a way that we can make a business plan that adds up. I am sure others will be doing the same thing and on Sky News specifically we absolutely think that the most valuable thing about Sky News to its viewers and to its businesses is that it is valued for its independence and its editorial integrity. One thing

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that sets it apart from all the other television news providers in the UK is that it is the only one that does not rely in any way on direct or indirect support from the State, so we would be very wary indeed about anything that involved taking public money or any sort of public subsidy for Sky News because we think that fundamental to its success is its commercial independence. Do you want to talk about children, Sophie?

*Ms Turner-Laing:* Just on the news point it is important to add that on Sky EPG we offer all the regional variants so it is one of the places you can go to where, if you live in the South, you can still watch the regional variants from the North.

**Q331 Lord Macdonald of Tradeston:** At the moment you have got on the digital/terrestrial television platform Freeview three Sky channels and you have said to Ofcom you would like to substitute those three channels for a bundle called Picnic which would have five pay TV channels. Would it also mean that if Picnic went on people would lose the free Sky News channel?

*Mr McWilliam:* As you may be aware the proposal that we put to Ofcom for Picnic has essentially been kicked into the long grass so it is not about to happen any time soon and the current three channels that we have on Freeview which are Sky News, Sky Sports News and Sky Three will continue for the foreseeable future. The proposal and the application that we made for Picnic would have had five channels, which would have included Sky News, Sky One, Sky Sports and Sky Movies Channel along with Disney and Discovery, so it would have been a different set of channels and it would have then used the band width on Freeview as it were that was broadcasting the three free channels, so it would have replaced them. It has largely become a moot point right now because the application is becalmed.

**Q332 Chairman:** Thank you very much; you have been very patient. There are a number of factual questions we would like to follow up and perhaps when we have looked at the transcript we could come back to you on specifics.

*Mr McWilliam:* Please do.

**Chairman:** Thank you very much, all three of you, for the way in which you have answered our questions.

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### Examination of Witness

Witness: MR ED RICHARDS, Chief Executive, Ofcom, examined.

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**Q333 Chairman:** Mr Richards, welcome; sorry to keep you waiting but we had a rather longer session than we expected just before. What we are doing is looking at public service broadcasting, obviously in the light of your review and in the light of the evidence we have taken, and also in the light of the Government's statement last week on this issue as well. Could I begin by asking you about how you see the future of the alternative service, if I can put it this way, in terms of public service broadcasting, the alternative to the BBC? You seem to be proposing a new institution based around Channel 4; would that be right?

*Mr Richards:* The way we thought about it was to ask ourselves what was at the core of the issue, what was at the heart of our concerns. The answer to that question was that we are all clear that the BBC should be the bedrock of public service broadcasting, but what do we want after that, and the truth is that the system in this country has worked at its best when you have had a variety of different sources for high quality original entertainment and public service content. What we saw happening with the analysis of the commercial broadcasters was the ability to sustain that kind of mix eroding very sharply—I am sure we will come on to talk about ITV and Five—and generally speaking that commercial broadcast contribution, which historically was with three different broadcasters eroding. Then we said what is

the core question here, and the core question is not Channel 4 per se, it is not save Channel 4 because Channel 4 is somehow a good thing because it is Channel 4, the core question is having a strong alternative public service voice to the BBC, so you start there rather than just start by saying we must save Channel 4 because we must save it. The core thing was therefore a second public service institution and then you say "What is the best way of securing that?" and self-evidently you quickly arrive at the point where audiences value Channel 4 highly, they are publicly owned, not seeking to maximise the interests of shareholders at the same time, they have very substantial reach and impact, they have a set of networks and relationships with independent producers and a commissioning structure and so on and so forth. Then you say if you want that strong second public service force it would seem very bizarre not to begin with the established force, capability and potential that Channel 4 represents.

**Q334 Chairman:** It may not have been your starting point in terms of analysis but your starting point in fact in terms of policy is that Channel 4 should be at the centre and as an organisation should be at the centre of this alternative public service provider.

*Mr Richards:* Yes, I think so, and let us just quickly consider the alternatives. The first alternative is to say there should not be any public service voice and we

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can just make do with the BBC; 98% of the feedback we had said that was a bad idea, we think it is a bad idea and there is widespread consensus that the BBC itself, as well as everybody else, will benefit from a bit more of a mix. The next alternative is to say could it be ITV or Five; the problem there is that you are going in the opposite direction. ITV and Five are finding the process through which they need to manage the pressure from shareholders in an ever-more competitive environment, in a digital environment, more difficult not less, so that does not seem to be the solution. The third option would be to create something completely new from scratch. You could do that, but that seems to be less advantageous because you literally then have to start building a brand from scratch, you have to establish reach and impact, some sort of relationship with audiences, trust and all those sorts of things which in Channel 4's case you already have. In a sense, therefore, by process of elimination, you say actually you have something that works well in many areas, though I am sure we will come on to the changes that we would need to see in order for Channel 4 or the second public service institution to be effective—and there would have to be change—but you have something which is a very good basis.

**Q335 Chairman:** Another way of doing it presumably would be you might say that as a competition to the BBC, news provision like Channel 4's news is a very valuable piece of public service broadcasting so we will support that but we will not support the whole organisation because the whole organisation after all provides everything from *Big Brother* downwards or upwards, whichever way you happen to look at it.

*Mr Richards:* That is a very fair point. The way we thought about that is that there are two central routes one can go down in this area to build a variety of perspectives and competition in public service content. One is that you could go for a purely contestable route, in other words you pick genres, you pick particular programme areas and you say we will make some money available to these and then we will distribute it according to who can do it best and offer the best reach, or you can do it purely through institutions. Our sense is that where you have an area where you want a range of alternative public service content, which is frequently very difficult to specify—it is very difficult to write down in a contract creative content of that kind—then you should err towards the institutional solution. What you have with Channel 4 and that type of model is, yes, of course you have news, and news is something you probably could specify and we recommend that approach in regional news, but you also have comedy, you also have drama, you also have factual programming, you have history programming, you have arts

programming. It is much more difficult to try and specify that in an endless series of contracts, and it seems to us much more effective to try and find an institution for whom that is the primary motivation, where they are not trying to compete with the interests of maximising value to shareholders at the same time but that is their primary purpose, and where that mission to provide public service content across that range of different genres is essentially at the heart of what they do.

**Q336 Chairman:** You have problems going either way, do you not, because obviously as has been made clear in the evidence that we have had in this Committee if you put Channel 4 together with *five*, *five* was very enthusiastic about this and Channel 4 seemed to regard it like poison. It does not sound the happiest marriage.

*Mr Richards:* We have a rather more cautious approach to that question than either Channel 4 or Channel 5. With Channel 5 you can imagine their position being the one that you described and I think Channel 4, understandably, are saying “We need to be cautious about what that means as well.” Our view, and we set this out very carefully in the document we published recently, is that it should not be ruled out but there are some critical issues which would need to be considered very carefully before anything of that kind was pursued, in particular for example the issue of control. When a Channel 5 and Channel 4 merger was last mooted a few years ago the way it was put to me at the time, which was essentially a 50:50 relationship with a casting vote or a veto in a sense on budget decisions and things of that nature lying with Channel 5, I felt that that was wrong and that that would not work. There are other versions of collaboration/combination which could offer significant synergies and cost efficiencies and which, if the context was right in relation to control and the incentives of the *five* organisation, I do not think at this stage should be ruled out. There are significant issues of that kind that have to be looked at.

**Q337 Chairman:** I am going to bring Lord Macdonald in in just a moment, but it seems to me that really what one actually is coming to is that your favoured course—and it would seem perhaps the Government's favoured course—is that you put BBC Worldwide together with Channel 4.

*Mr Richards:* I would like to take the opportunity to elaborate on that a little bit because it is often reported in the press in this rather superficial way and what we try to do in our work is illustrate that it is not superficial and it is not easy. We said that on balance we felt that the preferable route forward on this was to create a second institution, with Channel 4 at its heart, based on joint ventures, partnerships or mergers, but we also said that that was a complex and

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challenging task and not without risk and that is why we spelled out the alternatives very, very carefully. The next few weeks and months will see whether it is possible to create something of that kind which works for all parties and makes sense; the Worldwide partnership, joint venture, merger, combination—whatever we want to call it—is probably the priority to explore for one underlying reason, which is that in both cases—Channel 4 and BBC Worldwide—you have one common strand which is that both are in the commercial world raising commercial revenue, but with an underlying purpose of meeting a public service interest, a public purpose, in BBC Worldwide's case to raise revenue to return to the BBC to invest in public service programming, in Channel 4's case to have a public service commercial model. That is clearly different to Five who have a primary purpose of maximising value to shareholders. Our feeling which we set out in a nuanced way in the report is probably, on balance, a start in that area where you have that common underlying interest but do not rule anything out because the challenge is very significant, it is complex and we need to have something which provides, at the end of that process of assessment, a sound financial footing for the second public service voice.

**Q338 Chairman:** You say you are exploring Worldwide and Channel 4 but actually you are pushing it, are you not?

*Mr Richards:* We are saying that we think on balance that is the preferred route, so you can call that pushing it if you would like to. I would certainly say we are proposing it but we are doing so in the context of recognising that in a situation like that you have to bring people to the table and you have to identify what the true opportunity is, where there are cost efficiency opportunities, where there are synergy benefits. You have to explore them, see what they are really worth, see whether a joint venture or a partnership or a merger even is the best approach—you have to make an assessment about that and you do need a strong degree of willing partners. Mergers and combinations of that kind do not work if one party feels that it is a complete disaster and they do not want to be there, so there is a considerable amount of exploration that needs to be gone through.

**Q339 Lord Macdonald of Tradeston:** Just to take that further, obviously to create a viable institution rather than just a short term fix you would have to build a dynamic into this and that dynamic would be to make Channel 4 more commercial than it is naturally a commercial entity by instinct, but conversely you would lose the incentive on the BBC to be as commercial as it has been. That might be a relief to BBC programme makers who feel perhaps pressured at times to make stuff for an international

market rather than a UK market, but how would you deal with that? The BBC would lose interest in trying to make Worldwide as successful as it has been, for good reason, and Channel 4 would have to change its terms of trade to get more of the action for selling overseas from the independent production sector. I can see the attraction in it, therefore, but are you still rather tentative about spelling out the implications?

*Mr Richards:* Not tentative about spelling out the implications; those are some of the possible implications and those are some of the reasons why we said it is complex and challenging. We did not want to put in our report that the answer is this and it must happen in the following way, for precisely the kinds of reasons that you are describing. I do not think there is necessarily a single version of this. There is a version in which you go hell for leather for maximising the interests of the broadcaster and the commercial exploitation, and under that circumstance inevitably someone will come to your Committee and say, for example, that the terms of trade need to be changed so that Channel 4 has greater access, issues of that kind. Equally, on the other side, the balance that is struck with the BBC, what kind of partnership or joint venture there may be, will significantly determine the extent to which the BBC is or is not disincentivised to promote Worldwide and make sure it is successful. I do not envisage a version of this in which the BBC does not feel at the end of the process that it does not still have an interest in Worldwide being successful, that is important. In some ways there are opportunities on the other side. I have heard it said that people believe this could be a way to give greater freedom to BBC Worldwide, for it to be even more successful and more commercially adept because it could create a little bit more daylight between the concerns of the heartland of the public service and the commercial operations. That is another example of the kind of thing that can be sensibly explored.

**Q340 Baroness Bonham-Carter of Yarnbury:** Picking up on that what is your response to the suggestion that what you are creating—and it is Emily Bell's term not mine—is a BBC C4 and this is just going to become one big mega-operation; indeed, plurality and competition in markets such as magazines, on-line business, et cetera are going to be even more squeezed than they are by the BBC on its own.

*Mr Richards:* It is an interesting perspective. If it turned out to be like that then the construction and design would have been erroneous and will have failed. You are trying to do two things here and at the moment I believe it is possible to achieve them. On the one hand you need to address this issue of scale and the economic basis. Channel 4 is probably sub-scale in the contemporary media market, it certainly has economic challenges and we need to find a basis

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for changing that and giving it scale, breadth and greater ability to generate revenue which will support the public service purpose, so there is a scale issue on that side. In doing that, however, it is very important that we find a mechanism which ensures that the plurality concern, the alternative voices and perspectives are kept at the heart of it. I do not think it is in any way beyond the wit of humankind to design something consistent with that. The idea that, for example, the board of Channel 4 are going to volunteer for something which essentially inhibits them and transfers control of the decisions they are making about investment in public service content and all of their content to the BBC I think is just not going to happen. It is something to be guarded about and to look very carefully at but I do not see any reason why that should necessarily be the outcome.

**Q341 Baroness Bonham-Carter of Yarnbury:** I suppose the problem is that it would be one body that would be selling this content and if you are not just restricting it to broadcasting you are potentially, as I said before, treading on the toes of the magazine world, the on-line world outside this large organisation.

*Mr Richards:* The initial response to that has got to be that is already happening. Everything Channel 4 does is commercial and takes place in the market and in the BBC's case there is already exploitation in the magazine market in the UK and beyond.

**Q342 Baroness Bonham-Carter of Yarnbury:** But we spent some years trying to dampen that down.

*Mr Richards:* Some people have tried to dampen it down, others have tried to expand it—that is the truth of the matter—and there is a fine line that people are always trying to manage. People have very different views of this, so it is a very good question and it is obviously an important issue. I do not think in the scenario we have described that the issue will go away, but I do not think the issue goes away in any scenario to be honest. The issue only goes away if you close down BBC Worldwide period and/or if you said to Channel 4 “You now have no public service remit, you are privatised and you are a purely commercial network.” Under those scenarios everybody would know where they stood but in any scenario where you have a mixed economy of public and private—which is the one which has served us well in this country—then somebody is going to have to police those lines.

**Q343 Baroness McIntosh of Hudnall:** Mr Richards, one of the things that hang over this discussion is a slight uncertainty about where the boundaries of public service broadcasting as a definition actually are. We have just heard evidence from BSkyB which

I do not think you were here for, but essentially their perspective is that there is not a problem. There is the BBC doing the thing that the market cannot or will not do, why do you need anything else? It does seem that the definition is drawn so widely, principally through the way that your organisation has set it, that actually anyone can call themselves a public service broadcaster and given that that is the case it is quite hard to refute the argument—I am sure you can and I hope you will—that what is being provided by a wide range of paid-for services, that you do not really take into account, is supplying an enormous diversity of public service broadcasting within the definition that you have set. Why do you feel that this environment is so out of kilter that you need another significant intervention of the kind that we have just been discussing in order to restore some sort of proper integrity to a public service broadcasting environment?

*Mr Richards:* I would like to respond to that. Let me start not where you might expect me to but where I think it is right to start. We do not come at this by saying there should be public sector intervention because that is automatically a good thing; we do not start by saying historically we have had lots of public service broadcasters so we need that many again only more of them. Actually when we began thinking about this, when I arrived at Ofcom originally and I oversaw the first PSB review, we started in a completely different place, which was to ask the absolutely fundamental question why should there be any intervention at all, what is the market failure, what is the value to citizens, whichever perspective you want to take. We did a lot of work assessing that and we made two observations. One is that the pure market provision has increased, is very different to the world in which I grew up—digital television, multi-channel television, the on-line media—and there are substantial contributions from purely commercial players that make very important contributions to public service broadcasting and broadcasting whatever you want to call it. Sky is a very good example of that and it does some fantastic programming, from which one might pick out Sky News as the greatest example, but that is not the only one. Discovery one can think of—there are plenty of examples. The second observation we made was that there was no evidence to believe that that provision by the market was what people believed was sufficient, and we researched this and analysed this with audiences and with stakeholders on a very broad basis. The conclusion we came to was market provision had been expanded and was good and does not in any way need to be belittled, it is very important and choice in that is very valuable, but that as a society we take from what Parliament gave us to do and what audiences tell us that they want more public service content—so whatever the market

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delivers but they want some more as well. That was how we approached it, but there are two dimensions to that that I just wanted to highlight. One is reach. It is true that on some channels there is some pretty good programming on a, for example, factual basis—you can think of Discovery or National Geographic and so on and so forth. They are on pay TV channels, they are not universally available and they typically have extremely low audiences. Contrast that with the reach and presence of any of the big free-to-air public service broadcasters and you are immediately talking about the difference between, sometimes, an audience of 10,000 to 20,000 and millions, so there is a profound difference in that sense. The second area where there is a profound difference is the actual investment and expenditure on high quality content. The market has expanded enormously, it is doing all these things that I have described, but if you strip out sport and movies and think about all of the rest of broadcasting, the five public service broadcasters—BBC, ITV, Channel 4 and Five—still to this day account for about 90% of the investment in British content. The world has changed, therefore, it has moved on, the market does provide things in some areas but it is nothing like the degree to which some people would have you believe and actually the rich mix that we enjoy on our screens today is the product of that private sector market provision and that very, very substantial contribution by the public service broadcasters. Much indeed of what is on pay TV sometimes—the UKTV channels for example—is actually re-run versions of what was originally invested in by the public service broadcasters in the first place. That is the second point. The third point, which is it just the BBC only, is a point I responded to my Lord Chairman with earlier, which is of course you could have just the BBC only, and we have always said that is a possibility. It is very clearly what audiences do not want, it is very clearly what the whole of industry says is not a good outcome—and I include the BBC in that—and all the evidence of other markets and the UK's own experience is that the BBC is at its best when there is someone keeping it on its mettle, we reach wider groups of audiences when different organisations take different perspectives and, as a consequence, you get a richer mix. Let me give you one very quick simple example as a result. People often say to me “What does Five contribute?” If you look at the news on Five and the audience it reaches it is an audience that the BBC finds it very, very difficult to reach with news, it is socio-demographic D/E who watch Five and they will come to the news, coverage of politics and international affairs because we make Five do it and they agreed to it as a public service broadcaster. The BBC find it really hard to reach that audience; those people do not watch *Newsnight*, they do not watch the *Ten O'Clock News*, they do not listen to the *Today*

programme but it is really important that news as a public service is available and is able to reach as many people in this country as possible. That is what the mix gives you.

