

The transformation of broadcasting: public service broadcasting, the BBC and the distortion of new media markets

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Abstract

Broadcasting markets in Europe have traditionally been highly regulated, with large public subsidies seen as necessary to ensure that cultural and citizenship goals can be realised. While being outside of Polanyi's purview when he wrote his seminal work The Great Transformation, these "markets" exist alongside other public interest norms; in his words, they are embedded in society.¹ In the last 20 years, broadcasting markets in Europe have undergone something of a "transformation", in the sense that technological advances have facilitated a shift away from public provision towards a market-based model. The removal of spectrum constraints has led to new platforms and a proliferation of channels. More importantly, with the emergence of conditional access systems has come the growth of subscription and pay-per-view television, offering significant new revenue streams and the development of new markets in premium content. Latterly, non-linear television services have seen a shift in audience viewing behaviour, and the convergence between television and the internet heralds new, innovative modes of delivery of, and changing pricing mechanisms for, broadcasting services. So, as a consequence of technological developments, we see the rise of a new type of commodity in broadcasting services. Whereas once, such goods were universally available partly because their consumption was physically non-excludable, now technology facilitates charging and the emergence of a market based on willingness and ability to pay.

1 Introduction

Public service broadcasting (PSB) continues to have a special position in EU law. As a paradigm for quality, universal and free-to-air (FTA) television, however, it is being placed under substantial pressure. With more choice, audiences are becoming increasingly fragmented with a resultant fall in advertising revenues for those who, unlike the BBC, rely partially or wholly upon this type of income. The so-called "spectrum compact", under which commercial broadcasters accepted public service obligations in exchange for access to the spectrum, is now nearing an end, with the largest and most significant of the UK's commercial broadcasters indicating its intentions to merely hand back its licences once digital switchover is complete, thereby ceasing its additional PSB obligations. Similarly, the

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1 K Polanyi, *Origins of our Time: The Great Transformation* (London: Gollancz 1945). For an introduction to the life and works of Polanyi see G Dale, "On the conceptual innovations and intellectual affiliations of Karl Polanyi" (2010) 15 *New Political Economy* 369.

state-owned Channel 4 is arguing that it can no longer afford to meet its current PSB obligations, particularly those pertaining to high quality news provision, a core element of PSB. In contrast, notwithstanding the recent freeze in the licence fee level, the BBC enjoys a privileged position, with a guaranteed income of in excess of £3bn per year.

With the retraction of the commercial public service broadcasters, one might think that the BBC would enjoy an enhanced and more important role in the UK's broadcasting landscape.² The challenges to the BBC, however, come from different directions. First, precisely because of its insulation from market pressures, the BBC needs to act with heightened sensitivity, especially when its private counterparts are weathering particularly difficult commercial conditions. Second, with the marketisation of broadcasting services, the BBC is increasingly being the subject of regulatory controls, including competition law, which aim to limit the extent to which it can distort emergent markets. Yet entry into these new markets is crucial if the BBC (and PSB) is to secure a sustainable position in the long term. Hitherto, PSB has lacked a clear rationale, which poses a particular difficulty where it comes into conflict with highly juridified and articulated market-based norms.³ The difficulty is that while the economic approach, from which the market failure justification derives, is based upon a "well-defined paradigm", the political and cultural perspectives, which argue for a broader conception of PSB, are more "diffuse and less coherent".⁴

Competition law itself might not be seen as antithetical to Polanyi and the idea of embedded markets, now forming the cornerstone of economic sociology.⁵ Indeed, the existence of such laws perhaps lends further credence to the view that a market economy cannot survive without state intervention, in this case by limiting the concentration, and abuse, of market power. In the context of the media which, without intervention, tends to be highly concentrated, competition law might serve broader public interest values, such as securing lower prices, more choice and, therefore, greater access to media services.⁶ On the other hand, it may be seen to further entrench the market paradigm, especially where the rules restrict the ability of the state to distort markets through subsidies, as is the case in the EU.

The BBC and broadcasting in the UK are at a crossroads. One vision of the future is that the BBC should continue to play an important but receding role, merely filling the gaps left by the market. Another, competing vision would see the BBC as a central player in British broadcasting, continuing to take a leading role in shaping new media markets.⁷ The central question in this article is which vision is now reflected in the regulatory arrangements governing the BBC's activities. If the market takes precedence over public service values – if it is disembedded – then PSB will wither away.

2 For a general discussion of regulation and public interest in broadcasting markets see M Feintuck and M Varney, *Media Regulation, Public Interest, and the Law* (Edinburgh: Edinburgh UP 2006), chs 2 and 3.

3 G Born and T Prosser, "Culture and consumerism: citizenship, public service broadcasting and the BBC's fair trading obligations" (2001) 64 *Modern Law Review* 657.

4 D Helm, "Consumers, citizens and members: public service broadcasting and the BBC" in T Little and D Helm (eds), *Can the Market Deliver?: Funding public service television in the digital age* (Herts: John Libbey 2005), p. 1; S Deakin and S Pratten, "Reinventing the market? Competition and regulatory change in broadcasting" (1999) 26 *Journal of Law and Society* 323.

5 For an explanation of economic sociology and Polanyi's influence upon it, see K Hart, "Karl Polanyi's legacy" (2008) 39 *Development and Change* 1135.

6 Most Western countries have, in addition to competition law, specific rules designed to secure a sufficient level of media pluralism necessary for the functioning of a healthy democracy. Such rules might privilege pluralism over other goals central to competition law, such as lower prices and efficiency.

7 The term "new media markets" is taken to mean, among other things, broadcasting services offered over the internet (as a result of convergence), non-linear television services (such as VOD), and new innovations in user interactivity.

This article is structured as follows. Section 2 explains the definitions of, and continued rationale(s) for the public interventions, including funding, in support of PSB and the BBC. Section 3 then explains some of the criticisms that have been levelled against the organisation and its claimed propensity to “crowd-out” commercial operators. Section 4 explains the legal context in which the BBC’s operation on the market is scrutinised and controlled, while section 5 interrogates two recent cases decided by the BBC Trust (the Trust) concerning its entry into new media markets. Section 6 concludes.