**Q344 Baroness McIntosh of Hudnall:** It is right to say, is it not, that *five* get their news from Sky?

*Mr Richards:* That is absolutely true.

**Q345 Baroness McIntosh of Hudnall:** Which is interesting in the context of this discussion. Can I just press you on this question of definition? Do you think that the way public service broadcasting is defined and construed within your report and more widely is a bit baggy?

*Mr Richards:* No, it is more precise than it has ever been in the whole time that I have been looking at this and it is as precise as you can get it without taking it to a point where you have the problem which I think some people would like us to have which is essentially dissecting every single schedule and saying opera: public service; *EastEnders* not. That is the problem that you get to with that sort of scientific approach to these kinds of things. Our definition, which I am very happy to defend, tried to put real flesh on the bones of what for decades we had relied upon. Essentially all of us had relied upon the Reithian nostrum—inform, educate and entertain—and that was enough. What we did was say look, that really is not enough in this day and age, it is a wonderful triumvirate that has served us very well but now we do need to be a bit more precise. We set out a much more specified and detailed set of purposes and accompanied those with a set of characteristics, and we have been criticised, roundly, for that level of precision. I was personally taken to task by the director of programmes at ITV at the *McTaggart Lecture* last year because we were too precise, this was too much detail and we were trying to tell people what public service broadcasting was. I guess I conclude from that that in my position you cannot win either way.

**Q346 Bishop of Manchester:** Can I just ask about the Communications Act definition? Presumably none of this, in your view, is moving away from what is the one and only definition in law of public service broadcasting.

*Mr Richards:* It is entirely consistent with it and supportive of it.

**Q347 Lord Inglewood:** Can I refer to what may or may not come into being in some form as the second institution? I want to ask a series of questions looking at that and the first one is that it may well need some form of financial support from somewhere; do you have any particular views about the nature and character of that support? Also, bearing in mind the

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earlier discussions, on the second institution do you yet have any lines beyond which you will not go in terms of its actual legal ownership, bearing in mind you said earlier that your evidence suggested that something that was not in the private sector which was profit-driven was something which commanded public support. That poses a series of questions for the other parties who might get into bed with a publicly-owned entity of some kind, not necessarily anything we have got now. Finally, the BBC is the big player in public service broadcasting, is there any scope for transferring a bit of that into the second institution?

*Mr Richards:* What was the first one?

**Q348 Lord Inglewood:** The first one was if public funding was needed to get this thing going do you have a view about how?

*Mr Richards:* We have set out the different options and one of the reasons that we said our preference for examination now was the joint venture/partnership/merger route was because it seemed to us that that was the least worst. I do not think any of these approaches are without risk but let us take another example. An easy way to do it would be to say to Channel 4 we want you to revise your remit, this is what we want you to be now, we want you to be commercially funded and we are going to assess every five years how much money you need in addition and you are going to have that from the taxpayer. People say you cannot but of course you can do that; if you wanted to do that of course you could do it. Our concerns about that would be firstly you have got a very significant relationship then with the editorial and creative freedom and the Government as the paymaster in a very direct way. We would be worried about the incentives it creates because you in a sense have then said to the organisation you can get public money so carry on and the next time it comes around you can just bid for more public money, and the incentives on the organisation to make itself as efficient as possible and maximise commercial revenue in line with the public service remit are a bit confused at that point. The twin source of funding presents some challenges in terms of is one thing funding one set of activities and the other funding a different, and do you drive a wedge between what is actually a coherent channel, a coherent network. For all of those reasons and some others we think you definitely can do it these other ways but if we could find a way through the synergies, the cost efficiencies and the opportunities around joint ventures, partnerships and mergers then that might be the best way through because it preserves the integrity of a commercial publicly-owned, public service model and does not create those confused incentives which would have to be managed very carefully.

**Q349 Lord Inglewood:** If I could just ask you to expand on this, you envisage the second institution not necessarily consisting of a Channel 4 and a Five, it would be a hybrid which would require primary legislation and so on?

*Mr Richards:* Yes, and this addresses your second question really about are there lines beyond which we would not go? I do not think we have a precise answer to that but we have some very clear guidance on that. If your aim is a second public service institution whose mission it is to provide an alternative, offer a different perspective, reach other audiences and complement the BBC as well as compete with it—and this is an important combination of words—then what you have to do at the heart of whatever the outcome is is ensure that that public service purpose is both secure and properly funded. What you cannot do is invent something in which actually the public service purpose is an afterthought and is relegated to Friday afternoons. That is a waste of time.

**Q350 Lord Maxton:** I am a bit uncertain about your timescales in all these proposals because three years from now the analogue will be switched off, everybody will be digital, therefore everybody basically has to have the minimum of a Freeview box. There will be other technological changes; in my view there will be the linking of internet onto television so you are watching it directly. Is this not all a bit rather out of date thinking?

*Mr Richards:* No, I do not think so. The world you describe is the one that will unfold, we would agree with that very strongly. I would remind you that it is Ofcom that has pushed the arguments about digital media harder than anybody else but, thirdly, what you will need in that world I still firmly believe myself is strong public service content. I do not think the underlying arguments for that go away at all and the fact that you can access a streamed video of local television news in Toronto does not help us; it is quite interesting but it does not help us.

**Q351 Lord Maxton:** But if you can watch your local council debating an issue which interests you, that is public service broadcasting.

*Mr Richards:* All that will happen but I do not think that gets away from the root issue which we were trying to address which is that we have benefited in this country from very substantial public service content and that is as valid in the potential world as it is in the present. An interesting question people pose to me is, yes, but you have put a lot of emphasis on broadcasters and the digital world is going to be completely different. It is going to be completely different but you have to work with what you have and the truth is that broadcasters are very established brands, with very established relationships with audiences, are capable today and will be capable in

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the future of reaching millions rather than a few thousand and that is very, very important. So what we need to do is not jettison broadcasters as ancient history, we need to make sure we design something and ensure that they grasp the opportunity of the digital media and that we provide the means for them to do so. That is the critical thing and we really try to emphasise this. We do not see this as status quo protection of broadcasters; on the contrary this is all about liberating them and providing support and a new model for them to grasp the digital opportunity. If they do not do that they will absolutely decline in relevance, public service content will decline in relevance and the argument for it will decline correspondingly.

**Q352 Chairman:** Before I bring in Lady Scott I just want to ask you a question, going back to BBC Worldwide. You are pushing the Worldwide/Channel 4 solution—exploring it is the word you prefer to use. Does the BBC have the right of veto?

*Mr Richards:* I think it is unhelpful to get into that territory, I really do. Ultimately you are dealing with matters on which the Government needs to take a view.

**Q353 Chairman:** Surely the BBC needs to take a view, does it not?

*Mr Richards:* The BBC will take a view, you will take a view, Channel 4 will take a view.

**Q354 Chairman:** By your last remark you are really saying the Government could impose.

*Mr Richards:* I think that is a matter for the Government ultimately in discussion with the BBC. Let me reiterate what I said earlier which is that I think it is important for something like this to work for it to be regarded by everybody as the best way forward. The BBC have a crucial role, the BBC should not be damaged in this and a lot of what we said in this report was very clear on that. We do not see any benefit in trying to build a diverse public service system and by doing so irreparably damage the BBC, that is not a good outcome, but everybody needs to recognise and accept that there needs to be a creative solution found to this or we will all be worse off. I would not want to put it in those stark terms; it is important the Government takes a lead and it has begun to do so, it is important that the BBC enters into those conversations with a broad idea and a broad attitude towards the broader public interest, not only the BBC's interest and it is important that everybody else does as well.

**Q355 Chairman:** Do you need legislation for this solution?

*Mr Richards:* That remains to be seen and it depends upon the proposition that is actually identified as being the—

**Q356 Chairman:** If it was BBC Worldwide coming together with Channel 4 would that require legislation?

*Mr Richards:* I doubt it myself but it may do. It is not something I have looked at in detail.

**Q357 Chairman:** That is quite convenient from the Government's point of view.

*Mr Richards:* That is a matter for the Government. I do not think we should think about legislation as an issue here, we should think about what the best answer is and if it requires legislation then it requires legislation, if it does not—

**Q358 Chairman:** It actually has profound impact, does it not, upon the timescale and everything else?

*Mr Richards:* It affects the timescale.

**Q359 Chairman:** It might also affect the outcome as well.

*Mr Richards:* Possibly, but it would be better to start from trying to identify the best outcome.

**Q360 Baroness Scott of Needham Market:** In your reply to Lord Inglewood you talked about the need for competition with a second provider that would complement and provide competition. That is obviously going to be primarily commercially funded so where does Ofcom draw the line between the need to preserve the plurality and interference in markets? For example, at the moment with the Five proposal it is in some trouble itself; could it not be argued that you would be interfering in free markets and that these organisations ought to just go down?

*Mr Richards:* There is almost no part of broadcasting which is genuinely a free market and there never has been. There are parts of broadcasting which are closer to a free market than other parts, but there is no part that is not regulated, even the parts that look like they are purely commercial free market activities are regulated in some way or another, even if it is just getting a licence from Ofcom. So it is a heavily regulated area and that has always been the case, though in some areas there was lighter regulation in the past than there is today. We have focused on trying to identify the appropriate public service intervention to give us the best overall outcome. I think there is a whole range of other issues, however, which will determine whether or not any individual advertising-funded broadcaster or any other organisation survives and prospers in this world, and

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I think the risks you describe are accurate. I am very concerned about the impact of both what is structural change and cyclical change in combination on commercial broadcasters, and it is very unusual that those two things come together but they are coming together here. They are under considerable threat in that respect and one of the things we say at the end of the report, and we did so very deliberately, was that we are trying to have a ten-year horizon on this but, frankly, that is incredibly difficult and we said that people will need to keep looking at this and keep alert to it over the next five years because it is not clear how some of these things will unfold and whether somebody will survive or not in this world.

**Q361 Bishop of Manchester:** You have responded quite considerably this morning on the issues relating to various merger proposals but I wonder if I can just explore whether there are any other issues which you might want to come back on. Take, for example, the gap in the funding over the public service content for Channel 4—in your report you mention this as being between £60 million and £100 million a year by 2012 with possibly a further £50 million if Channel 4's *Next on 4* plan goes ahead. On the other hand you tell us that Five reported a profit of only 10 million euros in 2007 although in 2007/08 BBC Worldwide's profit was £44 million. If you were looking at the two merger proposals between Channel 4 and BBC Worldwide or between Channel 4 and Five which would you be reckoning would be the better option in terms of at the very least closing this gap that Channel 4 has at the moment?

*Mr Richards:* The way I would be thinking about it is not necessarily to start by saying who has got the most profit; that is a structured way of looking at it but I do not think it is the best way. The best way is to think about a range of different criteria. The first is can it work as a partnership or combination—and that was back to my point about the tension between shareholders and public service, do you have an underlying complementarity of rationale—and the second is where is there an opportunity to enhance the economic position of both parties, so it is not so much who has got the most profit, it is more if you combined or collaborated in such a way how much cost efficiency could you create, how much synergy could you create, is there better opportunity for co-ordination or cross-promotion, things of that nature. That is the way I would be looking at it and that is the way we have been thinking about it. That would be my approach to it.

**Q362 Bishop of Manchester:** Just looking a bit more closely at the Channel 4/Five option of merging and looking at the issue of possible commercial contracts, what is the way forward in terms of one party

outsourcing the outcomes such as advertising sales to another?

*Mr Richards:* All of those kinds of things are possible and some of those we would have to look at carefully on competition grounds as well of course. We note that in relation to the discussion about a combination between Channel 4 and Five in the report and we cannot pre-empt or prejudge our position on any of those things because it depends upon how they are done, the circumstances and the analysis at the time. All of those kinds of things are the areas that you would look at. We definitely do not have and I do not think anybody yet has a precise view on this is how you would do it. There are some obvious efficiencies in all of these areas—back office efficiencies are self-evident if you bring organisations like that together or combine them in a particular way and, equally clearly, the scope for cross-promotion, joint promotion, that sort of thing, is also very obvious. The question is how much are they worth and is it enough to address the kind of gap that you are talking about. That is what remains to be seen; this is exactly why, to reiterate what I said earlier, we said it is our preferable route but it does need to be explored and examined very thoroughly and then we need to stare at something which says “Here is how it would work; here is how the public service remit is protected and supported; here are the underlying economics and they are sound for a sufficiently long period to give us confidence that that is a good basis for it.” I should just say, going back to the control issue, there are models out there today which are interesting in the context of this kind of exploration. One obvious one is the Guardian Media Group where you have the Scott Trust playing a role which protects the operation of the newspapers, and another one is Reuters where you also have protection in place for a particulate duty in relation to news. There are therefore ways and means of doing this which can be combined with the evolution of a commercial model. That is the territory we are in here.

**Q363 Bishop of Manchester:** Would not the best of all options be though to put together Channel 4 and Five and Worldwide?

*Mr Richards:* That is something that a number of people have suggested and it is something we have given some thought to. It is an evolution of thinking which is possible but you do have to remember that as you add parties to a discussion the discussion becomes much more complex, as I am sure you will know from your own experience. I would inject a slight note of caution on that but it is one of these areas where you can probably find some bankers somewhere—they probably would like to come in and see you—and they will say, in great masters of the universe tradition, “We have a piece of paper here and this is how it can work, we have done the deal.”

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I would express significant caution in relation to that kind of approach.

**Q364 Lord Macdonald of Tradeston:** Your analysis of the changes to Channel 3 is persuasive and in Annex 3 you say: “The future of the non-ITV licencees is clearly dependent on whether ITV plc retains its public service status.” When we talked to Michael Grade we all agreed that if ITV Plc took off from Channel 3 then the other companies in the three nations outside England would not be viable. However, the conditions that Channel 3 want to extract from you include the renegotiation of their financial relationship with the companies in the three nations which might equally make them unviable, so either way there is a danger that they will be bust in Northern Ireland and Scotland and the other settlement for Wales would not happen. When we put that to Michael Grade he said the broker would be Ofcom. When would you start broking and would you hold back on the rest of the deal that ITV wants until you get some settlement that keeps the national companies alive?

*Mr Richards:* It is a very, very difficult issue this; it is the unwinding or the unfolding of an historic set of deals, agreements and understandings which have supported different companies and different nations in the UK and as the pressure on ITV plc mounts and the pressure on all of those mounts, so it is going to have to be resolved one way or another. Our brokering role as it were, or arbitration or resolution role as it might ultimately be, to be honest, is already underway since the review began. We are thinking about it carefully, quietly and privately. There are two stages to it: the first stage is the undertakings that were put in place when Carlton and Granada merged in 2003. Those are undertakings and the Competition Commission would have to remove those. We anticipate that ITV, in light of what they have said to you, will at some point quite soon seek to have those undertakings changed and that will be a matter for the Competition Commission. When that happens, or in parallel to that, we will look at our responsibilities to resolve the issue in relation to the networking arrangements with the network centre so we know how we expect that to unfold in process terms. In relation to the substance of it, because we have not begun that process yet I would not want to give a view. Both sides have unusually polarised opinions about this. ITV, you will have heard from Michael Grade, say it has got to go, it does not make sense, we are offering a huge subsidy and we cannot afford to do that any more. On the other side STV and UTV and Channel TV take the opposite view, that the net effect is positive for ITV and it should stay exactly as it is. It is therefore going to be a very difficult one to resolve. It does need to be seen in the context of all the other changes and it is true to say,

as our analysis set out, that the long term viability of the position in the nations—in Scotland and Northern Ireland—is challenging to say the least, and that is why we took some of the more bold positions we did on some of the other subjects such as news in the nations and the regions.

**Q365 Baroness Howe of Idlicote:** Can we have a look at sanctions for the future for, say, non-delivery of public service obligations? Last month you imposed a fairly interesting fine on ITV of £220,000, a couple of smaller ones for Ulster and Scottish Television in addition for non-fulfilment of regional production. £220,000 where a company has a turnover of £2 billion on the face of it looks pretty small. Of course there may be some background to that because the quotas imposed in the 2003 Act were relatively small, but you have bumped them up quite substantially and maybe that was a mistake. I do not know, I am trying to make some justification for why you imposed such a small fine. Perhaps you would like to comment on that at this stage.