2 Definition(s) of, and rationales for, PSB

There is no definitive meaning of PSB. The Communications Act 2003 offers a definition of the purposes of PSB which are to offer a wide range of programming, representing a balance of different genres, meeting the needs of as many different audiences as practicable.⁸ High standards are to be maintained; cultural activity reflected, supported and stimulated; information disseminated; and educational aims met, particularly with respect to science, religion and social issues. The BBC’s public purposes are enumerated in the Royal Charter and are as follows: sustaining citizenship and civil society; promoting education and learning; stimulating creativity and cultural excellence; representing the UK, its nations, regions and communities, and bringing the UK to the world and the world to the UK.⁹ As is explained below, European law secures a special place for PSB in promoting values such as citizenship, democracy, social cohesion and national identity.

There are two principal rationales for PSB. First, there is the market failure rationale, whereby state intervention in broadcasting markets is justified because the market will fail to deliver on consumers’ demands, and possibly on society’s broader political and cultural needs. Second, there is a broader conception of PSB which rejects the market paradigm, at least one based solely on consumer sovereignty, explicitly founding the need for PSB on broader societal and cultural justifications. Clearly, the difference between these two positions turns on the meaning of market failure. For the purposes of the exposition here a narrow conception of market failure is adopted, that is the extent to which a market-based system of broadcasting will fail to meet fully consumer demand. This important point is returned to in the conclusion to this section.

THE MARKET FAILURE RATIONALE FOR PSB (AND THE BBC)

The traditional case for intervention in broadcasting fixes upon four key market failures. First, spectrum constraints, or scarcity, meant that few channels could be broadcast with the attendant dangers that there would be insufficient diversity or choice for viewers. Clearly, technology advances have resulted in a proliferation of channels, though this does not necessarily mean an increase in diversity. Second, the advertising funding model for commercial television produces an incentive problem in so far as advertisers’ and viewers’ preferences may diverge. Advertising revenue will generally vary according to audience size, so that commercial operators will tend to produce content which attracts the highest level of audience share, with the risk that certain audience sectors will be under-supplied. Furthermore, in maximising profit, commercial operators will seek to produce programmes

8 Communications Act 2002, s. 264 (4) and (6). This definition informs Ofcom in its periodic review of PSB. The Digital Economy Act 2010 has extended this review duty to include public service content offered online and on VOD. For the most recent review, see Ofcom, *Public Service Broadcasting Annual Report 2011* (21 July 2011), available at <http://stakeholders.ofcom.org.uk/binaries/broadcast/reviews-investigations/psb-review/psb2011/psb-summary-A.pdf> (last accessed 26 July 2011).

9 Department of Culture, Media and Sport, *Broadcasting: Copy of Royal Charter for the continuance of the British Broadcasting Corporation* (London: TSO 2006), Cm. 6925.

which attract the lowest production costs (genres such as soap operas and reality television programmes). Third, traditional analogue broadcasting is non-excludable, with the result that there exists no price mechanism to reveal individual viewer preferences or, to put it a different way, there is no incentive to produce programming for those segments of the audience who are willing to pay for high quality, niche programming. A fourth type of market failure centres upon the positive value of having a well-informed public which results from, in part, the provision *and consumption* of high-quality news and current affairs content. In respect of consumption, while the individual's choice in viewing information makes only a negligible contribution to how well-informed society is, in aggregate the effect can be very substantial (the positive externality). The implication is that a model of broadcasting based purely on a model of individual choice (or consumer sovereignty) will fail to deliver the substantial benefits resulting from a well-informed public (for example, greater scrutiny of public institutions, greater participation in democratic processes, and so on).¹⁰

WILL (DO) MARKET FAILURES STILL REMAIN IN THE DIGITAL AGE?

A number of commentators now question whether PSB is necessary or sustainable in the new digital environment which – it is argued – has corrected or removed some or all of the market failures above. In particular, the development of conditional access systems now mean that broadcasters can be more responsive to audience preferences, both in respect of their demands and, crucially, their *willingness* to pay.¹¹ Furthermore, a number of writers have pointed to the potential for the BBC to frustrate the achievement of a competitive market, arguing for contestability in public funding.¹²

There are, however, a number of reasons to think that the multichannel environment will not yield the diversity and choice, both in terms of broadcasters and programme genres, one might expect at an intuitive level.¹³

Despite recent technological advances, programme production tends to attract high fixed costs, favouring a search for economies of scale, audience maximisation and, in turn, horizontal concentration. As with cultural goods generally, incentives tend to be affected by the “hit or flop” phenomenon.¹⁴ In the light of uncertainty over consumer demand, it is very difficult for producers to know which investments (possibly only a minority) will actually pay-off, with the need therefore for risk to be managed. Furthermore, on the demand side, it is very difficult for consumers to know *ex ante* whether they will actually enjoy a programme, meaning that strong channel brands and marketing will be important. Consumers also tend to purchase relatively large bundles of channels. High-risk investments reinforce tendencies towards concentration and can also lead towards vertical integration between upstream production and downstream distribution; having an installed subscription base makes upstream investments less risky. While vertical integration can be

10 S Hargreaves Heap, “Television in a digital age: what role for public service broadcasting?” (2005) 41 *Economic Policy* 111, p. 122.

11 M Armstrong, “Public service broadcasting” (2005) 26 *Fiscal Studies* 281. There is, of course, a crucial distinction to be made between willingness and ability to pay and this is reflected in one of the norms underpinning PSB, i.e. universality.

12 See, in particular, A Peacock “Public service broadcasting without the BBC?” in A Peacock (ed.), *Public Service Broadcasting Without the BBC?* (London: IEA 1997), p. 33.

13 For a broad, and early, discussion of market failures in new media markets, see A Graham and G Davies, *Broadcasting, Society and Policy in the Multimedia Age* (Luton: University of Luton Press 1997). A summary of these points can be found in Department of Culture, Media and Sport, *The Future Funding of the BBC: Report of the Independent Review Panel* (chair Gavyn Davies) (London: DCMS July 1999).