*Mr Richards:* Two comments if I may. Firstly, there was some considerable discussion around the industry as to whether we should fine them at all because the thrust of the longer term work was very clear to everybody which was that this kind of obligation on ITV would have to reduce, so a number of people I heard talking around the industry said that over the longer term it is very clear the obligation is going to have to fall and therefore they could not possibly fine them for missing something that is going to be reduced anyway. We took a slightly different view of that. We took the view that while the rules are the rules and while the regulation is the regulation it is clear that it is very important for licencees to meet those regulations and if they do not they will be sanctioned, and when we change the rules then they can change. We took the view that not to sanction them, not to record it as a breach and not to fine them anything would be essentially undermining the position of the regulatory policy. So we decided that we were going to sanction them and we were going to find a breach and fine them. We then had a separate conversation about the size of the fine and we try and do that in light of the circumstances and in light of the mitigation and the context given to us by the company in light of a broader set of circumstances and so on and so forth. We have to take a judgment about that; we think that that level of fine was, you could say, small compared to their turnover, and I would accept that, but on the other hand it was big enough to get in all the newspapers, it was big enough to warrant considerable unhappiness as a result of it and I think a lot of people would regard it as a considerable sum of money. These things are always a balance but I feel that that was a clear signal that when the regulations are clear you have to meet them.

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**Q366 Baroness Howe of Idlicote:** Are you within what you have said really also admitting that you might have got the hike wrong in the first place when you have not given any indication?

*Mr Richards:* I do not think so to be honest because it was not a hike; it was a very modest increase—I think it was from 40 something—

**Q367 Baroness Howe of Idlicote:** It was 40 to 50 I think.

*Mr Richards:* And they were exceeding 50 by some distance so it was a very, very modest change. It was not a hike, it was carefully considered. A hike would have taken it to something like 70 or 80% and that would have been incredible. Bear in mind that even though it sounds like a large number you are talking about a company that makes *Emmerdale Farm* and *Coronation Street*, so two of its biggest bankers, to which there is huge value and volume attached, which are not made in London and are automatically qualified to meet this quota. I do not think it was a mistake therefore. We were trying to strike the right balance at that time in the context of reducing ITV's obligations elsewhere. So it firstly was not a hike. Secondly, it was a very modest increase in the context of reducing obligations in other areas. People occasionally can forget that side of things.

**Q368 Baroness Howe of Idlicote:** But of course what we are thinking about is the future and, indeed, a lot of people might have thought that was a very small fine; I was really trying to work out the background. Are you saying that the same sort of sanctions would be applicable to whoever gets the licences in future or are there other ways in which you would like to regulate non-delivery?

*Mr Richards:* We could have fined them substantially more; it is all about the circumstance, the context and the way the company responds to the issue in question. We can fine companies up to 5% of qualifying revenue, which was a very considerable number, but we can fine them either zero or anything up to that. As I say, it is always a judgment and, as you know, in some other areas the fines for quiz TV breaches have been very, very considerably higher and have been in the millions. It depends on what the situation is and what the breach is.

**Q369 Baroness Howe of Idlicote:** Do you think the systems that you have got in place are effective for some of the more complicated areas you are moving into now?

*Mr Richards:* I think so. Where you are dealing with the quality of programming; that is where fining is a waste of time. Where you are dealing with the quality of programming you need an institution and you need a governance framework which delivers that effectively.

**Q370 Baroness Howe of Idlicote:** Of course one is talking about value as well as volume.

*Mr Richards:* Yes, and that is why you need a governance framework which meets that rather than the threat of a regulator fining you.

**Q371 Baroness McIntosh of Hudnall:** Can I just go back to something that we touched on earlier briefly which is the question of contestable funding for public service programming. You have made it very clear that your preferred option in terms of the mega picture is institutional funding but you have still got a little bit of a yearning for some contestable element to be available. Can you first of all just say where you think that fits into the overall picture and, secondly, do you have any thoughts at all about how, firstly, that funding would be secured and, secondly and probably more importantly, how it would be allocated?

*Mr Richards:* We do not have a yearning so much as a sense of the appropriate approach to different problems. The way we think about it is to say if you are dealing with something that can be easily specified and understood and contracted for through a contestable method then that is very, very worth looking at. Where you are talking about something which is more fundamentally creative, more unclear, more difficult to specify it is better to use institutions and that is why we arrived at this balance. The area where we believe there is both a problem and a need potentially for a contestable route to resolve it is regional and nations news. There are two things about that: firstly, there is a very serious problem here and we have focused our attention on broadcast news, but the problem is as deep if not deeper in the press where regional journalism is being hollowed out as a result of the loss of classified advertising. We see this therefore as a very big issue and I have a strong personal view about this as well as Ofcom as an institution that if we lose the spine of local and regional journalism around the country outside of the BBC we are heading for a quite serious problem in terms of the quality of accountability and the quality of our democracy. I feel very strongly about this. It is not just TV, it is also radio, it is also newspapers. What you observe about that area is that in commercial TV and indeed radio—and we talked about *five* earlier—there is a very strong track record already established of essentially people contracting for news provision. ITV contracts from ITN, there is a contract specified every seven years, they compete, they win it and they deliver it. They have done it for years and it works very well. Sky won the bid to provide *Five's* news so the contestable method based on contract is actually familiar to the entire sector and delivers very, very well. Our thinking led us in that area to say there is a real opportunity here to do something slightly different, a bit more radical but

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which we know from the evidence that is already out there can work. There is also a big advantage to it which is that at the moment we have an approach to this which is we have regional ITV news, that is great and that is all we need, but actually in the future it is not all we need. We need to have a TV base but that news needs to be provided on the radio, it needs to be provided on-line, on broadband, on demand and so on and so forth, and if you move to some kind of contestable model of that sort for this area you would be able to push that and you would be able to say “Compete for a proposition which has TV at its root, at its core, but tell us also what you will do on-line, tell us what you will offer on demand, tell us how you will collaborate with local newspapers or local radio.” All sorts of opportunities will be potentially created that are currently not available.

**Q372 Baroness McIntosh of Hudnall:** I think the question that is unanswered in that otherwise very helpful response is who “us” is. You say “tell us” and you are implying—

*Mr Richards:* The answer to that is that you have to find money for this and the money can come from the variety of different sources that we have laid out—it could be taxation, it could be the switchover surplus, the issues embedded in the licence fee, it could be spectrum proceeds.

**Q373 Baroness McIntosh of Hudnall:** But you do not have a preferred option at present.

*Mr Richards:* We have been cautious about expressing a strong opinion on that because we feel very strongly that we are a big and powerful regulator, a big and powerful organisation, but there are lines which are very clearly matters for Government and Parliament. Funding and the use of public money is one of those and we think we should just keep the right side of that. But those are the different routes and I think that helps you answer the question who “us” is, because whoever is providing the money, probably there should be a connection between that and who is deciding who wins the fund. We do not envisage that it is Ofcom doing that, I should make that clear; we think there is a slightly different function.

**Chairman:** Lady Bonham-Carter, you wanted to come in on this.

**Q374 Baroness Bonham-Carter of Yarnbury:** Just a quick question, which is that as evidence is given I am getting increasingly concerned about the many uses that the surplus from digital switchover is for. I have made a little list: upgrading of boxes, helping Channel 4 and, as you have just mentioned, funding local and regional news.

*Mr Richards:* I could add a few more. Broadband, universal service obligations is another, there is a whole host that one could add to it. The important thing here is to be clear, as I think we have been, that there are two elements of money here: there is the underspend that is likely in the current amount of money that is in the licence fee for the switchover help scheme which I have heard runs into the hundreds of millions now, so that people believe will be there, and then there is the second post-2012 where all you do is if you elect—we always say “if”—to keep the licence fee constant in real terms then there will be approximately £130 million per annum that could be used for something else which would have no impact whatsoever on the BBC’s programmes and services. The first thing is to establish that that is a legitimate topic for public debate and to stop this nonsense about it does not exist or it is theoretical. It does exist, it will exist in the near term and the question about the future—of course you could just give it back to licence fee payers as we have said very clearly, that is an option, but on the assumption of a real terms constant basis, that is what there is. There is, therefore, a legitimate public debate to be had about it. The second set of questions is a very straightforward one, which is, what is the priority? It could be giving everybody a lower licence fee, it could be using it for more BBC services—so you could just spend it all on extra money for BBC 1—it could be universal service for broadband, if you thought that was a sensible use of it, it could be funding regional news to ensure there was competition and plurality in news everywhere across the UK. Those are the two questions: be clear about whether it exists or not and on what terms it would exist and, secondly, then think about what the priorities are.

**Q375 Baroness Eccles of Moulton:** Mr Richards, Ofcom has said that the licence fee with efficiency gains will rise 15 to 20% by 2012—this of course does not take account of possible effects of serious inflation which we might well have experienced by 2012, but that is obviously a guess. I just want to ask you specifically about this and the question that it is seen by some as upsetting the balance between the funding received by the BBC if this happens and other broadcasters, particularly when their revenues are falling. The question that we have not addressed today is the one that I know the BBC is not at all keen about, which is the question of top-slicing and the consequences being distributed more widely.

*Mr Richards:* On the first issue, in the next year or two we are far more likely to face negative inflation rather than rising inflation, which will have the effect of making the BBC licence fee settlement more generous not less.

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**Q376 Baroness Eccles of Moulton:** This is 2012 we are talking about.

*Mr Richards:* We are where we are today, the settlement is today as well as 2012 and RPI is now 0.9%, and if you look at the graph it is going like that. You can read the Bank of England monetary report as well as I can and the outlook is that the concern at the moment is not for inflation, it is about whether there is going to be deflation. That could change by 2012 of course, but the current position is the opposite of what everyone expected and it is very helpful if you have a nominal settlement which is what the BBC have. That is the first point. The second point is that of course you have this dynamic within the settlement which is household growth, so there are more households. Every household has to pay a licence fee; therefore, even if the amount every household is paying is the same, your revenue is rising, and that has been the case for the BBC for years and years and years and there is no sign of it abating. The BBC is in a very robust position on that. The final part of your question, which is very significant, is the overall balance. I do not think it is any secret that a number of people around the industry, if you talk to them, would say that they are concerned about the balance in the medium term. The BBC is absolutely the cornerstone, it is crucial that it is funded well and properly but if we do not resolve these other issues that we have been talking about this morning in the right way you will face quite a significant divergence, and that will have consequences, because if you are an independent producer or a producer of factual programming or things of that nature you will quite quickly only have one place that you can go. That will be the BBC and that will be good, but it will not be great because you should have somewhere else to go. Those are the issues at the heart of this; there is a slight risk that TV becomes more like radio where radio is completely dominated by the BBC to the degree that it takes about 58 to 59% of all audiences and in substantial numbers of areas commercial radio simply cannot compete. That has presented its own kind of challenges; we are not at that point in television and it would be a shame if we did get to that point in television.

**Q377 Baroness Eccles of Moulton:** The top-slicing could do what?

*Mr Richards:* What we said on top-slicing was really clear: we do not think that the best way of solving these problems and creating a diversity and mix in our view is to cut spend on the BBC's programmes and services. That is not where we would start and we do not think that is a good idea. The switchover surplus is a different matter because that has nothing to do with the BBC's programmes and services.

**Q378 Chairman:** No, but there was top-slicing, was there not?

*Mr Richards:* I do not accept that version because when people talk about top-slicing, if you talk to people who work in the BBC, programme makers and department heads, what they mean by top-slicing is taking our money away so we have got less to spend this year on the *Today* programme. That is top-slicing.

**Q379 Chairman:** That was exactly what happened. This Committee actually in fact said it should be social security spending—it is social security spending.

*Mr Richards:* It is a form of social security spending.

**Q380 Chairman:** And it has been taken away from the licence fee.

*Mr Richards:* It is a form of social security spending, it is a subsidy for people on low incomes and the over-75s. That is exactly what it is.

**Q381 Baroness Eccles of Moulton:** But if you top-slice a surplus you are not reducing the amount that is left to spend on the output.

*Mr Richards:* I do not agree that you should describe that as top-slicing; it is not what programme makers and people who actually make programmes in the BBC regard as top-slicing because you could use the £130 million for something completely different, as it is today used for, and it would not affect their budgets at all so it simply is not what most people regard as top-slicing. Do not get me wrong, it is a different question about whether it is the right thing to do, it may not be the right thing to do; the right thing to do may be to give all of that money to BBC 1. Personally I am sceptical about that but I recognise that that is an option; but it is not top-slicing in the sense that ordinary people who work in the BBC understand it and we really should be clear about the distinction.

*Chairman:* Okay. The very last question; Bishop of Manchester.

**Q382 Bishop of Manchester:** I just put this very briefly at the end and you may want just to give a quick response because it would have been interesting to explore the balance between supply and distribution of the content of public service broadcasting, particularly in terms of the news and probably also children's television. Given the fact that in your report you do concentrate on the provision of supply, and in the light of what you were just describing in terms of the current financial situation and the problems for channels that rely very much on advertising, have you got any view very quickly about how the schedulers can be persuaded to provide the slots for this kind of public service

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broadcasting when the economic climate is working so much against them?

*Mr Richards:* I might, given the time, just stick to one headline answer on that, which is this is why it is so important to have the second public service institution, because the battle we will have on that topic with a company that is fundamentally all about serving the interests of its shareholders in a difficult economic climate is almost impossible to win. If you have a different institution where the people wake up in the morning and say “Our job is to make public service content, make it engaging, entertaining and attractive and to put it on screen when people are

there to watch, that is what we are here to do, that is our purpose in life and we have a governance framework to support that and a clear remit”, you have a chance of it happening.

**Q383 Chairman:** Mr Richards, thank you very much, you have been very patient and you have answered our questions very well and very clearly. Perhaps if we have any other factual points we could come back to you but thank you very much for coming.

*Mr Richards:* Thank you for having me.

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 WEDNESDAY 11 FEBRUARY 2009
 

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Present	Bonham-Carter of Yarnbury, B Corbett of Castle Vale, L Fowler, L (Chairman) Hastings of Scarisbrick, L Howe of Idlicote, B	Macdonald of Tradeston, L Maxton, L McIntosh of Hudnall, B Scott of Needham Market, B
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**Examination of Witnesses**

Witnesses: LORD BIRT, a Member of the House, and LORD BURNS, a Member of the House, examined.

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**Q384 Chairman:** Welcome and thank you very much for coming. Lord Burns, you were asked to carry out an inquiry by the Government in 2005 before the beginning of the Charter process and, broadly speaking, where did that inquiry get to?

*Lord Burns:* I worked almost continuously as an adviser to the Secretary of State through the Charter Renewal process and, as one part of that, we set up a group of people to look at some specific aspects. We held a huge number of public sessions and we then wrote a report. Part of it was about the changing nature of broadcasting and where the BBC fitted into it. Quite a lot of it was about the governance of the BBC. The proposals that we put forward were to have a corporation, which was the BBC, with a normal board and governance structure and separately to have a Public Service Broadcasting Commission which would do the oversight of public service broadcasting generally including the whole question of funding of other public service broadcasting. We also talked quite a lot in broad terms about the nature of public service broadcasting and what it was and the way in which the marketplace was heading and some of the problems and complications that were likely to arise through the growth of multi-channel.

**Q385 Chairman:** Thank you for reminding us of that and we will obviously not go into all those proposals and I notice with interest your proposal on the Chairman of the Board of Directors for the BBC which is a proposal that a number of us held very dear, but your proposal and our proposal were ignored in equal measure. Let us turn to contestable funding which is really what we are interested in at the moment about which I know Lord Birt also has views. First of all, you take the view that it is necessary to support public service broadcasting outside the BBC in order that there is some sure competition as far as the BBC is concerned.

*Lord Burns:* Certainly in the work that we did and in the report we produced on this, we took the view that, for a whole series of reasons to do with the growth of multi-channel, it was likely that the amount of public service broadcasting on the non-BBC channels was going to be in structural decline. As the viewing

figures were dispersed across channels, the revenues that the other channels would receive from advertising were likely to be diluted and they would be under pressure. Furthermore they were no longer getting the monopoly elements that they had under the old system. Secondly we took the view that it would be better if the BBC were not the only public service broadcaster and that there was some competition and that there were other routes to supply that service.

**Q386 Chairman:** Would that be something with which you agree as an analysis, Lord Birt?

*Lord Birt:* Broadly. I wonder if you would however allow me to express it in my own way in my own words.

**Q387 Chairman:** Of course.

*Lord Birt:* I think that we are at an absolutely critical point in the fortunes of British broadcasting and I cannot overstate that enough. We are literally coming to the end of the analogue age and are in transition to the digital age. We have had the analogue age for close to 100 years. Britain arguably has managed broadcasting in that period exceptionally well, arguably better than any other country in the world. It got off to an excellent start. A stubborn, obstinate Director General of the BBC created an institution which is literally now one of the most effective organisations of any kind anywhere in the world. A number of things had to happen however before we had the modern BBC in its current form. I think that the introduction of competition in 1958 had a profound impact on the BBC. It lost 70% of its audiences overnight. It was an organisation that was not in touch with audiences, it was not in touch with quite a lot of things, and that fundamentally changed the BBC—it did not change its nature or its values but it changed the way it operated and much of what it did. When ITV reached the point where it developed exceptionally large surpluses, we had an independent broadcasting authority, which I think in retrospect we can lavish high praise on, which insisted that the ITV companies spent a very large proportion of their revenues, something like half, on developing

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an alternative public service tradition and that too had a profound impact on the BBC because ITV invested in every genre of programming. I spent much of my career, as did Lord Macdonald, in ITV in that period and it was a golden period not just for ITV but for British broadcasting because the quality and intensity of the competition was so great. A Conservative Government introduced Channel 4. The ITV companies at the time had wanted to own Channel 4 themselves, but another really good decision was made that Channel 4 should be independent. An even better decision was that we should move away from the old monoliths in the production of programmes, and that Channel 4 would not make its own programmes but would commission them from the independent sector. So, suddenly, we had a developing independent production sector with much greater diversity and plurality, and I think we then come into the golden age, truly diverse and truly plural—within the context of the then technologies. We were going along very nicely and we come now to a completely different era. Indeed, that golden age has ended for reasons we all understand, and I do not point the finger here, because the ITV that I used to work for is in a fundamentally different economic and financial position now. I think we should note en passant that we have stood by and watched that tradition decline and we must not stand by again and watch another wonderful programme tradition represented by Channel 4—different, a different value system, nonetheless hugely valuable—go into decline too. The big picture issue for me is, we should not want to see a return to the pre-1960s world of a BBC, an institution which I hope everybody understands I very greatly value, become again a monopoly provider. Monopolies are dangerous things.

**Q388 Chairman:** We will probably examine some of that because there is obviously a case to be made why one should intervene on Channel 4, but let us take it that you perhaps both take the view that some support for Channel 4 is necessary. How would you do that? How precisely? What is the mechanism whereby you would do that? Would you actually put companies together or would you actually think of funding in a different way?

*Lord Birt:* I do not think that there is any one way. I think what is absolutely essential is that our politicians focus on the big picture and do not get lost in the weeds here. This is a fundamental structural change and we have to step back—and I hope that this Committee will help us do that—and ask ourselves the big question, do we want to maintain that tradition and, by the way, it is a tradition in a completely different technological environment and I think a lot of the debate is looking backwards rather than forwards. We are moving into an infinitely more

complex world which brings huge opportunities as well as huge risks where the old concept of broadcasting will increasingly cease to apply. It will happen gradually and slowly, but we move to a world where there can be—there already are and there can be more—multiple providers and different organisations that can aggregate content in different ways. I would rather not ask myself question, how can we support Channel 4? I think that the bigger question is, how can we create a system where we can migrate from a world where we have been fantastically successful as a country to another world where we invest public money in those kinds of content which the market alone will not produce? Do I think that in that world the BBC will be hugely important? I very much hope so. Do I think that Channel 4 should be important? I very much hope so. It would be wonderful to maintain some important traditions in ITV not least the regional programming, not just regional news but regional programming. So, there are all sorts of traditions that I would wish to see maintained. I am for opening up things. I want to see new providers and new opportunities for people to make extraordinary content; a new explosion of the kind that we saw when Channel 4 came along. I am very suspicious of the current debate which feels to me a short-term quick fix. I am not opposed to short-term quick fixes provided that we are on a strategic journey to a bigger and better answer. Yes, there may be some short-term arguments for helping Channel 4, but not if that is the end game.

**Q389 Chairman:** Surely there is the question of how we can support public service broadcasting in the new age you are talking about, and Channel 4 is one part of that. If I were the Minister, I would be asking what the best way of doing that is and perhaps I could ask Lord Burns that and then come to you. If the Committee is going to be of any value, it has to point out some of the options as far as this is concerned.

*Lord Burns:* I share the view that, as we move forward, the emphasis should be on the issue of content and provision of certain types of content. I think that the issue of corporate engineering and the particular way in which they are supplied is something that should follow that. It may be that it runs parallel to it but, as we move forward, I think it is the issue of content that is critical here. It is both about defining what it is that you mean by public service broadcasting and what it is that the marketplace will not provide. There are so many different definitions of public service broadcasting. Indeed, in any document, you can see three, four or five different versions. Some people think it means it is free to air broadcasting; some people think it means it is things that the market will not deliver; some people think that it simply means high quality; some people even think it means what is on the BBC. We

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have to be much more focused about what it is that we mean. If we are heading towards a view that it is that which the marketplace will not provide, with the focus that we want upon audiences, I also agree that it follows that public money in some form will have to support that. That is what led me to the view that the emphasis should be on content; and it should be upon a mechanism that enabled one to set up competition about content and then leave much more to the marketplace the issue of who it is who is best positioned to provide that content. The only additional thing I would say is that of course nowadays the issue of content is a much broader thing than was traditionally the case. We see the same content now being delivered across many different channels: we see books become television programmes; they become DVDs; you have first runs of things; then you have later runs of things; and we see them on iTunes at a later stage still. The same content is being exploited in a whole variety of ways. I think that we also have to have much more focus upon that than just the issue of how and in what way it is delivered to television audiences. However, I accept that television audiences typically remain probably the biggest issue we have. I am very doubtful about trying to produce solutions by coming at it from the direction of corporate engineering. It seems to me that it can produce short-run solutions as John says and it can fix things in certain circumstances. But it does not strike me as where one should start in this debate. I would see that as something that should come somewhere down the line.

**Q390 Chairman:** That in effect would mean that one would look over the provision of public service broadcasting. For example, one could say that news is not going to be viable, so you would support the news or news programme rather than supporting an institution. Would that be roughly speaking what you are proposing?

**Lord Burns:** Yes. To a degree of course as I understand it, we have already seen a certain amount of that going on with news. Of course, there are channels being provided with news from other providers.

**Q391 Chairman:** What would be your view, Lord Birt?

**Lord Birt:** There are a number of different issues there. The first that I would emphasise is that broadcasters all over the world provide news. News can be provided quite cheaply, but I take the drift of your question to be that the kind of news that we would expect from a public service provider is completely different. It involves a high investment in expertise, worldwide networks, a pattern of programmes that allows you to tell different stories to

different audiences, to investigate, to identify the issues of the day and make sure that they are properly discussed. That is more of a public service news. That costs an awful lot of money and will not be sustained in the marketplace. If I may say so, I am not one of the people who struggle over defining public service, having worked not only in the BBC but in ITV in the period I spoke of earlier. If you are in the system, you truly know the difference. I think that people are hung up on one definitional question which is that they sometimes confuse high-quality programming with public service programming, and I think that this is an important issue including for the Committee. We have had a system in this country which has encouraged high-quality drama production, documentary making and so on and so forth because of the way in which we structured and funded ITV. We have had huge amounts of UK production made for UK audiences and with UK values, very high quality indeed pretty much on all networks. That is a risk in this new world. There is already less of it and there will be much less of it still as ITV goes into inevitable economic decline. That is an issue and an issue for government, but it is not exactly the same thing as public service. Public service is a programme tradition. It is not narrowly defining individual programmes, it is why you are making them. You make them with the citizen rather than the consumer in mind. You work with the best talents in the society whether writers, comedians or artists, and you let them innovate and experiment, and you serve people's educational needs. I have been watching a programme on BBC4, probably not many with me, on the history of mathematics. You do not get programmes like that in the marketplace. To me, it is abundantly clear that there is a tradition here. The interesting thing about that tradition—and it is probably best understood in respect of the BBC's nature and science programming, the scale of the expertise of all kinds that you see that is self-evident in *Planet Earth*, which is a range of dazzling expertise of lots of different kinds—is that you simply do not get that in the market. There are equivalents in Channel 4 and equivalents in the old ITV tradition. The issue is, are we going to continue to invest in that expertise as we migrate to this very different digital environment? To come to your question, I think that there is a quantum issue here. Let us not forget, in the period that I have been discussing, the sheer scale of investment through the BBC licence fee, through the revenues that ITV was obliged to spend on the public service broadcasting tradition and which, along the way, Channel 4 was too. That pot was very big. It has already declined. I see people in the papers suggesting that the pot available to the BBC will be too big because others will be in decline. That seems to me to be completely faulty reasoning. The issue for the nation is, how big should the total pot be? My vote:

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it should be bigger than just the BBC licence fee for all the reasons I hope I have given about maintaining the strength of that tradition.

**Q392 Chairman:** Say it was, but then how would you actually get it there? How would you actually get it to public service broadcasting?

*Lord Birt:* Plainly, the biggest element of that pot is the licence fee and that is really good news because it is a significant sum of money and, going forward, it will allow a significant investment. Not, as I have suggested, probably enough given where we have come from. There are other ways and they are all fraught with difficulty and I do not have any monopoly of wisdom over this. Direct public funding we know from across the world brings hazards but we are a clever nation and we can undoubtedly find ways of investing public money, if that is what we choose to do, through a means which stop government getting as close to a content provider as they do in most countries throughout the world. There are other things we can consider like a levy—and the former Permanent Secretary of the Treasury sitting by my side will bridle at this—on the value of our public spectrum, for instance. I think that if the will is there to do it, we would then have to find the means.

**Q393 Lord Macdonald of Tradeston:** The recent Ofcom review suggested that a second institution should take up the competition, as it were, with the BBC and it will be made up of BBC Worldwide and Channel 4 and perhaps other elements too. As Lord Birt has been saying, traditionally there has been that wonderful balance between the BBC on the one hand and commercial public service broadcasting on the other. However, with the creation of a new institution, the BBC would probably outrank it in audience share by at least three or four to one. After 27 years, Channel 4 has not yet reached 10% of the audience. What would you have to pump into a second institution—and I know, Lord Burns, that you are not keen on one—in terms of money or different elements of existing and future structures to make it properly competitive with the BBC?

*Lord Burns:* As you say, in the longer term, I am not sure that I would be setting about this by trying to create a second institution. My preference is to provide the means by which some public money would be tagged on to content and that would be contestable and it might involve a variety of channels. I think it is very difficult to imagine that one can create a second channel that, on its own, is really going to compete with the BBC without it receiving a very large amount of money. What we are seeing at the moment is that the other broadcasters are having some problems. Some of it is a secular problem and it has been going on for some time. On top of this, of course, we have the punishing effects of the recession

which also may go on for some time and is of course having a very adverse effect. It is difficult to disentangle how some of the companies are doing from the point of view of the secular trend and the impact of the cycle. I think that it would be quite difficult to set about this from an institutional point of view although I am not that close to this, as you know. I have not spent much time looking at this since I was involved in the review. For the reasons I have already expressed, I am quite cautious about that route. Some of the proposals that I have been reading about from some of the witnesses you have had seem to me to be really trying to manufacture something out of a strange mix of things. Almost, somehow or other, with size being the criterion. I will stick to what I have said. I think that we should be asking ourselves, for the longer term, in what kind of ways are we going to provide this content and then address some of the short-term issues separately of how it is that people who are currently having some difficulties might be able to be helped to survive through the recession.

**Q394 Lord Macdonald of Tradeston:** I wonder if Lord Birt is more sympathetic to a second institution.

*Lord Birt:* I prefer two to one; I prefer two institutions to one institution. I hope it is clear from what I said earlier that I would rather not stop at two. I am more attracted to the notion of a more diverse, more plural, world. What does the technology now allow you to do? Twenty or thirty years ago, it was not so much the technology but the system that allowed you to open up production. The technology now allows you to open the gateways to market whilst in the past only a handful of organisations through limitations of spectrum and funding could reach the consumer. We are not in that world any longer. I prefer an organisational framework which is frankly more liberal which would look at audience need and looked at how genres need to develop. You point out the obvious difficulty of having a second small institution and asked bigger and bolder questions. However, having said that, institutions really matter. Groups of people come together and they are greater than the sum of their parts, and it is to me unthinkable that we should devise any kind of world where both the BBC and Channel 4 and RIP ITV do not play a major part, but let us beware of being over-structured in our approach to that world.

**Q395 Baroness McIntosh of Hudnall:** I would like to return to the point Lord Burns made at the outset when you said that you felt that politicians should be focused on the big picture and indeed that has emerged from what both of you have said in that you are making long-term strategic judgments and assessment of how things could be over a medium to long term, but we might be another 100 years given

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that we have already discussed 100 years as the age we are coming to the end of. However, there are some very immediate short-term problems which Lord Burns has mentioned which require some kind of direct intervention and I think that it would be very interesting for the Committee to understand what you see as the appropriate interventions. I would say for example that it appears to be accepted by nearly everybody that advertising revenues are in permanent historic decline or anyway will be spread over such a wide range of possible outlets that they will no longer provide a reliable source of income for ITV in the way that they once did or indeed for Channel 4. In addition to that, it appears to be accepted that the value of the regulatory assets that those organisations have are diminishing quite rapidly and we are not talking about a medium-term or a long-term future, we are talking about a future which is upon us. In those circumstances, would Lord Birt amplify what has just been said about the necessity for some kind of intervention to sustain the range of broadcasters that we have now, leaving aside the possibility that there are more to come into the market, so that the kind of long-term thinking that you are now putting before us will have somewhere to start from.

*Lord Birt:* We should have asked these questions five years ago. These trends were perfectly evident but, politics being what it is, I am afraid that a number of politicians only want to make decisions when the tsunami wave hits you. It is tragic that we are talking about quick fixes for Channel 4 when it has been perfectly evident for a long time that there was a problem. We should have had a proper debate about this at the time of the last BBC—

**Q396 Baroness McIntosh of Hudnall:** May I interrupt you for one second, Lord Birt. Is it not right to say that the thing which has made this more acute is the accelerating factor that the current recession has brought into the mix?

*Lord Birt:* I think it is a factor and, as I said earlier, I am not against quick fixes. Let us be clear that there is a structural decline; all the evidence shows that there is a structural decline in television advertising not just in the UK but in other countries. We are seeing a transfer of resources by advertisers to on-line advertising. That should not surprise us at all. It allows very, very much more efficient targeting of audiences and I would be absolutely amazed if that structural decline does not continue though linear television channels will remain important to some degree for some time. They are not going to disappear overnight, but there is structural decline and that is compounded by the severe cyclical difficulties that we all understand. However, what is the danger? The danger is that all of our political focus goes into a quick fix and we are sitting round in five years' time

saying, "Hey, the quick fix worked for a little bit, but we still have this big picture". The other thing that will happen is that we will all be saying, "Channel 4 is making a lot of very bad programmes because it is guided by commercial imperatives and it is no longer worth saving", because that is what people have been saying about ITV over the last few years, that it is not worth saving because they blame the individuals for letting ITV go downhill rather than the circumstances that we find ourselves in. I have to put it back to the politicians indeed in all the main political parties because this should be a cross-party issue and this is not the only issue before the country.

**Q397 Chairman:** You say that you put it back to the politicians but you know perfectly well that the Charter is not actually decided by the politicians. The Charter is decided by the Government and the BBC. We have been round this now. Politicians can try to influence but we have no power of decision on this.

*Lord Birt:* I make no comment!

**Q398 Chairman:** Lord Birt, you defended this situation in the past.

*Lord Birt:* I think that again it is important to be clear that, as we make this transition from the analogue to the digital age, although the question before us today is vitally important, there are other important questions that arise from this technological transformation. There is one upon which I think the Government is focusing which is that we are behind in creating a world-class digital infrastructure, and we simply must catch up, and I would have some hope that that question will be focused on and we will move from being way down the pecking order as a country to where we should be. There is a huge set of issues to do with how we are going to regulate this new world. All sorts of terrible things are happening in digital space upon which governments will have to focus, not just in the UK but in other places. There are some very, very meaty strategic issues arising from this technological change and it is vital that we do not get down into the weeds and just focus on short-term fixes but look at the big picture.

**Q399 Lord Maxton:** Listening to what you have been saying, it seems to me, particularly perhaps from what Lord Burns has said rather than Lord Birt, that it is content and I agree with you. Within five years' time—it is not the next 100 years that we are talking about but the next five years—people will want content. Channels will no longer be the major concern. If it is content, should we not be looking at some way in which we fund people to produce content that is not necessarily commercially viable? Are we not moving towards something like the way in which we fund British films at the present time whereby there is an organisation from which

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somebody can come along and say, “I have this idea to produce all the Shakespearean plays on DVD” or something like that, which the BBC started to do though I do not think they finished it, and they will say, “We can make some money available to you”? Is that what you are beginning to move towards?

*Lord Burns:* Yes. That was very much the notion that lay behind some of the ideas that we presented in our report during the period of the Charter Review. As John says, I have a great deal of sympathy with the notion. Of course, one also has to look at the institutional framework and who it is who is going to supply this. But we are moving to a situation in any case where, in many cases, probably it is the same production company that might be supplying this material to one channel or another channel. And it is a question of asking what type of product do we need, what is it that we are not getting and of course thinking ahead as to what type of things one wants to encourage. A certain amount of experimentation is also an important part of that. It seems to me that does require a commissioning process. It certainly requires some public money in order to support that process and it seems to me that that is likely to be the long-term direction that we go in. In the short term, Lady McIntosh asked the question as to how we now deal with the recession. I do not see any route to this other than it is going to have to involve some public money that goes into Channel 4. The only issue is the question of where it comes from and the particular route that it should take. My personal view is that it is better just to face up to that straight on and make a decision about it rather than trying to play around with the institution and doing rather artificial mergers between different organisations. There is money that is going to be available after digital switchover and it may be—and the BBC will hate me for saying this—that some of the licence fee does have to be directed in that direction. I would face up to that and I would do it quite openly and recognise that that is a short-term issue of getting through this next difficult period.