14 N Garnham, “The broadcasting market and the future of the BBC” (1994) 65 *Political Quarterly* 1, pp. 13–14.

pro-competitive, it can also result in foreclosure of rivals (both at the levels of production and distribution), leading to less diversity.

With the advent of digital television, spectrum scarcity is no longer an issue and, so, one might expect greater choice and diversity in broadcasting. Some have suggested, however, that audience fragmentation results in greater homogeneity in content as the incumbent suppliers, who still capture around 80 per cent of linear television audiences, become less willing to take risks for fear of losing audience share and, in turn, advertising revenue. The empirical evidence on this point is, however, ambiguous.¹⁵

There may also be strong efficiency arguments against using charging mechanisms in broadcasting. Broadcast programmes are public goods in the sense that one person's consumption does not rival another's (non-rivalrous and non-excludable).¹⁶ Exclusion here does not turn on the ability to exclude through a pricing mechanism, rather it denotes that the welfare maximising strategy will be not to exclude.¹⁷ In the economic parlance, this is because once a programme has been produced, absent distribution costs, the marginal cost of supplying an additional viewer will be zero. A strategy of fragmenting the audience through subscription has the perverse result of raising the cost to all those at the margin and, in turn, removing more people at the margin.¹⁸ This is a powerful market failure argument for those contending that broadcasting should be underpinned by the universality principle. On the other hand, it is the case that allowing charging generates profits and revenues that may be used to fund better upstream production, leading to higher quality content.

One further issue arises which appears to often fall off the agenda – the interests of viewers as consumers. While broad entreaties are made towards the importance of consumer sovereignty and respecting consumer choice, very often the interests of commercial operators and of viewers (even when narrowly defined as consumers) are seen as coterminous. We see later in one of our cases the very real danger of making this a priori assumption; in the *Local Video* case the ability of the BBC to meet existing product demand was not in question, but commercial interests were given priority, in the short term at least. Indeed, under the present regulatory structure, one which imposes upon the BBC so-called “fair trading obligations”, there is the danger that the careful balance between type I and type II errors is being disturbed in favour of outcomes which seek to ensure that markets are kept open to commercial operators, even if this results in harm to consumers.¹⁹

Even within the narrow consumer welfare rubric, the advent of technologies which allow broadcasters to efficiently price-discriminate while reflecting consumer preferences (i.e. through willingness to pay) has a number of important welfare effects: it results in a transfer of rents from consumers to producers (which may meet a total welfare standard, but would hardly satisfy a consumer welfare standard, the latter being the relevant one for European and UK law); it results in the preferences of those willing to pay being met while

15 See Hargreaves Heap, “Television in a digital age”, n. 10 above, pp. 119–20, for a brief review of the literature.

16 Garnham, “The broadcasting market”, n. 14 above, p. 13; Helm “Consumers, citizens and members”, n. 4 above, p. 7.

17 Garnham, “The broadcasting market”, n. 14 above, p. 13; Helm “Consumers, citizens and members”, n. 4 above, p. 8.

18 Helm “Consumers, citizens and members”, n. 4 above, p. 8.

19 A type I error simply means a false positive (in this context, an incorrect finding that something is welfare-reducing), while a type II error is a false negative (an incorrect finding that something is welfare-enhancing or neutral). In competition law, there are many contexts where a competition authority is dealing with firm conduct that may have ambiguous welfare effects and, in deciding whether or not to intervene, it will need to balance the probability that it will make a mistake against any expected welfare benefits of intervening. Note, however, that the strong obligation upon the BBC to refrain from activities which harm commercial rivals will mean that less emphasis is being placed on the positive effects such activities may have on viewers/consumers.

those unwilling to pay (at the market price) are denied provision; and price is only a proxy for utility (i.e. that markets suffer from a common problem that they are based upon prior entitlement). This is not to say that these pricing mechanisms cannot be justified on welfare grounds, only that the rubric for assessing the welfare consequences of intervention are very much more complicated than is sometimes supposed.²⁰

A BROADER CONCEPTION OF PSB?

So, there are strong reasons to suppose that digital television will remove market failures and leave untouched or exacerbate existing ones, as well as possibly introducing new ones, which in turn require control. There is a second line of defence, however, which goes to the very root of the justification for intervening in support of PSB: to view the public interest case for intervention in broadcasting markets through solely the narrow focus of a market paradigm based on consumer sovereignty ignores many other very important societal and cultural justifications.²¹ As Prosser and Born put it in a seminal article on PSB:

[T]he cultural and citizenship purposes usually taken to characterise the normative basis of PSB should be primary, and not subordinate to economic and commercial criteria in determining the future of such broadcasting.²²

It is often said that broadcasting services are “dualist” goods, in the sense that they are both commercial and cultural products.²³ PSB should, therefore, be seen to have a wider role than simply filling in the “gaps left by market”; it may play an important role in shaping preferences prior to the market. It is clear also that universality can be argued to be a core value. There is a key danger that, while new technologies have the potential to bring benefits to viewers, when provided on the basis of willingness *and ability* to pay, there is also the potential to exclude, with all the attendant costs that will attract both for those individuals and for society more broadly. Furthermore, if it is true to say that a pure market model of broadcasting will likely lead to high levels of homogeneity and a concentration of providers, then social and cultural diversity will suffer. Raising levels of quality is also often cited as a core justification for PSB, and the BBC in particular. Rather than dampening competition, the BBC can “raise the game” because it has the capacity to give priority to production values over the constraints of the market.

The sustainability of PSB has been questioned. This argument turns on audience behaviour; investment can be made in the provision of PSB content, but this has little value if consumers cannot be persuaded to watch it.²⁴ In answer to this problem, proponents of PSB reply that this justifies a model of PSB based on a mixture of programming, with entertainment genres scheduled alongside more educational and informative content.²⁵

20 Because of the ability to price-discriminate, such that viewers' surpluses can be extracted, commercial broadcasters have an incentive to deliver a diverse range of programmes (M Armstrong and H Weeds, “Public service broadcasting in the digital world” in P Seabright and J von Hagen (eds), *The Economic Regulation of Broadcasting Markets: Evolving technology and the challenges for policy* (Cambridge: CUP 2004), pp. 81, 115–19.