**Q400 *Lord Corbett of Castle Vale:*** Unsurprisingly, Jeremy Darroch from BSkyB took the view—and he has published an article about it as well—that public service content will look after itself. If people want it, they will put their hand in their pocket and get it. It does not need government intervention or special regulatory arrangements. How do you react to that?

*Lord Burns:* What he is right in saying—and I saw an article in the *Financial Times* by him—is that there are increasing amounts of content on subscription television that would historically be described as public service broadcasting. But I find it difficult to imagine that the whole spectrum of what we have been describing and what is typically taken as being public service broadcasting would come through the

marketplace. When we looked around the world at what happened in other countries with pure market systems, by and large that did not happen. With a multi-channel world, there is a greater chance that it will happen because of course, when we are just dealing with a small number of terrestrial channels, inevitably the people, left to themselves, were going for the biggest audiences which meant a move to the centre ground. The new world does provide some of those opportunities and there are many activities in the arts too where people can get quite a long way without public support. My position is that it will require public support; it does require a separate process; it requires the identification on an ongoing basis about those things that are not being supplied by the marketplace; and then a mechanism for delivering them.

**Q401 *Lord Corbett of Castle Vale:*** What do you think, Lord Birt?

*Lord Birt:* Given what I was saying earlier, you would know that I disagree, but I would disagree respectfully because, as I again said earlier, it is very clear that there is a great deal of high-quality programming outside of the conventional public service universe. There is a great deal of excellent drama on ITV, there are some lively programmes on Sky and I would hate anybody to take my football away from on Sky; it is manifestly exceptionally well done.

*Lord Burns:* Sky Arts Channel may not be watched by many people but it provides some terrific programming.

*Lord Birt:* Absolutely. There is a dialogue that goes on here which is that everybody learns from everyone else and I would say that one of the great arguments for the public service tradition in the UK is that commercial broadcasters have learned from it and have emulated a great deal of its discoveries and vice-versa. The public service has learned from the commercial broadcasters and has moved on, and that dialogue is extremely healthy and we should wish to maintain it, but I simply cannot agree with the notion that we will maintain the tradition that I expect everybody around this table will value except through an investment of major public funding of the kind that we have enjoyed for the best part of a century now.

**Q402 *Chairman:*** In addition to the licence fee?

*Lord Birt:* I see the licence fee as the main source of public funding but, as I said earlier, because we have seen an overall decline in the investment of the public service tradition, I think that as a country we should say, let us look at finding something on top of the licence fee to maintain that tradition.

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**Q403 Baroness Howe of Idlicote:** It is quite clear that, whether you love it or not, some idea of competition is very much what the public are saying because of the value they place on public service broadcasting, the BBC and others that have been involved since. I think that the more worrying aspect of this, hearing about the need for flexibility—and I am sure that that is right—and quickly being able to adjust, is (a) who actually decides both what is needed at this particular time—Lord Birt’s point—and (b) that it should be the Government. How do we do this without setting up yet another organisation to administer the sum of funds and decide what is necessary and available? How do we do it because I think that this is really quite complicated?

**Lord Burns:** I have been slightly stymied by the particular arrangements the Government introduced for the BBC. As I said at the outset, the proposals we made were to have a BBC with the normal governance and to have a separate organisation, the Public Service Broadcasting Commission, which would do a lot of those things including the oversight of the BBC and other forms in which public funds are spent. Of course, what we now have for the BBC is a mixture of these things. We have a Trust which is doing some of the tasks that we had envisaged would be done by the Public Service Broadcasting Commission. There are now some quite real issues and I think that it depends on the timescale over which one was doing this. I still prefer the model that we put forward and there is nothing that has happened in the period since to make me change my mind about that. Indeed, some of the difficulties that the BBC has faced seem to me to have shown some of the weaknesses of the new arrangements. I am less opposed than I was to Ofcom playing a part in this process in default of any other way of introducing it. To have both the BBC and the BBC Trust and another organisation and Ofcom just begins to make this space rather crowded. I think that much would depend on how quickly one was going to do this. If it was to happen relatively quickly, I think that we would have to look for some other arrangements. But I am afraid that this becomes heavily tied up with the whole question of governance of the BBC, because the way in which you deal with the whole question of how public service broadcasting as a whole is dealt with has to be looked at in parallel to the governance of the BBC.

**Lord Birt:** I think that Lord Burns, who did not act alone—he had a very distinguished band of colleagues with him—thought through these issues from first principles at the time and broadly came to the right answer. I think that when you go back, you see perhaps that you would factor in a better understanding of what the digital age means now but, broadly speaking, I think that they came with the right answer. The Government chose not to embrace

it. The Government did however recognise at the time, as I recall, that there would be unusually a half-term review through the Charter recognising these issues but not at the time willing to address them. I think, dare I say it, that if the arrangements suggested by Lord Burns and his Committee had been instituted, I do not think that we would be where we are now discussing the things that we are discussing today and we will be back discussing them unless we find the right structural solution. My answer to this would be, let us have the right arrangements in place for all public service broadcasting at the end of this Charter period. Are the Government going to have a half-term review?—is *Digital Britain* it?—because I am not clear—and if they are, let us get the right answers to the question this time around and then let us address the short-term issues of how we get from here to there, but let us not just discuss these problems incrementally.

**Q404 Baroness Bonham-Carter of Yarnbury:** You referred to the golden age of that truly diverse and truly plural time when we had Channel 4, ITV and BBC and you have also said how important you feel it is that there should be competition to the BBC. One of the suggestions on the table at the moment is a merger or part-merger with BBC Worldwide and I wondered what your thoughts about that are. Also, slightly reversing Lady McIntosh’s question, is there not a chance of this becoming, as one writer in *The Guardian* put it, a BBCC4, so that actually what you do is create an even greater monolith with less plurality and competition rather than more?

**Lord Birt:** I am at risk of repeating myself if I say this would not be my first choice and I will not repeat all that I have said earlier. I have also said that, in the real world, we may have to be a little pragmatic about the position we are in and look for some short-term fixes. I am not by temperament somebody who likes short-term fixes, but we are where we are and we may have to go down this route. I have not seen any detailed work on this question. Plainly, there would be some synergies. It is easy to see that there would be some efficiencies in that both organisations have similar operations, channel operations for instance, some sales operations and so on that, even without any help from anybody else, from government, subject to competition issues—and that may be a big consideration—it may well be that there are some operational synergies here which will bring improved effectiveness and efficiency, but I would like to see some numbers attached to that and to understand what degree of extra value would be created and how that would be shared and whether the quantum is remotely sufficient to solve Channel 4’s short-term problems. So, I would retain an open mind but I would be the broken record saying, “Ok, but . . .”

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*Lord Burns:* My mind is slightly more closed than that about this. I understand all the points. On the basis of what I have seen so far—and of course I also am in the position of not having seen very much in the way of worked out detail—I am rather suspicious of this proposal. It seems to me that it is a way of transferring resources from the BBC to Channel 4 through some obscure merger of operations which do not necessarily fit very comfortably together. And, if it were a genuine merger whereby, in a sense, there was a Channel 4 Worldwide to go alongside BBC Worldwide, which were put together, there are undoubtedly, I would have thought, competition issues involved. It seems to me that this is a classic case of reaching for a solution to resolve a short-term problem where the long-term consequences are quite doubtful. I reserve my position in the sense that I am only going on the basis of what I have read in the various documentation and the evidence that people have given to this Committee.

**Q405 Baroness Bonham-Carter of Yarnbury:** Going back to the accusation that some politicians lack imagination and initiative over what we are facing, you would say that government policy of encouraging consolidation within the broadcasting world is not something that should be being pursued.  
*Lord Burns:* My concern is with what I think of as this rather artificial consolidation. I have another concern about this which is that I actually prefer the notion that the BBC should be earning more of its revenues through the marketplace than simply through the licence fee. If this is a device to move that money to Channel 4, it increases my doubts about it.

**Q406 Lord Hastings of Scarisbrick:** It seems as though this whole conversation is like a storm in a teacup because we are circling around protection of Channel 4 and ITV and the real nation is worrying about survivability of jobs in industry. So, the sense of panic in the media is probably a little over-bloated. Would one of the implications of that be, if you take both your argument that the BBC is a bedrock and the licence fee is the only available easy money that is on the table versus that we should push towards or government should push towards reduction of channels both in the BBC and commercially, there are too many chasing too little money?

*Lord Birt:* I do not agree with that. I think that the politics of all this are dreadful. There could not be a worse moment for us to be discussing these absolutely critical national issues. These things really matter; they will continue to matter long after our financial crisis is over. It is vital that we keep our nerve. I do not believe I am exaggerating when I say that we have had a fantastic system for nearly 100 years, we are in transition from one technology to another, and it is really important that we get it right

for the next period of our history as much as we possibly can. We must focus on the big picture. It is a time for politicians to show imagination and bravery. Nobody would expect a ton of money to be launched at this. So, yes, perhaps a degree of pragmatism will be necessary in the short term, but it should not be at the expense of getting the right long-term, strategically well-considered structural solution.

*Lord Burns:* I think that once one moves into this multi-channel world, I find it very difficult to start thinking in terms of too many channels because this goes—

**Q407 Lord Hastings of Scarisbrick:** Too many channels funded by public money.

*Lord Burns:* There are two issues there. One is the issue of competition and, repeating myself, I would like to see alternative suppliers. I think that then comes down to an issue as to whether the BBC have too many channels, which I do not think is really the source of the problem. When I look at the way in which the advertising revenue has been distributed within commercial television and those people who are relying upon it, it seems to me that this is all to do with the individual providers themselves introducing more and more channels to try and get a marginal increase of advertising. And I notice that some of these channels are showing exactly the same thing but delayed by one hour in some cases or reruns of things that you have missed. Most of that must be a service to the people who wish to watch it. I would not be looking to ration the number of channels which are getting advertising income.

**Q408 Lord Hastings of Scarisbrick:** How do you square this?

*Lord Birt:* I think that the focus should be on content. Channels are a way of distributing content, and channels are increasingly an old world concept. In the new world, as you well know, there are multiple ways of reaching consumers, online, through My Space or whatever. We are in a world where there are many routes to the consumer and the issue to me is whether we have the right content and the right public service content properly funded. I said earlier that we are spending a lot less money on content in that tradition. One obvious casualty is a 20 to 30-year old tradition in ITV of often really wonderful regional current affairs and features programmes. They are hardly there anymore. We are already losing vital content.

**Q409 Lord Hastings of Scarisbrick:** If I may quickly be specific, should the BBC then fund content on the other channels following your line of argument? To ensure the protection of content, should the BBC fund it?

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*Lord Birt:* I do not think that that is the right structural solution. I think that we would get into labyrinthian complexity. I think that we need to step back and get real simplicity here which is that, as a nation, we have to be clear what sort of content we want to fund and—

**Q410 *Lord Hastings of Scarisbrick:*** There is no other pot of money.

*Lord Birt:* I said earlier that there is already a large funding in the licence fee which will take us a very long way. I do not think that we need huge top-ups but we may need some top-up.

**Q411 *Lord Macdonald of Tradeston:*** The last point is on regional broadcasting and you say that that is now in crisis with the virtual collapse of ITV's regional base. The BBC is doing an enthusiastic job. What kind of priority would you put on that if there were to be a pot of funding that people could bid for? As citizens, is it important that we serve the people of Britain at a regional level for news and particularly important now in the three other nations because we have had a Scottish Broadcasting Commission suggesting that with £75 million they would create a new platform, a new Scottish network, and it is something that the Welsh and the Northern Irish might look at too. Where would the money come from for that? Broadcasting in Britain is at the moment a reserved matter but, if the Parliament in Edinburgh were to say, "We will put up the money for that", would you be in favour of that, or would you want the British Government to be funding public service broadcasting across the UK?

*Lord Birt:* From bitter experience, I would not want to trespass on any Scottish issue for those around the table with long memories! To emphasise the area of

agreement, I think that a proper service of regional programming, not just news but current affairs and other genres of programming, is vitally important. Everybody has to remember that the BBC historically has not invested anything like as much in that as ITV. The BBC was not well-funded enough to match ITV in its regional and local programming. I do not see any prospect of the licence fee stretching to match what ITV used to do. That is an example of why we have to put some new funding on the table if we want to get back some of these things. Having said all of that, I would be very cautious about listing some genres of programming, which I see in some of the literature that I have swatted up on over the last few days, because all genres matter: children's programming matters, arts programming and programmes for minorities and so on. We do not want to come out of this with a tick box solution that we must focus on a particular genre of programming; we have to focus on the whole tradition and all the many aspects of it and not just one.

**Q412 *Chairman:*** Do you want to add anything, Lord Burns?

*Lord Burns:* I do not have anything to add to that other than to say that from the evidence I have received there is a public demand for this type of broadcasting. Where I start is that it is important to pay a lot of attention and indeed to begin from the position of the consumer, customer, or citizen, rather than from the position of the producers.

*Chairman:* Thank both of you very much. You have added, from my point of view, a very valuable dimension to what we have been considering. If I may say so, both of you have given your evidence with admirable clarity. Thank you very much for coming and putting yourselves out in this way.

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### Examination of Witness

Witness: LORD CARTER OF BARNES, a Member of the House, Parliamentary Under-Secretary of State for Communications, Technology and Broadcasting, Department for Business, Enterprise and Regulatory Reform, and Department for Culture, Media and Sport, examined.

**Q413 *Chairman:*** Lord Carter, welcome to the Committee and thank you very much for coming. As you know, we are doing a brief examination of some of the very complex issues around public service broadcasting and we have taken evidence from most of the broadcasters in this field. We have had the benefit, obviously, of your White Paper and your statement in the House of Lords. I wonder if I could ask first: Do you believe that it is necessary to have public service broadcasting in addition to the BBC?

*Lord Carter of Barnes:* Thank you, my Lord Chairman. This is a timely conversation, given where we are in the development of our thinking. The

Government looks forward to hearing the conclusions of the Committee's investigations. I think our position on that question is a very clear "yes", that we believe that public service content as well as broadcasting is a great strength of both the UK economy and the UK culture and that it has driven enormous benefit, social and educational, entertainment and commercial benefits. I think there is a UNESCO study that clearly shows that this country is one of the leading if not the leading exporter of so-called cultural goods, of which the contribution from broadcasting sources is significant. Therefore, the evidence seems conclusive that there is

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significant value, and we believe there is real value in having another alternative provider of that, which is publicly owned, in addition to the BBC.

**Q414 Chairman:** Is there something exceptional about broadcasting? If, for the sake of argument, a well-known but highly respected newspaper got into difficulties, would the Government intervene in those circumstances?

*Lord Carter of Barnes:* We start from different places. I think it is worth being very clear for the record that the difficulty often with these conversations is that—I am sure this is not the case with this Committee—they often become very narrow very quickly and there arises an understandable debate about largely publicly-owned institutions, in this case the BBC and Channel 4, although clearly there are others, S4C, Gaelic Media Service and others. Clearly the market is a significant provider of high quality, very valuable content. The newspaper industry is a classic case in point, and indeed there are many significant providers of high value content in the broadcasting space and in the on-line space. We absolutely do not start from the view that there is not significant market provision. The judgment is: is there a continued case for public intervention? We believe there is. Is there a continued case for public intervention beyond the BBC? We believe there is. We think there is a difference between the contribution of broadcasting and, as broadcasting is evolving more broadly into content available in lots of forms, the newspaper market.

**Q415 Chairman:** It is impossible then to have this discussion without actually taking into account what you have already said, and what indeed Ofcom said to us last week. It would seem that by far the favourite solution which is being put forward at the moment by the Government, and indeed it seems to be supported by Ofcom, is that Channel 4 and BBC Worldwide should come together. That is correct, is it not?

*Lord Carter of Barnes:* Almost, if I might say. Sadly, I did not have a chance to hear the entirety of Lord Birt and Lord Burns's evidence but I caught the back end of it. I do agree entirely with Lord Burns's comment that there is a real need for us to have imaginative solutions to this problem/opportunity.

**Q416 Chairman:** If I may intervene, I do not think that when you have read Lord Burns's evidence necessarily you would agree with everything that he said in it.

*Lord Carter of Barnes:* I will take that as a given, although I am sure it will all be worth reading.

**Q417 Chairman:** Very much so.

*Lord Carter of Barnes:* We do start this discussion from the questions around the BBC and Channel 4, for the very obvious and legitimate reason that they are both, if one can describe them this way, publicly-owned or publicly-funded assets and therefore they are in a different category. I have certainly tried to apply a reasonably self-denying ordinance, on myself at least if not on others, that government speculation about privately-owned companies, or even public-listed companies, and what they may or may not do is a matter for them; it is not a matter for the Government. But we have I think been clear in the interim *Digital Britain* report that whilst we believe there may be merit—we are still at the point of validating it—in looking at some combination between a revised Channel 4 remit and BBC Worldwide in some structural organisation to be determined, we are also of the view that there may be other private parties who may wish to participate in that. A number of private parties have, confidentially, come to us with some very interesting ideas. At this stage, we will respect that confidentiality. We have made clear to them that it is our view that this entity should be majority publicly-owned and that it will have a very clear public service remit, but could you imagine a scenario whereby a private party and private capital could be a minority part of that? I think you definitely could. The Government's position is that at this stage it would be wrong to close our minds to that analysis until we have done the work. You are absolutely right to say, my Lord Chairman, that we start from both the assets that, if you like, the Government has more immediately responsibility for and therefore in some ways more immediate control over.