21 For a defence of PSB, see S Pratten and S Deakin “Commentary: the scope of public service broadcasting” and C Fairburn “Commentary: why broadcasting is still special” in Peacock (ed.), *Public Service Broadcasting*, n. 12 above, pp. 8 and 58 (respectively).

22 Born and Prosser “Culture and consumerism”, n. 3 above, p. 659.

23 See, for example, the Directive 2010/13/EU on Audiovisual Media Services (Codified version) [2010] OJ L95/1, recital 7.

24 Armstrong and Weeds, “Public service broadcasting”, n. 20 above, pp. 115–19.

25 Born and Prosser, “Culture and consumerism”, n. 3 above.

CONCLUSION

In language which resonates with Polanyi's warning over disembodiedness, Helm states:

Markets . . . exist within a *social* context, with all its politics, freedoms and cultures, rather than the other way around. At stake here is something very fundamental. In discussing [PSB], whilst economics and the market failure framework have a great deal to offer, their universalisation of the problem should not simply be assumed.²⁶

A broad definition of market failure, which embraces the importance of the market being embedded in society, might accommodate many of the public interest goals underpinning the broader conception of PSB. The scope of market failure and, therefore, the justification for intervention, in itself depends upon what we want markets to deliver – merely consumer demand or broader public interest goals.

There is a threat to the future of PSB to the extent that it lacks a clearly articulated rationale, especially when broader public interest values come up against the apparently “hard” values of competition law, with a strong presumption in favour of undistorted markets.²⁷ It goes without saying that market-orientated norms are highly juridified, both at a supranational and national level (these are touched upon briefly in section 4). The difficulty comes where a market-orientated solution will not deliver up, or even conflicts with, the broader public interest goals being pursued under a PSB intervention. So consider, for example, the question of whether a market distortion is proportionate to the pursuit of a PSB value (one of the planks of the public value test explained below). How can the question of proportionality be decided without a clear idea about the goal being pursued and its relative importance within the hierarchy of PSB norms? Furthermore, the lack of a clearly articulated rationale also raises accountability problems and the risk that the institution(s) charged with delivering PSB will seek to forward their own narrow organisational interest at the expense of the broader public interest. While market failure does have to be judged against the possibility of governmental failure, the relevant counterfactual, the latter is more likely to occur, or will be more serious, the less defined is the public service remit. The position in the UK has been contrasted unfavourably with other European countries where PSB has been elevated to constitutional principle.²⁸

The future direction of PSB depends crucially upon which rationale predominates. If market failure is the exclusive justification for intervention, then any action which the BBC takes in entering new markets must be judged against what would (might) happen without entry (the need to avoid market failure paradox). On the other hand, if it is based on the broader public interest notions of citizenship, universality and cultural diversity, then market-based norms must *ultimately* give way.²⁹

3 The BBC's incentives and ability to distort new markets

It may seem counterintuitive to suggest that a public firm will have an incentive to act anticompetitively, especially where its primary objective is not profit maximisation. Indeed, it seems reasonable to suppose that a public firm would act less aggressively towards its

26 Helm “Consumers, citizens and members”, n. 4 above, p. 4 (original emphasis).

27 Born and Prosser, “Culture and consumerism”, n. 3 above, p. 659.

28 See *ibid.* p. 661. See R Craufurd-Smith, *Broadcasting Law and Fundamental Rights* (Oxford: Clarendon Press 1997).

29 This is not to suggest that markets cannot deliver cultural diversity, merely that, given the market failures explained above, they are less likely to do so without some form of public intervention. What form that intervention should take is a question beyond the scope of this article.

competitors than would a private, profit-maximising firm.³⁰ It has been posited, however, that public firms often have *stronger incentives than private firms* to pursue market strategies which harm their rivals. Moreover, it is precisely because the firm is motivated by objectives distinct from profit maximisation that such strong incentives exist.³¹

The literature in this area turns on the assumption that a public firm has the objective or incentive to maximise output (or revenue), rather than profit. There are a number of reasons for this. First, it might be that the public firm is statutorily mandated to maximise output. The BBC's public purposes are clearly underpinned by the requirement of universality and, further, the licence fee would be vulnerable were the BBC not able to demonstrate that it has broad appeal. Another might be that the government is using the BBC in order to pursue broader social objectives (for example, redistributive goals, by making lower-priced products available to consumers).³² Here too, with particular relevance to new media markets, the BBC has a specific purpose to encourage the use of new communications technologies across the population.³³

The BBC certainly enjoys benefits over and above many of its commercial counterparts. As a result of the licence fee, it has the advantage of stable and high levels of funding, a strong brand, and is able to cross-promote its (new) services across its numerous outlets. Some have argued that it has engaged in "crowding out" commercial operators in certain key markets.³⁴ The Culture, Media and Sport Select Committee has been consistently critical of the BBC's commercial operations, and its record of harming competitors and distorting markets.³⁵ As a result of such criticisms, the BBC Trust has laid down a number of limiting principles and oversight mechanisms governing the BBC's commercial operations.³⁶ In recent times, the regulatory framework governing the BBC's entry into new markets has been considerably strengthened and augmented. This stems from the EU's interpretation of the state-aid rules, and from pressure from increasingly powerful commercial operators.

4 The regulatory framework governing the BBC

THE APPLICATION OF THE GENERAL COMPETITION RULES TO THE BBC

The BBC is subject to the general competition law. For example, any joint ventures it enters into are subject to control under the prohibition on anticompetitive agreements and the merger laws. With respect to the latter, the UK Competition Commission recently

30 This appears to be the view of the US Supreme Court, see D Geradin and J G Sidak, "The future of the postal monopoly: American and European perspectives after the Presidential Commission and *Flamingo Industries*" (2005) 28 *World Competition* 161, pp. 186–9.

31 For a number of different examples from the US, see R R Geddes, "Case studies of anticompetitive SOE behavior" in R R Geddes (ed.), *Competing with the Government: Anticompetitive behavior and public enterprises* (Stanford: Hoover Institution Press 2004), p. 27. Despite its apparent importance, this is an area which is rarely the subject of research (D E M Sappington and J G Sidak, "Review: are public enterprises the only credible predators?" (2000) 67 *University of Chicago Law Review* 271, p. 283).

32 The Universal Service Obligation in postal services is a classic example.

33 Beyond this, the public choice literature points to the possibility that public firms may engage in bureau shaping; that is, given that managers are not constrained by the discipline of the capital market, which would likely remove them were they not maximising profit, they may instead seek to maximise output because of all of the attendant benefits in terms of salaries and prestige. For a discussion, see J Lott "Predation by public enterprises" (1990) 43 *Journal of Public Economics* 237, pp. 240–1.

34 See, for example, M Cave et al., "Regulating the BBC" (2004) 28 *Telecommunications Policy* 249.

35 See, for example, House of Commons, Culture, Media and Sport Committee, *Fifth Report of 2008–2009: BBC Commercial Operations* (London: The Stationery Office 2009), HC 24.

36 BBC Trust, *Commercial Operations* (November 2009), available at www.bbc.co.uk/bbctrust/our_work/other/commercial_activity.shtml (last accessed 27 April 2011).

prohibited a joint venture between the BBC and other PSB providers to make available their back catalogue of programmes over the internet.³⁷

The competition rules do, however, need to be interpreted in accordance with Protocol 29 of the Treaty on the Functioning of the European Union (TFEU)³⁸ which reserves a special place for public broadcasting and states that the provisions of the treaty – including the competition rules – shall be “without prejudice to the competence of Member States to provide for the funding of public service broadcasting”.³⁹

More broadly, PSB may benefit from the coverage of Article 106(2) TFEU which provides that undertakings entrusted with the operation of “services of a general economic interest” will not be subject to the competition rules in so far as their application would obstruct the performance of the tasks assigned to them.⁴⁰ This is subject to the general qualification that “[t]he development of trade must not be affected to such an extent as would be contrary to the interests of the Union”. In the landmark *Altmark* case,⁴¹ the European Court of Justice laid down four cumulative criteria which must be satisfied in order for the undertaking to benefit from the coverage of the provision.⁴² Where these criteria are not satisfied, the rules on state aid (Article 107 TFEU) are engaged, with the requirement that the member state must notify the European Commission of any new service which is being funded by public subsidy. The rules generally prohibit, subject to derogations, the use of public subsidies which have a market-distortionary effect.

Several complaints have been made against the BBC under these provisions, on the provision of new digital channels, and on the involvement of the BBC in the provision of interactive learning materials to homes and schools.⁴³ None of these cases were found to transgress the competition rules. Nonetheless, these cases, together with others, do underline the importance of defining PSB clearly, not least in order for commercial operators to have some level of certainty over whether a state-supported broadcaster might enter a market at some later date. On this point, Harrison and Woods lament:

Defining PSB runs the risk of ossifying it and therefore preventing change, innovation and growth. This is because either a member state defines PSB too narrowly, forcing a PSB provider to go beyond its proper remit if it is to retain viewers in a changing broadcast environment; or the member state defines PSB too broadly, so as to exceed its competence in the view of the Commission.⁴⁴

37 Competition Commission, *Anticipated Joint Venture between BBC Worldwide Limited, Channel Four Television Corporation and ITV plc* (London: Competition Commission 2009).

38 Protocol 29 is generally referred to as the Amsterdam Protocol.

39 The protocol enters two key qualifications: first, the funding must be granted for the fulfilment of a defined public service remit; and the funding does not affect trading conditions and competition in the EU to an extent which would be contrary to the common interest.

40 For more detail on the application of the state-aid rules to PSB providers, see J Harrison and L Woods, *European Broadcasting Law and Policy* (Cambridge: CUP 2007), ch. 13; T Prosser, *The Limits of Competition Law: Markets and public services* (Oxford: OUP 2005), ch. 9; I Katsirea, *Public Broadcasting and European Law* (Netherlands: Kluwer 2008).

41 *Altmark Trans GmbH and Regierungspräsidium Magdeburg v Nahverkehrsgesellschaft Altmark GmbH*, and *Oberbundesanwalt beim Bundesverwaltungsgericht* (C-280/00) [2003] ECR I-7747.

42 First, it must be required to discharge a clearly defined public service. Second, the parameters for compensation must be established in advance in an objective/transparent manner. Third, compensation cannot exceed what is necessary (net commercial receipts/reasonable profits). Fourth, where there is no public procurement procedure, the level of compensation must be no more than required to cover the costs of a typical, well-run undertaking.

43 *BBC News 24* (N 88/1998) [2000] OJ C/78; *BBC Licence Fee* (N 631/2003) [2003] C23/6; *BBC Digital Curriculum* (N 37/2003) [2003] C 271/06.

44 Harrison and Woods, *European Broadcasting Law and Policy*, n. 40 above, p. 311.

They characterise the approach of the Competition Commission in the past as being one where the interests of commercial operators seem to be protected without any focus upon the consequences for viewers.⁴⁵

While the need for defining PSB, as a matter of EU law, has not receded, the European Commission has made its position clearer, recently issuing the *Communication on the Application of State Aid Rules to Public Service Broadcasting*, with guidance on the diversification of PSB providers into new media markets.⁴⁶ This would appear to have the clear advantage of leaving the assessment of state-aid compliance with member states, in the first instance at least.