**Q418 Chairman:** How have the BBC responded to this proposal?

*Lord Carter of Barnes:* With imagination and engagement.

**Q419 Chairman:** That is not entirely our impression. Having received evidence from them, there seems to be a degree of hostility towards it. Would that be putting it too high?

*Lord Carter of Barnes:* I am not trying to stand on what little dignity I have if I say it is not for me to speak for the BBC; it is for them to speak for the BBC. The observation I would make is that on this question, and indeed on many others, there is not one BBC: there are literally three and probably more in that there is BBC Worldwide, there is the management of the BBC and there is the BBC Trust. In a sense, so there should be because they each have slightly different responsibilities. So you might find you get slightly different views, depending upon which part of the BBC you engage with. My

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judgment is that in the round, all joking aside, the BBC have engaged with this question with real attention. There is a genuine recognition that the provision of high quality, public service content in this country is facing significant challenges. Anyone who has spent any time at the BBC, and some colleagues around the table have, has public service in their blood stream. I do not think it is therefore at all surprising that these people do not recognise that there is an issue and there is a need for a solution. Reasonable people may disagree about what is the right solution or how to structure it, but my sense is there is an absolute common understanding that there is both a problem and opportunity and that now is the time for us to try to reach for some solutions. We are in the process now of working with those parties and others to try and get that to the best of our abilities and our analysis.

**Q420 Chairman:** You say there are three BBCs. Which is the BBC that makes the final decision here?  
*Lord Carter of Barnes:* In public interest terms, the Trust.

**Q421 Chairman:** The Trust makes the final decision, not the executive?  
*Lord Carter of Barnes:* On questions of the public interest, the BBC Trust is responsible for representing the public interest.

**Q422 Chairman:** Would the BBC Trust therefore have a veto, if I can put it so crudely, on this proposal?  
*Lord Carter of Barnes:* You are asking me a question I genuinely do not know the procedural answer to but in a sense, whatever the Committee may have determined from evidence taken or even private conversations had, it is not the nature of the conversations that are being held. The nature of the conversations that are being held are engaged conversations about how we find a workable solution.

**Q423 Chairman:** But if, at the end of the day, the BBC Trust say, “We simply do not see how this could work”, is that the end of the matter?  
*Lord Carter of Barnes:* I am genuinely not sure it is productive to speculate on that. I do not think that is where we are in discussion. We would not have said in the White Paper or in the interim report what we had said if we had not had pretty full and open discussions with the BBC Trust and other parts of the BBC. We have been the first to say that there is further work and analysis to be done. We have not yet reached a determinative view ourselves, let alone asking them for their determinative view.

**Q424 Chairman:** I think I am asking you a perfectly legitimate question. I am just asking the question: constitutionally, could the Government insist upon this happening or would it require the permission of the BBC?

*Lord Carter of Barnes:* Genuinely you are asking me a constitutional question to which I do not know the answer, but we will find that answer for you.

**Q425 Chairman:** If such a proposal went forward, would that require legislation or not, or is that another one which is further down the road?

*Lord Carter of Barnes:* I think it is further down the road. I suspect the answer slightly depends upon what the structural solution is. I could imagine outcomes which were partnerships or joint ventures which would not require primary legislation. I could imagine more profound structural changes that may. I think it very much depends upon what the outcome ends up being.

**Q426 Baroness Scott of Needham Market:** I want to ask about news provision. You know that we produced our report about media ownership and the news and our findings were very clear that despite the plethora of ways in which we receive the news, news gathering has become less. In the light of the current funding crisis and all the talk of consolidation, how are we going to protect not just the number of sources of news but the industry of news gathering?

*Lord Carter of Barnes:* We certainly share the view that this is a significant question. I think so far we have said three material things in relation to that. The first is that we want to look into both the radio market and the newspaper market, which are also providers of news—I am assuming yours is a news-in-the-round question rather than just television news—and we wish to do work, and in the case of the newspaper market we have asked the OFT and Ofcom to do an independent study of the operation of the current market rules and ownership rules, to see whether or not there is evidential truth in the assertion being made by the newspaper industry that those current rules are actually operating not only to their commercial disadvantage but also to the disadvantage of fully-funded, high quality local news. That is one part of the equation. The second part of the equation is similarly in the radio market. I was having this discussion with some colleagues around the table last night. There is equally a set of rules around radio franchises, the points system, the allocation and the ownership structures, as to whether or not they too are now beginning to work against the public interest. As I am sure many people will know, those rules have been in existence for a very long time, many of them dating back to 1990. The world is a very different place since 1990. Is it having the effect, given the pressures on local radio,

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of undermining local radio's ability to be able to invest in high quality local news? On the traditional broadcasting of news, I think we have made it very clear that whatever the structural solutions, what we are calling PSB2 as a working title, news and impartial news would be a substantial part of the remit of that entity. I have to say that one of my observations, which you could interpret as a criticism, of Channel 4 at the moment is that their relative investment in news is small. If you compare what Channel 4 as an operation spends on news by comparison for example to BSkyB, a market provider, it is of an order of magnitude smaller. I happen to think BSkyB's news and Channel 4's news are both excellent products. The difference is that Channel 4 are required to do theirs by their remit and by their licence and BSkyB are not; it is entirely a corporate choice for them. The market, the viewers, the listeners and their customers benefit but it is not guaranteed. To your question, if we are looking to provide a guaranteed level of high quality, impartial news, I think we have to look at it on those terms.

**Q427 Baroness McIntosh of Hudnall:** What I want to ask arises quite naturally out of what you have just said. The way the conversation has gone with a number of witnesses, as we have gone into this inquiry, is that there is a tension between, on the one hand, an assumption or an awareness that there is some market failure, and your report has made this point as well. There are kinds of content which the market simply does not naturally provide. However, on the other side of the argument, many of those who are providing say this is not necessarily true, and you yourself said earlier on, and I think I quote accurately, "the market is a significant provider of high quality content". You appear to start from the position that there is market failure and that therefore there have to be some ways of addressing it. Is that correct?

*Lord Carter of Barnes:* I do not start from that position but it is where—

**Q428 Baroness McIntosh of Hudnall:** It is an underlying assumption over quite a lot of what you believe needs to happen in order to secure public service content. Is that right?

*Lord Carter of Barnes:* I would not say it was an underlying assumption. I would say, having studied this for some time, I think the evidence points very clearly to there being a case for considered and defined public intervention.

**Q429 Baroness McIntosh of Hudnall:** Can you therefore tell us what you are particularly concerned about in terms of shortfalls in content and whether, given what those shortfalls are, that provider (I think you put it a provider of scale) needs to be in the public

sector, or is there some other way in which those shortfalls can be met but not necessarily through creating another institution? The question is: How is the balance to be achieved between the market, which claims that it does provide—and you have just given an example of news—and the way in which public service broadcasting is secured through requiring broadcasters that they do that?

*Lord Carter of Barnes:* There are so many ways to come at that question.

**Q430 Baroness McIntosh of Hudnall:** Could you start with the shortfalls in content?

*Lord Carter of Barnes:* Why do we not start with that? Let us take a 20-year sweep, because then we are talking about a long-ish period where you can do some sensible trend analysis because that is a reasonably 'validatable' period. We have had 20 years of a pretty explosive development of the media market in this country in lots of different media. Much of that has been enormously beneficial, culturally and economically, and has driven, as I said in my opening remarks, the strength of this country both domestically and internationally. But it is interesting to note that whilst there have been some significant exceptions, and I would say Sky News is a significant exception, actually if you look at the consumption of content through broadcasting channels, a significant majority of it still attaches to the content produced by the public interventions. After 20 years of letting the market at it, and indeed many people will tell you that if you do an economic analysis of the multi-pay/mini-pay, package business malls of BSkyB, the cable television operators, top-up TV, BT Vision and all the other platform operators, what has driven an awful lot of that subscription has been the "must offer" provisions that are laid on the public service broadcasters, the "must carry" provisions that are laid on cable of public service content, and in some instances the joint ventures between the public service providers and the private operators to find a way of recycling the long tail of archive content into Alibi or Dave or UK Gold, or whatever it may be, which forms the base of most of the packages those platform operators then sell. That is not to say that there has not been significant innovation in the presentation of films (perhaps some time ago), sports (I think continuing) nor that we have not seen significant innovation in other media. That is just an interesting reality that we have seen over that period. Equally—and on these matters I more than most listened to Lord Birt's analysis keenly—I would slightly contest his slightly dismissive tick box reference because I do think you have to look at genres. If you look at kids' television, there is pretty clear evidence over that same time period to say that the market will not provide significant investment in kids' television. It will

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provide significant investment in the distribution, the packaging, of cartoons and American series. I quite like cartoons and American series, and so do my children, but I do believe there is a value in the provision of high quality, home grown domestic kids' television and kids' content, on-line and off-line. News: I have two televisions on permanently in my office; one of them is permanently tuned to Sky News. I think it is a marvellous product. I repeat the point I made earlier: there is no requirement for them to broadcast it. We have to ask ourselves the question, particularly given the pressures placed on other news providers, as was asked earlier: do we want to find ourselves in the situation where the only required news provider is the BBC? I profoundly believe we do not. Then if you look over the same time period at the independent production sector, why has the independent production centre gone from being a series of cottage businesses into large-scale companies where we are demanding 60 to 70% of the format market globally? It is because of public intervention. I could come at this question 20 different ways. It is not that I start with a presupposition; I genuinely do not, but the evidence, time and time again, tells you that the case for moderated and defined public intervention—and I am a very big fan of that as well—is very strong. You then have to look at it tactically. If you look at it tactically and you strip out the higher order ambitions, the brutal truth of the matter is that the Government is the shareholder of a company called the Channel 4 Corporation. By definition, the Channel 4 Corporation is a single market commissioning broadcaster that earns, for all intents and purposes, 90+% of its income from selling advertising airtime in a market which is exploding in volume of impacts and declining in value. As a shareholder, we have a problem. You therefore have three choices. You sell it because essentially it is an asset that is declining in value in that business model, which it is. Why would you sell it? Even if you did not have a public policy belief, as we do, why would you sell media assets declining in value in the worst market we have seen for many years? It would not seem to me to be an intelligent exercise of shareholder responsibility. Alternatively, you look at a different way of giving that asset the scale and capability to continue to be able to compete in the market and, at the same time as doing that, look to see whether or not in finding that recovery you could also ensure it makes a broader contribution to broader issues you have identified.

**Q431 Baroness McIntosh of Hudnall:** What you have not touched on in that otherwise very helpful and illuminating answer is another way in which you could target these market shortfalls. The one that has come up quite frequently is the issue of contestable

funding; i.e. that the money that might otherwise be invested in building the strength of the second public service broadcaster, or some of it, would be made available to providers who are extremely diverse, as you yourself have just said, and wide-ranging and who might bid for the right and the opportunity to address particular market segments. Do you have a view about that and where does it fit into your overall scheme?

*Lord Carter of Barnes:* If I may, I think that is the most difficult question to either answer or defend the alternative position because, as you have just done, you can very precisely construct the argument in favour of contestable funding as a structure. What are our reservations? I think our reservations are that I suspect it will turn into a bit of a bureaucratic administrative nightmare. I have a slight feeling, if I am allowed a prejudice, that the people who advocate it most strongly are the people who will be least interested in participating in it; and we do have existing public institutions. In a sense, it is not an either/or because it would be odd to replace an institution, whatever its commercial challenge is today, and so you would be introducing a third element. I suppose finally as an ex-operator, I slightly have a view that institutions or entities, companies, things, are better ways of getting stuff done. It is not the most coherent of answers.

*Chairman:* It is very clear.

**Q432 Lord Macdonald of Tradeston:** I am wondering, from that answer, if you would see that new institution centred on Channel 4, with all the contestable funding that might go out to the regions, for instance, for regional news across England, and indeed in the more sensitive areas of provision that would be in competition with the BBC in the national areas like Scotland, Wales and Northern Ireland, where of course with their parliaments or assemblies it is particularly important that you have a proper democratic discourse, that it is not dominated by one broadcaster, even one as estimable as the BBC? How would that work? Who would decide how much would be given to the provision of news and current affairs and so on in the regions and the nations? As you may have heard me ask Lords Birt and Burns, if the governments in those nations wanted to take part in this—at present broadcasting is a matter reserved for Westminster—what would be your reaction to that? I am sure it would be fine if the Scottish Government said, “We will give money towards a new Scottish network”. As you know, that has been canvassed by the Scottish Broadcasting Commission, which has done a very worthwhile job and had the unanimous, all-party support of the Scottish Parliament. How would you feel about the £75 million, or whatever, coming part from the new

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institution and perhaps part from Scottish Government sources?

*Lord Carter of Barnes:* I feel on this question you know more about this issue than I do. I, too, like you, am a Scot. I think the Jenkins Commission did an excellent piece of work. I think it is a considered analysis of the questions. Putting to one side the specifics of your question, it raises some very interesting philosophical questions about when you grant devolution, or when devolution happens, what are, if you like, the consequences of devolution that you need to think about that maybe do not strike you at first instance? One of those consequences I think is independent media that offers, as you say, compelling discourse and debate between parties and is impartial, as well as the cultural benefits for a nation state that is reasserting itself. These are very real questions. I do not think they are narrow questions. They are very real questions for the devolved United Kingdom. What are the options? This is not helpful because it does not tell you the answer but I think one option is that the recommendations of the Jenkins Commission are accepted in some way, shape or form. I have my doubts, as they say as to whether £75 million is actually a real number or whether it is a sort of debating number, but in a sense that is not really the point. The point is whether a decision is made that there needs to be a fully-funded, independent Scottish digital network? Question: if the Scottish Government wanted out of their funds to fund it, I am not sure there is much that the British Government could do about that, or indeed should do about that. It is not evident to me that they are leaping forward with that proposal. Secondly, there is an open question for us to look at, which we are looking at, as to how significant a part of the remit of what we are looking at as PSB2 should responsibility for diversity in the nations and regions be. That could be a part of a solution. Thirdly, you could take the view, and many people do, that actually where this issue really bites is on news and current affairs. In truth, however desirable it might be to have a fully funded, fully rounded, doing everything entity, really where you need that level of focus is in news and current affairs, and there might therefore be different ways of doing that. Fourthly, collectively we could come to the conclusion that it would be nice to have but it is not necessary or affordable. I think right here and right now we are all in the process of trying to work out what the answer is.

**Q433 Lord Macdonald of Tradeston:** I have spent most of my working life in the media, in fact in the regions of England, in Manchester, and I know therefore the pride that they had in their production base there. It is very good that the BBC should be transferring work from London to Manchester, but there is a great disgruntlement across the regions of

England, and indeed in particular the nations, about the very poor deal they have had from the golden age of British television over the last 40 or 50 years. If you look at your network peak time schedule where the expensive programming is, then the nations which supply 17% of the audiences would provide probably less than 1% of the content. Some of the steam could be taken out of this argument by an institutional decision to force production of public service broadcasting into the regions and into the nations. What can you do about that?

*Lord Carter of Barnes:* We are doing some of that already, both directly and indirectly. We have public intervention in the markets from the regional production process. The BBC has made a significant relocation decision that involved Scotland. The BBC has said over a period of time it is going to extend, I think by 2014/16, and that they will get the level of commissioning coming out of the Scottish market to the level that was requested by the Jenkins Commission. So there have been some moves in that direction. You may say “too little too late”, or you may just say “it is right but a bit late”, but whatever way, there have been some moves do so some of that.

**Q434 Lord Macdonald of Tradeston:** Are you accepting that at least Ofcom was suggesting that ITV will not have those obligations in such large measure in future? You are also basing the new institution perhaps on Channel 4, which has always been the most hostile to any kind of regional opt-out or regional service?

*Lord Carter of Barnes:* Yes. Someone once said to be that ‘4 Scotland’ was the definition of the number of people employed by Channel 4 in Scotland! I think behind this entire discussion has to lie a truth that for some reason we all find quite difficult to say, which is that by the time these things come to pass, what we can or cannot lay on ITV as an obligation will, by and large, be long gone. I think the sooner we all become comfortable saying that, the cleaner the decision-making becomes, because then you can look at the world as it is going to be rather than the world as you would like it to be. It might well be that there was a golden age of television. I was a viewer of it rather than a beneficiary or a practitioner in it, but that is not where we are. It is not the world we are going to be in; we are going to be in a world where ITV is going to be, post-digital switch-over, for all intents and purposes, bar at the margins, a commercial entity. That is where it is going to be. So the question then goes back to the Baroness’ question about the justification for market intervention. I think that puts the justification for market intervention into even sharper relief. To your point about ‘is it not odd therefore to consider PSB2 however constructed as a part vehicle for solving some of the nations and regions because of the historical position of Channel

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4' assumes that the new entity will carry forward those historical practices. It is not evident that it has to. That might require a significant change.

**Q435 Lord Maxton:** Can I just say to you as the third Scot in the room—maybe there are others behind—  
*Lord Carter of Barnes:* I am sure there are. They are everywhere!

**Q436 Lord Maxton:** In terms of the broadband, which is where you might expect me to be coming from, actually the Scottish Executive had initiatives on this under Jack McConnell, not under Alex Salmond, in terms of extending broadband out to the remoter and rural areas of Scotland, even before your report was published. Can I just suggest to you, maybe looking at my slightly wider view of where I think we are going in the next five to ten years, that you are quite right. Your objective of giving every household broadband at a minimum by the way of 2 megabits, and I think you need to emphasise that, actually does to some extent contradict some of the things that you say in the rest of your report about public service broadcasting. I think once every household has access to broadband, and if you look at the development of what I think will be broadcasting services on the internet, which already allows me as a broadband user basically to download almost any film that has ever been produced at any time in the past—

*Lord Carter of Barnes:* Legally, of course.

**Q437 Lord Maxton:**—legally of course, or any piece of music that has ever been recorded, legally of course, then to some extent some of the arguments made in favour of public service broadcasting become less relevant. Also, of course, the whole thing about the news is that every local organisation will provide its own “news”—that might be the wrong word—or its own facts about what it is doing, whether it be the local council, the local football club or the local school, it does not matter; all of them will be available on the internet. If you then take what I think is the next big thing, which will be the use of the internet available on your television controlled by a remote control from your television, and then ultimately of course the television and the box below it being an internet provider, then where does this whole argument over the next five to ten years about public service broadcasting and Channel 4 come into this?

*Lord Carter of Barnes:* I do not start from the view that these are “either/ors”; I think they are “alsos”. I think we have a set of questions, issues, obligations and I think legitimate social, cultural and economic ambitions for a public service which we need to resolve. We need to take a view on this. Also, we need to have a higher level of ambition for where we are as

a nation in terms of our usage and access to broadband and what it can deliver. They are not either/ors. To paraphrase another Scot, as Adam Smith would say, this is about wealth, not cash. The net benefit will be enhancement. I always find these debates slightly remind me of the debates about the licensing of mobile phone companies, because at the time the incumbent fixed telephone operators all said it would be terrible, because everyone will give up their fixed lines and they will take mobiles. There has been some fixed-to-mobile substitution but no-one imagined in their wildest dreams that we would be spending the billions of pounds that we spend as a nation on ringing in real time, the amount of money we spend on mobile telephony, that we do now; it is additive, the same as with broadband connection. The appetite domestically and commercially for homes and businesses to spend on communication services seems to me to be not limited. Why is that? It is because it opens up a wealth of access, as you rightly say, to content and ways of getting content, but people still want the content to which it opens up access to be of high quality, whether it be great music or great movies, but they do also spend an enormous amount of time on-line on new sites, on information sites. The relatively recent success of the BBC iPlayer would suggest that catch-up capability on-line to traditional public service content, albeit distributed through other means, is very high. I absolutely accept that wherever we come out on PSB2, it needs to be a multi-platform business from the beginning rather than a broadcast. I absolutely accept that the content has to be commissioned and provisioned with multi-platform distribution in mind rather than just is broadcasting and particularly DTT distribution in mind, but I do not think it mitigates against the argument for solving it.

**Q438 Lord Maxton:** Would you see eventually maybe a funding body which internet providers of content could come to for funding rather than it just being for broadcasters?

*Lord Carter of Barnes:* That slightly goes back to the Baroness' question around contestability. I am not necessarily sure. My sense is that those entities, much like today's satellite capable or other broadcast entities, that want to produce that sort of content will produce that sort of content. The market will provide, but, in addition, I think there would be a reservoir or an oasis of publicly-funded content. Again, I do not think they are in conflict.

**Q439 Lord Maxton:** Let me give an example. It may be that it would be the education department that would do it. The internet is an enormous educational provider. Would the education department be prepared to help fund, say, a project on Shakespeare plays on the internet?

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*Lord Carter of Barnes:* Possibly, and my understanding is that the education department does already do some of that. There are multiple sources of funding for high-quality content on-line, so I think you will see that.

**Q440 *Lord Corbett of Castle Vale:*** Before I come to public service broadcasting content on the internet, can I clear a couple of things with you? I much welcome what you said about the need for a high level of ambition, which brings me to action point 17: of 23 European countries, the UK has the slowest internet speed—we are seventh from the bottom out of 23 European countries. Going back to your ambitious plan, action point 17, you say that you set an option here for a speed of up to, not a minimum of, 2 megabits per second. Why is that so unambitious? The second point connected with that is that the whole of this relies upon doing something we should have done 30 years ago and constructed a telecommunications infrastructure which is not there. BT could not do it by the way it was privatised; Mercury was given the job and never completed it; BT thought that if they are going to do it, why should we invest in it, so we have lousy connections in many parts of the country because we have never had a complete fibre network. Unless those things are put right, the other ambitions around that are just not going to be met, are they?

*Lord Carter of Barnes:* I share your ambition, and I certainly share your frustration with the historical decisions made on the approach to the telecommunications market and in other places they have tried to find solutions that, to a degree, compensate for those historical decisions. I think on the universal service proposal and action 17, I would encourage the Committee to look at the universal aspects of it rather than the speed aspects of it. The critical point in action 17 is that we are proposing changing the current universal service definition in this market, which is for up to 56 kilobits down a telephone line. That is what the law says; it is a European framework and that is what is enshrined in UK law. What we are saying in this document, and maybe we did not make it as clear as we should and we clearly did not because I have had this discussion now with a number of colleagues, is that that is out of date and we need to change it and we need a modern universal service obligation around connectivity. I think that is quite a big statement because we do not have universal availability of modern connectivity today. There are many people, I know from my own postbag and I am sure members of the Committee do from theirs, who since we published the document have written to me laughing at my ambition to get to 2 megabits because they do not have anything. There is a point about universality which we have to address; that is a significant issue to change in the

European framework. Then we need to find the mechanisms for extending the existing capability to a base level. We are absolutely not saying that is the limit of our ambition; far from it. We say in action 1 in the report that we want to do further work to see whether or not there is a case for public incentives to encourage the development of next generation access networks at speed levels. My own view is that the speed levels we should be aiming for are between 15 and 100 megabits per second. All the evidence from studies from around the world is that that is the level where you see the centre of gravity of innovation, development of network peripherals, software capability, content and on-line distribution, but you have to start from where we are and where we are is that BT was privatised in the way in which it was privatised; we have the telecom structure we have; we have 50% of the country connected through cable—BT have said that they are going to get to 40% by I think the end of next year—that raises a question about how we are going to get that level of capability to the remaining 50% of the country. We have to do the work to see what the answer to that is. The point about universality and the point about ambition are quite separate points.

**Q441 *Lord Corbett of Castle Vale:*** I will come to the main question in just a second. Let me just say this to you. The only way you are going to get universal service provision in many parts of the country is through wireless means of delivery.

*Lord Carter of Barnes:* Agreed.

**Q442 *Lord Corbett of Castle Vale:*** There are some big cost implications in that for low-income families. I just wonder how much thought has been given to that and is going to be given to it. Let me come back to the question. Given the ambitions for what *Digital Britain* is talking about, do you see a role for public service content in attracting people to use broadband services to get those public service programmes? In other words, can that be a sort of pull factor in increasing usage of it?

*Lord Carter of Barnes:* Absolutely, but on your point on wireless, we say explicitly in action 6 that in the issues we are trying to resolve with the mobile operators—I know we are slightly going off piste here, Chairman but to answer the question—we will make their contribution to the universal service delivery a central part of any agreement we have on the liberalisation of spectrum. We absolutely are doing work to make wireless as well as wire-line part of the delivery point. To your question about public service content driving on-line take-up, I think the evidence is there to see. I read with interest in the newspapers this week that the BBC is configuring its iPlayer service to make it available for mobile delivery. That is going to eat up capacity on mobile

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networks because I think it will be a highly popular thing. So I think aligning what some people glibly call “the pipes and the poetry” more effectively will help drive take-up and participation. The other point to make on that is about getting the internet off the computer will also happen. Partly it is an income point, partly it is just a comfort and usage point, but for many people access to the internet or to on-line services through a computer is a limiting factor. Other devices delivering connectivity—wireless devices, mobile devices, gaming devices—I think will be a significant driver of other people coming on-line.

**Q443 Baroness Bonham-Carter of Yarnbury:** I want to return to Lord Macdonald’s question about regional coverage and in particular press you on the solution to the provision of regional news once ITV is no longer responsible for this, which I think is 2011, is it not? You referred earlier to believing in a considered and defined public intervention. Is this an area where you see that happening?

*Lord Carter of Barnes:* Again, I think we very clearly say that news and regional news is an important part of the remit questions for PSB2. I am not so sure that we will see a complete disappearance from the regional news market by ITV. That is my own personal view. I think one of the reasons why the BBC partnership and ITV conversations have been happening is partly because they make commercial sense for ITV and partly because they make good policy sense for the BBC, but it is also because I think there is a genuine desire within ITV to maintain its regional roots. Lord Birt made the point that if you go to the tap root of ITV’s strength in the market, it goes back to its regional connections. I think there are strong voices within ITV that would not want to see that disappear in its entirety. I suspect they will be part of that, even if we are past 2012/13 when the imposition of it is hard to do, but I do not think that mitigates against us looking for alternative provision.

**Q444 Baroness Bonham-Carter of Yarnbury:** What I heard very loud and clear from the ITV people I have been listening to is that they do not feel they will have the money to provide regional news.

*Lord Carter of Barnes:* I have heard that, too. I am making a slightly different point. I have heard them say that and I understand their argument and I understand the economics of their argument. There may be different ways of doing it, different ways of delivering it. This goes back to Lord Corbett’s question about 2012; this market is moving at an enormous pace. In four years’ time, and that is a lot of time, there could be very different ways of delivering much more economically the sorts of local or hyper-local or regional news services that people are talking about. There is a sort of perversity, is there not? It is one of the perversities of regulation that

when you impose something on people, they resist it, but then when you remove it, they still do it. They do not always and they do not necessarily do it in the same form. I am not trying to be glib about it. People’s reactions often change when they find themselves with complete freedom to choose.

**Q445 Baroness Bonham-Carter of Yarnbury:** At the moment, any solution that you are suggesting is a work-in-process?

*Lord Carter of Barnes:* Correct.

**Q446 Baroness Howe of Idlicote:** Going back to the fairly dramatic statement by Lord Birt that we are in the digital age, everything is changing and we are able to be viewing, seeing and listening to everything via digital, DAB and so on, we have clearly fallen fairly far behind as far as radio is concerned. Listening to radio in the car or wherever is absolutely a basic requirement for most people and they still want to do it. There is commitment in this very interesting report on the future of radio, but how have we allowed it to fall so far behind and what hopes have you got that you will get the sorts of partnerships you are referring to in this report with telephone companies and with other partners?

*Lord Carter of Barnes:* I certainly share Lord Birt’s view that we are absolutely living in the digital age. We try to capture some sense of that in this report. I sincerely hope, if I am allowed to say so, that your own report on this question absolutely makes that point unequivocally. One of the dangers always is that whilst public policy has to have its own time period, it is developing I think rather too slowly on some of these questions. This is a real area of strength for us as an economy and we need to make sure that we do not fall behind. I do feel that some of these legacy questions frankly absorb more energy than they merit; that is not to say they are not important. On radio, I think the answer is: it is small and all of us—perhaps not you, Lady Howe—are often guilty of dealing with the bigger beast and the bigger questions and the bigger issues and television is a bigger beast and a bigger issue and a bigger question. Radio is a relatively small medium. Commercially radio is £560-£600 million of revenue. That is less than Channel 4, one player, and Channel 4 is complaining that it as one industry does not have enough income. That is the entirety of the commercial radio industry. The BBC spends £460 million, a large amount of money, and interestingly almost spends as much as the commercial industry makes, which gives you an insight into what the competitive strength of the BBC is in the radio market, but still it is a relatively small number by comparison to what it spends on television. I think it is only about twice what it spends on-line on content. I think size has often meant that it has been sort of the

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little brother in public policy debates. You and I touched on this yesterday. If you go back to the discussions around the Communications Act, really there was virtually no debate about the radio industry; frankly, we were all slightly asleep on the watch, I would say, and I would include myself in that. We just transposed a lot of rules and a lot of requirements in the radio industry from 1990 to 2003. So it is no surprise that in 2009 we slightly wake up and said, “What about radio?” What we have tried to lay out in the report is a very clear statement and commitment to DAB, a very clear statement and commitment to radio as a discrete medium, and an obligation upon us and upon others to look at the rule book to see whether it is out of date and if it is getting in the way. I am a huge fan of radio, as it happens, and I think radio has a real role to play, both socially and commercially. It is a much more low cost and effective medium for an advertiser than television; it does things which television does not do in terms of targeting and local delivery; and also for the user and the listener, and we have seen it very recently in the snow period, people turn to radio in a very real way. It is a very real part of people’s lives. We are very good at it. That is something that we forget. If you go round the world, we are very good at radio. Radio is one of the things we export. It is another great British success story. I think it is important to give it strong support, but it has been slightly forgotten about.

**Q447 Chairman:** We dealt with this in the *Ownership of the news* report, so I hope that in your consideration you might look up that report and see what we said there. I want to recap on where we are. We must not get mesmerised with one particular issue but obviously it is an important issue. Can you just summarise very briefly: what is the actual case for putting Channel 4 and the BBC Worldwide together?  
*Lord Carter of Barnes:* You will forgive me if I do not make that case because we have not made that decision.

**Q448 Chairman:** What is the case for considering putting them together?

*Lord Carter of Barnes:* The argument that is made is not the Government’s argument. The argument that is made is that BBC Worldwide is essentially a business that exploits rights internationally—it is a rights exploitation business—and that that is where you are going to see growth in the market. That is partly for the reasons that were made earlier because of people being able to access content in lots of different ways; that we are going to discover hidden value in content we do not know about today; that that essentially is a commercial activity, 100% commercial activity; and that BBC Worldwide is therefore at a point of development, or the entity that

does that commercial activity, whereby having it fully integrated within the BBC is beginning to limit its potential. Separately, over here, we have another entity which is also public-held called Channel 4, which is also funded entirely by commercial activity, a combination of advertising revenue and rights exploitation and pay TV activities. BBC Worldwide also has paid TV activities—joint ventures with rights and others. When you put those two together or consider putting those two together as a coherent entity, what you have is a publicly owned but commercially funded, combined entity with scale that both could provide a funding stream for domestic content here in the United Kingdom and also provide a vehicle for international exploitation of the rights of that content around the world. Could you make that coherent? We need to do the work on that. Does it add up financially and provide the necessary funding? We need to do the work on that. Will the BBC Trust agree to it? We need to have those conversations with them. There are lots of questions still to be answered, but that is, in summary, the case.

**Q449 Chairman:** A new organisation could be publicly owned if there was such?

*Lord Carter of Barnes:* We have said that, yes.

**Q450 Chairman:** Therefore, does it also follow that the other proposal, which is very enthusiastically put forward by Five, that Channels 4 and Five should go together, is off the table?

*Lord Carter of Barnes:* It is not off the table. At this stage, we have been very clear that nothing is off the table, but we have said to all commercial parties that have approached us with proposals, some have done it slightly more publicly than others, that we will entertain those proposals but that they should understand that what we are seeking to create here is an entity with a very clear public service remit and set of obligations that would be a multi-platform entity and would have some specific areas where we would wish to focus because that is where we see there are market failures. If there are private parties who believe that that could be commercially attractive to them, then by all means they should come to us. Indeed, later this week we will be issuing an open letter to all interested parties to approach us on those terms.

**Q451 Chairman:** In that letter and in what you are setting out, you are not going to make it there a condition that it is entirely publicly-financed; in other words, the proposal obviously of the BBC Worldwide and Channel 4 is two public corporations coming together, but you do not set your mind against a public/private partnership?

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*Lord Carter of Barnes:* Not at all. We set our minds firmly in favour of a majorly public/private partnership.

*Lord Corbett of Castle Vale:* Chairman, could we ask for a copy of that letter?

*Chairman:* I am sure it will come in due course.

**Q452 Lord Macdonald of Tradeston:** If I could take you back to Channel 3, we heard from ITV plc, which has the majority of the licences on Channel 3, that the reduction in its advertising revenue might force it to give up its public service broadcasting status, and that would mean that the licences left behind in Northern Ireland, Scotland and the Channel Islands would be unviable. I think everybody accepts that might well be the case. But, on the other hand, ITV is also asking Ofcom for a reduction in its public service broadcasting commitments. Amongst that, it wants the renegotiation of its terms with these small broadcasters. Their fear is that with big ITV plc against these small companies, that again might make them unviable. When asked what should be done about this, ITV said that the broker would be Ofcom. When we put this to Ed Richards from Ofcom I thought he seemed distinctly unenthusiastic about having to be the broker in the middle of this commercial negotiation. He certainly did not radiate optimism. Given the national and indeed political sensitivities of the collapse, perhaps in the next few years, of those smaller companies in the nations, is there anything that the Government can do to try and encourage a fair commercial settlement?

*Lord Carter of Barnes:* My understanding of those issues, and I certainly recognise their importance both in absolute terms and particularly in Scotland and in Northern Ireland, is that they are absolutely matters between the licencees and the regulator. It may well be that Ed Richards feels uncomfortable but that goes with the brief. The only wrinkle I would put on that, and my memory may be wrong on this

and obviously record me but you might want to check this, is that my memory tells me that the arrangement between ITV plc and the minorities were undertakings as a result of the merger, and therefore my sense is that the Competition Commission would have some purchase on that question.