The guidance admits the need for PSB providers to enter new media markets, including digital and new markets not traditionally viewed as programming (e.g. internet, video-on-demand (VOD), etc.). This is, however, subject to a series of substantive and procedural safeguards. The use of state aid to support such entry must address the democratic, social and cultural needs of society, and must not entail disproportionate effects on the market which are not necessary for the fulfilment of the public service remit. Member states must have in place mechanisms to monitor PSB providers entering new markets, and arrive at a balanced, reasoned decision which takes into account the interest of commercial operators. It must include an assessment of the impact on the market in question against a counterfactual of non-entry by the PSB provider; the assessment must include inter alia an analysis of existence of substitutable offers, the potential for commercial exploitation, and the crowding-out of private initiatives. The decision must be made by a body independent of management (but internal control is permissible). Other safeguards include the avoidance of over-compensation and cross-subsidisation of public and non-public activities, and the need for universality should be balanced against possible negative effects of funding, including the deterrence of entry, innovation and investment.

No doubt some might criticise the guidance as placing too much emphasis on protecting commercial operators, it does at least provide a clear framework for an assessment at member-state level, while at the same time making clear, as a matter of principle, that PSB providers have a future in new media markets.

THE FRAMEWORK FOR REGULATING THE BBC'S ENTRY INTO NEW MEDIA MARKETS

The procedural and substantive rules under the state-aid regime are given expression through the regulatory controls imposed on the BBC under the Framework Agreement. The latter contains detailed rules on the role of the BBC Trust and the media regulator Ofcom in deciding whether or not the BBC should launch a significant new offering in pursuance of its public purposes. The agreement contains a list of UK public services – including its internet offerings – and significant changes or expansions to these services must first be subject to a public value assessment (PVA) and a market impact assessment (MIA), the latter undertaken by Ofcom. The PVA assesses the value licence fee payers would attach to a new service (or change to a service), its contribution to the BBC's public purposes, and the value for money it represents. The MIA assesses principally the effect on commercial players in the markets in question. The BBC Trust will then apply the public value test (PVT) which provides that before giving consent:

[T]he Trust must be satisfied that any likely adverse impact on the market is justified by the likely public value of the change . . .⁴⁷

45 Harrison and Woods, *European Broadcasting Law and Policy*, n. 40 above, p. 311.

46 [2009] OJ C 257/01.

47 Department of Culture, Media and Sport, *Broadcasting: An Agreement between Her Majesty's Secretary of State for Culture, Media and Sport and the British Broadcasting Corporation* (London: TSO 2006), Cm 6872, cl. 26(6) (hereafter the Framework Agreement).

There is separate provision made for the launch of a non-service activity. This is a new service which is not contained on the list of UK public services, but nevertheless contributes to the BBC's public purposes.⁴⁸ In such a case, the BBC Trust has discretion whether or not to conduct a full PVT, but is still required to have regard to public value and market impact. There is no requirement to engage Ofcom in this exercise, a somewhat curious anomaly given that the provision of these services does not have any explicit legislative backing.

The BBC Trust is also required to make a competitive impact statement.⁴⁹ Within this document, the Trust has stated that approvals for non-service activities will only be granted where it is satisfied that "the BBC has endeavoured to minimise its negative competitive impacts on the wider market, whilst always ensuring the fulfilment of the BBC's Public Purposes".⁵⁰

5 The BBC's entry into new media markets: two case studies

The principal purposes of these two case studies, concerning the entry by the BBC into new media markets, is to explore the application of the BBC's rules on entry into new media markets in order to analyse the extent to which the need to minimise market distortions is given priority over the public interest, or vice versa.⁵¹ In the first case, the Trust appeared to give disproportionate weight to the interests of commercial rivals, while the second can be characterised as a retrenchment of the priority of public interest goals.

The *Local Video* case⁵² originated with an application by the BBC to launch a bespoke broadband local news and sports service, in 60 areas, over its current local websites. The BBC management claimed that the proposition would promote two of its public purposes – sustaining citizenship and civil society, and representing the UK, its nations, regions and communities – contributing to the closure of a significant performance gap with respect to the latter.⁵³ This "purpose gap" was said to be becoming more pronounced with shifts in audience attitudes and behaviour, particularly the value attached to "localness" in content and the increase in demand for on-demand news:

Local Video will reinvent the BBC's regional/local news offer: compensating for the decline in the reach of the BBC's regional TV audiences, attracting a younger demographic to local news and deepening users' appreciation of the *BBC Local websites*. It will preserve the BBC's valued provision of local news – a role the BBC has played ever since its foundation as a group of local radio stations in 1922 – in an on-demand age.

48 Framework Agreement, cl. 22.

49 Framework Agreement, cl. 66. See BBC Trust, Statement of Policy on Competitive Impact: Competitive impact framework (June 2007) available at www.bbc.co.uk/bbctrust/our_work/protocols_policy/competitive_impact.shtml (last accessed 27 April 2011).

50 BBC Trust, *Statement of Policy on Competitive Impact*, n. 49 above, p. 8.

51 There are a number of other cases decided under this framework: BBC Trust, *BBC Trust final conclusions on BBC Participation in a "Freesat" proposition* (April 2007) – concerning the BBC's involvement in a joint venture offering FTA digital television via satellite; BBC Trust, *BBC high definition television channel: public value test final conclusions* (November 2007) – considering the launch of a BBC HD channel; BBC Trust, *Gaelic digital service: public value test final conclusions* (January 2008) – concerning proposal to launch a dedicated digital TV channel in Gaelic; BBC Trust, *BBC mobile apps: Trust final decision* (July 2010) – concerning the provision of BBC services over smart phone applications. All available at www.bbc.co.uk/bbctrust/our_work/index.shtml (last accessed 28 July 2011).

52 BBC Trust, *Local Video public value test, final conclusions* (February 2009), available at www.bbc.co.uk/bbctrust/our_work/pvt/local_video_proposal.shtml (last accessed 27 April 2011).

53 BBC, *BBC Management's assessment of the public value of its Local Video proposals* (June 2008), available at www.bbc.co.uk/bbctrust/our_work/pvt/local_video_decision_supporting.shtml (last accessed 27 April 2011).

After a lengthy investigation, comprising both a PVA by the Trust and a MIA by Ofcom, permission to launch the new service was declined. The Trust relied primarily upon the limited public value of the proposal. Chief among the considerations was the lack of universality, that is that the service would fail to reach certain key audiences, particularly those in rural areas and those on low incomes, partly due to the limited availability and take-up of broadband among those groups. It also questioned the potential demand among younger user groups, especially given that the content did not extend to general entertainment, listings and reviews.

Ofcom's MIA pointed to a number of potential negative impacts on commercial providers, particularly local newspapers, and the prospect for them to monetise the provision of online video content.⁵⁴ The difficulty for Ofcom was that this was very much a nascent market with few newspapers having successfully launched their own local video services. As it readily admitted, predicting the future in the face of so many uncertainties posed particular difficulties,⁵⁵ and while it was possible to estimate the static effects of the proposal on revenues for commercial operators,⁵⁶ it was not possible to quantify "in any meaningful way" the dynamic effects.⁵⁷ The latter would result from the BBC's dominant presence in the new market for local video content since commercial operators would not be capable of operating at anything like an equivalent scale.⁵⁸ Ofcom concluded that the dynamic effects could be "substantial".⁵⁹ Nevertheless, a counterfactual – how would this market develop absent entry by the BBC? – was particularly difficult to predict; it was "possible, but by no means certain, that at least some [local newspapers] will develop substantial online services".⁶⁰

Taking both the PVA and negative market impacts identified by Ofcom together,⁶¹ the Trust concluded that the permission for the new service would not be granted. Instead, the resources for the project should be redirected towards the enhancement of the BBC's current linear television and local radio services.

The case can be criticised on a number of different grounds. First, it was clear that the counterfactual being forwarded by the commercial operators was illogical. On the one hand, they were pointing towards a significant and persistent decline in revenues over time, and characterising this emergent market as potentially creating new revenue streams for them. Yet, it is difficult to see how, in the light of their parlous finances, they would be able to invest substantially in new offerings over the internet, or how such services could generate new revenue streams in the light of fierce competition for internet advertising. A rigorous analysis of the counterfactual should also have included the negative effects on consumers of leaving demand for these new services unmet, at least for the foreseeable future. Second, as was pointed out by a number of respondents to the Trust's consultation, this gave the BBC an opportunity to reconnect with younger audiences. Others pointed to the potential for the BBC to fill the gap left with the scaling back of the commercial broadcasters' local news

54 Ofcom, *Market Impact Assessment of the BBC's Local Video Service: Statement* (November 2008), available at www.bbc.co.uk/bbctrust/our_work/pvt/local_video_decision_supporting.shtml (last accessed 27 April 2011).

55 Ibid. para. 2.4.

56 Principally the effect of a fall in newspaper sales as a result of the service.

57 Ofcom, *Market Impact Assessment*, n. 54 above, para. 2.95.

58 Ibid. para. 2.96.

59 Ibid. para. 2.103.

60 Ibid. para. 2.99.

61 BBC Trust, *Local Video public value test, final conclusions*, n. 52 above, para. 3.1.4.

provision and the falling quality of the local press. The Trust, however, was of the view that it would have limited appeal to the young, despite evidence to the contrary from Ofcom.⁶²

The *Project Canvas* case appears to represent a more robust assertion of the public purposes.⁶³ It originated with an application in November 2008 from the BBC Executive for permission to participate in a joint venture that would set and promote a common standard and user-interface for the delivery of on-demand TV and other internet content through a broadband connected device. The relative contribution of the BBC in financial terms was small, but by frontloading of its stake, investing in research and development, and bringing credibility to the proposition, the participation of the BBC was clearly of central importance. This was underlined by the experience of the launch of the BBC's VOD proposition (the BBC iPlayer), which remains one of the leading products in the market. Objections to the proposition came from those who were in the process of developing alternative hybrid platforms, and two pay-TV operators that offer VOD services over their platforms.

Controversially, the BBC Trust determined that the proposed activity was a non-service activity, with the consequence that it, rather than Ofcom, would conduct the MIA. The joint venture involved all of the other public service broadcasters, two telecommunications firms and a communications infrastructure provider. The proposition if approved would provide a successor to Freeview (the digital terrestrial platform in which the BBC also plays a leading role) and would not be subject to any subscription fee. It would bring a new dimension to FTA television, allowing such viewers the ability to access VOD services, including the BBC iPlayer and cognate services offered by the other public service providers. Currently, other than over the internet, such services are generally limited to subscription platforms.

After a lengthy consultation process, the BBC Trust eventually settled upon allowing the BBC to participate in the joint venture, subject to a number of conditions intended to limit the negative impact on other industry players and as a means of securing compliance with competition law, particularly the state-aid rules.

The Trust's PVA concluded that the proposition was consistent with the furtherance of the BBC's public purposes (in particular the sixth, helping to deliver the benefits of digital communication technologies), represented value for money and was in the interests of licence fee payers.⁶⁴ It considered this against the counterfactual of what would happen absent the proposal. There was considerable controversy over whether it was necessary for there to be a common user-interface (UI) in order to fulfil the public purposes being pursued. The MIA had revealed that mandating a single UI and linking that to the Project Canvas brand would reduce the incentives of other potential entrants to innovate and invest in alternatives, as well as having the potential for the BBC and other joint venture partners the opportunity to give undue prominence to their VOD services, to the detriment of other content providers.⁶⁵ Other broader negative impacts were noted, including the potential to reduce the subscription base for pay-TV operators offering such services, either currently

62 Ofcom, *Market Impact Assessment*, n. 54 above, para. 2.13. Ofcom's own research found that around half of broadband users surveyed indicated that they would either definitely or probably use the new service, and this did not vary significantly between age groups. It did note, however, the propensity of respondents to overstate their potential interest in the service.

63 BBC Trust, *Canvas proposals, final conclusions* (June 2010), available at www.bbc.co.uk/bbctrust/our_work/canvas/ (last accessed 27 April 2011).

64 BBC Trust, *Canvas, public value assessment* (December 2009), available at www.bbc.co.uk/bbctrust/our_work/television/canvas_provisional_conclusions.shtml (last accessed 27 April 2011).