**Q453 Chairman:** You have been very patient. I must ask you one other question. In the House of Lords I asked you a question about the advertising in regard to an appeal on the BBC and you said then that it was not part of your function to interfere with the editorial decisions at the BBC. That is your decision.  
*Lord Carter of Barnes:* Correct.

**Q454 Chairman:** Is that a general decision now, because of course we have had in the past complaints from various people from the BBC that, from Alistair Campbell onwards, a lot of interference has taken place with the BBC. We can take it this does not take place any more?

*Lord Carter of Barnes:* Well, there are now very firmly established processes for complaint handling, some of which have arrived relatively recently. I do not know why those changes might have been put in place, but they have. I think if government departments or government officials wish to make complaints about the BBC, or indeed other broadcasters' editorial judgments, then they are free to do so. I think as a Government Minister, particularly as the Minister for Broadcasting, it seems to be inappropriate.

**Q455 Chairman:** Good. So it is not just a new digital age; it is a sort of new age as well in terms of Government and the BBC?

*Lord Carter of Barnes:* I think a new age is a good point to end on.

*Chairman:* Minister, thank you very much. You have been very patient and we are grateful for the time that you have given to us.

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**Supplementary letter from Lord Carter of Barnes, the Department for Business Enterprise & Regulatory Reform, and the Department for Culture, Media and Sport**

I promised to write to you following the Select Committee's session on public service broadcasting on Wednesday 11 February.

During this session you asked me about the institutional process for decisions related to the BBC's assets—in particular BBC Worldwide—and whose responsibility it was ultimately to make such decision.

Under the current Charter, the Trust is the guardian of the public interest in the BBC and has the ultimate responsibility for the BBC's stewardship of its assets. Consequently under the current provisions a partnership between BBC Worldwide and Channel 4 would require the agreement of the Trust in order to proceed.

The BBC responded positively to the Digital Britain Interim report and is committed to exploring a number of options, including a possible partnership between BBC Worldwide and Channel 4. I am confident that Government and the BBC Trust—as well as Channel 4's board—will reach a shared understanding of the

potential of the option. Indeed, discussions have been taking place between the BBC and Channel Four to identify synergies.

I would like to thank you for the very stimulating session we had on Wednesday and look forward to reading your report in due course.

I copy this letter to the other members of the Committee.

*13 February 2009*

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# Written Evidence

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## Memorandum by stv group plc

### INTRODUCTION

stv welcomes this opportunity to contribute evidence to the House of Lords select committee. This is a pivotal point in time for Public Service Broadcasting (PSB) in general and provision in the devolved Nations in particular. Both Ofcom's Review of PSB and the interim Digital Britain report just published underscore the importance of regional news and other programming continuing to be available for viewers in Scotland.

As the holder of two Channel 3 licences in central and north Scotland for over 50 years, regionality is at the core of what we do. Our focus is entirely on Scotland, providing content and serving audiences under a strong and proud brand identity. This is markedly different from ITV plc's position, where over time, regionality has given way to a homogenised network under the ITV1 brand. stv's approach to PSB is also different. It remains a key part of our DNA and we are committed to finding a way to continue providing high quality, relevant content for Scottish viewers. To this end it is imperative that the Channel 3 system continues to provide a bedrock of high quality network output around which Scottish news and other material can be included to continue to provide a potent offering for viewers.

However, in considering how stv continues to be the platform for current and potentially increased levels of Scottish content, we are in no doubt that the future sustainability of our business requires immediate and resolute regulatory engagement. We would summarise the key issues as follows:

1. The need for stv to forge a new relationship with ITV plc over the operation of the Channel 3 network. The current system is out-dated, overly complicated and the full value to ITV plc of network content is not reflected in the present cost sharing arrangements. ITV plc continues to claim that it "subsidises" stv, UTV and Channel TV, making for a very unhelpful and inaccurate backdrop to a forthcoming commercial negotiation. In fact stv and UTV commissioned independent research, which demonstrates the flow of benefits is in fact in the opposite direction, with ITV plc deriving considerable value from the Channel 3 system. ITV plc, however, continues to uphold its initial views.
2. The difficulty of agreeing such a new relationship where ITV holds such a dominant, 92% share in the network. Arriving at a new model for Channel 3 will require significant regulatory involvement including continued protection for stv from the Merger Undertakings imposed on ITV plc at the time of the Carlton/Granada merger in 2003. We look to Ofcom to help facilitate the process.
3. Swift resolution of contestable funding for regional news. The cost of providing nearly 600 hours of high quality news across Scotland, approximately £7 million per annum, will imminently outweigh the benefit of holding a PSB licence.
4. Further consideration of BBC partnerships. stv and BBC Scotland are neighbours at Pacific Quay and there is potential for collaboration between us to add value to PSB.
5. Independent status for stv's production division, recognising our complete lack of influence in ITV network scheduling and commissioning. Through the PSB review process, this was repeatedly acknowledged by Ofcom and DCMS as being a just and appropriate course of action and stv is dismayed that this has not been addressed or indeed that there is no reference to it in either recent report.

stv, which has held the central and northern Scottish Channel 3 licences and delivered a strong, recognisable and valued regional service for over 50 years, recognises that there is a very real possibility of a change in our current relationship with ITV as part of the Channel 3 network. Whilst Ofcom's recommendations as part of its recent Review of Public Service Broadcasting are widely positive, possible significant changes to the Channel 3 network system may be to the severe detriment of stv and more widely to the provision of public service broadcasting in Scotland.

To be clear—stv is completely focused on being a commercial provider of PSB for Scotland, developing a vibrant production centre in Scotland, serving viewers, working with advertisers, creating jobs, and enhancing the cultural identity of the Scottish nation.

We broadly welcome Ofcom's Final Report on the PSB Review, which has the potential to result in a positive outcome for viewers in Scotland. The report demonstrates that Ofcom recognises the pressures facing commercial public service broadcasters and the need to modernise the current system. We also welcome Ofcom's recognition that the needs of each of the UK's nations are different and there is unlikely to be a single solution that fully meets the needs of each of the three devolved nations.

Whilst Ofcom's recommendations are broadly positive, there is still a long way to go. What is important going forward is that we have a strong, resolute and fair regulator in place, safeguarding the interests of the nations and regions. ITV's actions ultimately impact on stv and we are seeking assurances that Ofcom, and indeed the Government, are mindful of the non-ITV licensees' preferences which have been outlined as central to serving viewers and continuing to provide a much-valued service as an effective competitor to the BBC.

## NEWS

Ofcom's final report on PSB highlighted stv's contribution in providing plurality and much-valued high quality news and programming. Over the past five years our news programmes have seen a 13% increase in viewing share: our news service is currently watched by 2.1 million people per week.

We offer two dedicated regional services at 6.00 pm compared with one national BBC news programme at 6.30 pm, as well as four new, localised "sub-regional" bulletins within our main programmes, which bring a new editorial seam to television news in Scotland and have been warmly welcomed by audiences and acknowledged by the regulator Ofcom.

Our preference is to continue providing news output at current levels although as Ofcom acknowledges, the cost of doing so—in excess of £7 million per annum—imminently outweighs the benefit of holding our public service broadcast licences. We therefore welcome Ofcom's recommendation that contestable funding should be made available for news services in Scotland and we would also welcome this option for current affairs output. It is vital for continuity of news provision that contestable funding is put in place as soon as possible. Given our strong track record in this area, our history of investment, our current infrastructure and the popularity of our service, we would like to believe we are in a fairly solid position to compete in such a process. However, we have concerns regarding the selection process and would argue that the regulator, which is familiar with the current set up, would be best placed to lead the funding award process, supported by relevant local expertise.

Our over-riding aim is to continue our current provision of news, relevant to a devolved nation, as a strong alternative to the BBC.

## THE CHANNEL 3 SYSTEM

The Channel 3 network is currently underpinned by a series of Networking Arrangements, more appropriate for the original federal system with 15 discrete licensees. There is no doubt that this system needs modernising now that ITV plc owns 92% of the Network and changes must be made to ensure a positive working relationship going forward.

We would like to see dynamic collaboration between the non-ITV plc licensees and ITV plc itself at the heart of the new arrangements and we should work together to bring mutual benefits. We are keen to work with ITV plc on a new model for the Channel 3 network which secures guaranteed, flexible access to network content at appropriate rates, with the right to opt out where it is in stv's and our viewers interests to do so.

In arriving at a new agreement with ITV plc for the supply of network content, cognisance needs to be taken of the value derived by all from the existing federal system. For example, ITV plc transfers network material to its digital channels, from which stv receives no benefit. Therefore, contributions to the Network Programme Budget need to be re-based taking this into account. Independent research by Ingenious Consulting Network commissioned by stv and UTV shows that through this additional exploitation of production funded for primary use on ITV1, together with the ability to cross promote its digital channels, benefits of over £225 million flow to ITV plc from its participation in the Channel 3 Network.

stv has always retained sovereignty over its schedule and brand identity in its own licence areas and we strongly believe that this should continue.

Clearly the current networking arrangements need to be simplified to reflect the operational reality of ITV plc's dominant position within the Channel 3 Network and, given the inherent difficulties of negotiating with such a majority shareholder as ITV plc, we will look to Ofcom to ensure that any new arrangements are appropriate. Similarly, stv will look for continued protection through the Merger Undertakings, designed to protect the position of the minority licensees at the time of the Carlton/Granada merger in 2003.

## THE FUTURE OF STV

stv remains absolutely committed to providing public service broadcasting as part of the Channel 3 network in Scotland, within a more sustainable framework for a digital landscape. Content is at the very heart of all of stv's plans for the future and we have an unyielding commitment to maintaining a healthy creative culture within Scotland as part of a strong Channel 3 network.

We will shortly be announcing significant new commissions for stv across a variety of genres which we will accommodate on our schedule by opting out of ITV Network programmes, forging a stronger identity and a closer link with our viewers.

We hope to secure the future of our comprehensive news services, which ensure plurality of services in Scotland. We will investigate the potential of forging new partnerships with the BBC for some aspects of our business; and we are committed to enhancing digital delivery of public services.

We broadly welcome the Scottish Broadcasting Commission's report, which recommends a Scottish Network and indeed Ofcom's suggested alternative of a competitive fund for Scottish originated programming. Any initiative that supports Scotland's creative industry can only be positive. However, a Scottish digital channel must not and should not be at the expense of stv. The maintenance of a strong and visible stv as part of a Channel 3 network must be a priority for Scottish broadcasting, and must be recognised and protected by a robust and fair industry regulator.

stv has a strong brand and market positioning, and this year we will rejuvenate our on-screen appearance at the same time as we revitalise our schedule, showcasing more Scottish content and embracing the power of localness. We have also invested in our online platform stv.tv which has shown significant growth over the past six months as viewers access high quality catchup video streaming as well as expanded news material. We will replicate the success of our micro-region television news by launching online "city TV" sites with more localised content. stv is a restructured, financially sound business with positive momentum and a clear and focussed strategy.

Whilst we have a strong a clear vision for the future of stv, this can only be delivered with a new and commercially sustainable agreement between ourselves and ITV plc which in turn requires positive and immediate engagement from Ofcom. Effective regulation does not mean allowing the will of the majority partner to prevail; the needs of the Nations have been recognised, they now need to be secured within a new framework. The Select Committee should be in no doubt that PSB in Scotland and stv's ability to deliver are in a fragile and perilous state.

Given the urgency and seriousness of this position, in addition to this short written submission, we are keen to amplify our evidence through a meeting with the Committee or chair as appropriate.

*February 2009*

## Memorandum by UTV

### INTRODUCTION

UTV is grateful to the Committee for the opportunity to submit this written evidence to your Enquiry. We understand that you have already received evidence from ITV plc, BBC, Channel 4, Five and BSkyB.

We strongly believe that, both as a devolved nation and a Channel 3 licensee, our views on public service broadcasting and news provision in particular, differ dramatically from that of ITV plc.

### BACKGROUND

This year UTV celebrates 50 years as the Channel 3 licensee for Northern Ireland. We are proud of our regional heritage and put our audience at the centre of all our output.

We are by far the most watched public service broadcaster in Northern Ireland and the most successful regional licensee in the whole of the ITV Network. We produce not only the most watched evening news programme in the network but also the two most popular regional non-news productions. In fact, we are the only ITV region that has a higher regional news audience than its BBC counterpart.

Our quality programming is recognised by both viewers and opinion formers alike as UTV makes a major contribution to cultural life in Ulster. Ofcom's own research as part of this Review process, showed that UTV news delivers a greater satisfaction rating and a greater rating for handling breaking news than BBC Northern Ireland.

## REGIONAL NEWS PROVISION

In UTV's submission to Ofcom for their Second Review of Public Service Broadcasting, UTV argued that regional news provision should be the only obligation on a Channel 3 licensee.

We did not believe that a subsidy should be offered for news provision. However, we did argue that non-news provision should be subject to contestable funding on the basis that any funding should be provisional on a broadcast partner for the production.

In addition, we felt that co-operation with the BBC in Northern Ireland was impractical. We believe this view is also held by BBC NI. The reason being that, because of Northern Ireland's recent history, journalistic competition has been so entrenched that editorial co-operation would be close to impossible. Shared resources would be detrimental to the quality of UTV's regional news which currently far outstrips BBC Northern Ireland's provision in terms of both share and volume.

Having read Ofcom's thoughts in relation to future funding of local news, as published in "*Putting the Viewers First*", the Final Statement and Recommendations of their Second Public Service Broadcasting Review, we believe that while contestable funding for news provision in England (and Wales) may be ITV's preferred choice, in Northern Ireland UTV is fully committed to regional news provision and within our licence period (which runs to 2014) there is currently no threat to the service we offer.

If contestable funding is implemented for regional news from 2011 as Ofcom recommend, then UTV although not complacent is confident in the high quality of our programming and our proven track record to submit a successful bid.

Where we have concern is threefold.

Firstly, funding. There is no clear indication of where such funding would come from and in the current economic conditions we believe neither Westminster nor the devolved Stormont Assembly will have the appetite to use scarce finances to fund commercial broadcasting.

Secondly, the selection process for the award of the news provision contract. Ofcom has indicated regional contestable funding contracts should be awarded from a panel chosen from within the region that the licensee is based. We have significant concerns about this and believe that only the regulator is best placed to judge the quality, content and viability of business plans which will be crucial to sustain this much-valued output.

And lastly, our final concern is the compliance process for this outsourced content should it be awarded to another provider. It is not clear whether these arms-length companies would be responsible for programme compliance or the Channel 3 licensee. It is difficult to imagine the Channel 3 licensee to be the liable party should compliance fail if they have had no contribution to the selection or production process as we would with any independent programme commissioned by UTV.

## RELATIONSHIP WITH ITV PLC

In relation to ITV1, UTV does not need to remind The House of Lords Select Committee on Communications of the arguments put forward by ITV plc to reduce its regulatory burden. UTV has found many of these arguments deeply frustrating as UTV believes the lack of commitment to PSB licence obligations by ITV plc reflects negatively upon all the other Channel 3 licensees.

During this debate on the future of public service broadcasting in the UK, ITV plc has made it clear that it believes there is a flow of benefits away from ITV plc in the direction of the non-ITV plc licensees. Michael Grade has indicated he believes that flow of benefits is £25 million away from ITV. While he has not revealed how this figure is made up, much has been made of this so called subsidy by ITV plc in the media.

In order to address this allegation of subsidy, UTV and stv commissioned independent research from the Ingenious Consulting Network to look at the true value of membership of ITV Network to ITV plc. The research showed that through mechanisms such as transfer pricing, cross promotion and other benefits, ITV plc receives a benefit of between £28.2 million and £30.8 million directly from the UTV, stv and Channel Television licensees.

A copy of this report, the background and the methodology has been sent to Ofcom and is available on request to the Committee.

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### ITV PLC LICENCE HAND-BACK

We also believe should ITV plc take the view that there is not a value to holding a Channel 3 licence with PSB obligations, others will see a value. The concern Ofcom may have for a void being created in high quality commercial PSB provision would undoubtedly be filled by another operator.

The significance and value of the regulatory assets, not least the highly prominent EPG positions and a “must carry” mandate to all platform operators, will ensure this.

### FUTURE OBLIGATIONS

It is clear ITV plc is looking to reduce PSB obligations to a bare minimum and is continuing to threaten licence hand back.

UTV would argue very strongly that with the appropriate model there is value in a Channel 3 licence post 2014, even with a significant level of PSB commitment. As a bare minimum this should include a sustainable level of UK origination and high quality national and international news.

In addition the devolved nations should have the ability to place high quality news in peaktime and also be able to “carve out” slots for a sustainable level of peaktime regional programming. The level of this programming should be defined closer to licence renewal and reflect the prevailing commercial conditions.

We do not believe that the current Channel 3 model is sustainable, but the ability to use content made for the licenced area television service on other platforms should allow other forms of revenue to be maximised.

### CONCLUSION

We once again wish to thank the Committee for inviting us to submit our written views in relation to regional news.

This is a brief document as requested which I hope summarises our position. However, as we have been so successful in delivering local content compared to ITV plc, we would if possible welcome the opportunity to speak directly to the Committee or to Lord Fowler as Chairman of the Committee as we believe the metrocentric voices may be heard louder than those in the devolved nations in this debate.

*11 February 2009*

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