65 BBC Trust, *Canvas, Market Impact Assessment* (December 2009) available at www.bbc.co.uk/bbctrust/our_work/television/canvas_provisional_conclusions.shtml (last accessed: 27 April 2011).

or in the future.⁶⁶ In balancing the two assessments against each other, and consistent with the regulatory framework, the Trust noted that some negative impacts could not be mitigated without compromising the delivery of the public purposes. This was true in particular of the use of a common UI, which established a “simple upgrade path” for viewers, providing choice and reducing confusion, offering a consistent experience from one box to another and enhancing accessibility.⁶⁷ In this regard, the Trust privileged the interests of viewers over those of commercial operators.

The Trust did, nevertheless, make the approval of the BBC’s involvement subject to a number of conditions. With respect to the drawing-up of the standard, it required that there was sufficient time for industry consultation before launch, notwithstanding the joint venture partners’ concerns that this might result in a delay in bringing the product to market.⁶⁸

Concerned with raising barriers to entry from third-party content providers, the joint venture partners’ could not impose editorial controls on content beyond those required by law, inconsistent with the original proposition which had proposed controls consistent with PSB values. The Trust also stipulated that access to Project Canvas branded platforms should be on a cost-recovery-only basis and, in response to concerns that undue prominence would be given to the PSB partners, listing on the electronic programme guide and the UI would be awarded on a fair, reasonable and non-discriminatory manner.

Syndication was another particular concern. According to competing platform providers, the PSB partners’ participation in the joint venture would reduce their incentives to syndicate their content and they might tacitly engage in a common syndication strategy to the disadvantage of rival platforms.⁶⁹ The Trust sidestepped this issue alluding to a separate review being undertaken of the BBC’s syndication policy, although it did signal that it would be particularly concerned if any the PSB partners refused to syndicate their content to third parties without objective justification, especially given the “nascent” state of this market.⁷⁰

The Trust had clearly been concerned with state-aid laws, given the public source of its funding and the “very high level of assurance” that it sought that the BBC’s involvement was compliant.⁷¹ To this end, there had to be no subsidy given to the joint venture partners. Two issues were of particular concern. The first related to the front-loading of the BBC’s contribution to the joint venture, which might be characterised as shifting the investment risk disproportionately upon it. The second issue concerned the research and development expenditure which the BBC had undertaken before the entry of the other commercial partners. With respect to the latter, and despite being contrary to the advice of independent auditors, the Trust required a contribution from the other partners. It also stipulated that any frontloading of the BBC’s contribution should be treated as a loan subject to repayment on the “market economy investor principle”, thereby reflecting the cost of any additional risk.

These two cases have been used to demonstrate how the BBC has to justify clearly the public benefits resulting from entry into new media markets. As was stated at the outset, if

66 Positive market impacts were also noted, such as the increase in broadband demand, and the increased competition in the triple-pay markets (i.e. where telephone, broadband and TV services were offered together).

67 BBC Trust, *Canvas Proposals, final conclusions*, n. 63 above, para. 3.8.

68 Ibid. para. 4.23.

69 A similar concern had been raised by the Competition Commission in the *Project Kangaroo* decision, n. 37 above.

70 BBC Trust, *Canvas Proposals, final conclusions*, n. 63 above, para. 4.87. Virgin nevertheless pursued this issue in a competition law complaint to Ofcom which declined to open an investigation. Ofcom Press Release, “No investigation into Project Canvas”, 19 October 2010, available at <http://media.ofcom.org.uk/2010/10/19/no-investigation-into-project-canvas/> (Last accessed 28 July 2010).

71 BBC Trust, *Canvas Proposals, final conclusions*, n. 63 above, para. 4.105.

PSB is to be sustainable over time then the BBC must be permitted to have a central presence on new platforms and innovations in delivery. If PSB is broader than simply correcting market failure, then the pursuance of the BBC's public interest remit must take priority over any necessary market distortions and the interests of commercial operators. The Trust clearly has a difficult task and is subject to much criticism, especially from the commercial media, whose interests are often implicated in its decisions. The *Project Canvas* decision appears to suggest that, while cognisant of the need for state-aid compliance, the Trust is willing to give priority to the public purposes even if this prejudices the interests of commercial operators.

5 Conclusions

As the European Parliament recently observed, the future of PSB lies in new media markets.⁷² The difficulty for PSB providers in the UK and other jurisdictions is that the entry of a PSB provider into these markets will often rely upon a prospective analysis. The rationale for PSB – market failure or broader public interest goals – has a key bearing upon the outcome of such an assessment. If the market failure rationale is the exclusive justification for intervention, this would suggest that entry into new media markets should only occur when *and only when* it can be demonstrated that commercial operators will not enter or develop the market. With respect to nascent markets, this may require a wait-and-see approach, as in the *Local Video* case, with obvious adverse consequences for consumers in terms of unmet demand. It also implies only a residual (and receding) role for PSB providers. On the other hand, if PSB is underpinned by a broader public interest rationale, then entry should only be prevented if the market will deliver an equivalent level of service, range and quality, and within a reasonable timeframe. The *Project Canvas* decision more closely reflects the latter approach.

Focusing on the subject of this article, the control of the BBC's new market entry is subject to a curious regulatory framework. First, some have questioned the independence of the BBC Trust; it is entrusted with the apparent incongruous task of being an economic regulator, while at the same time is perceived to be the champion of the BBC and its interests.⁷³ The alternative might be to assign its powers to the media regulator, Ofcom, although this might lead to a pro-market bias. Second, the level of scrutiny as between service and non-service activities appears anomalous, being more intense where the activity is one where the BBC has an explicit legislative mandate. Third, the processes could hardly be characterised as being streamlined, and the need to conduct such an in-depth analysis might in itself constitute a significant barrier to entry.⁷⁴

On the substantive side, there are a number of problems with the way in which the rules are being applied. Market distortions appear to be the core concern, yet competition and markets are a means to an end and not an end in themselves. This issue is especially present in the MIA which only looks at the effects of the BBC's entry on commercial

72 European Parliament resolution of 25 November 2010 on PSB in the digital era: the future of the dual system (2010/2028(INI)), available at www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P7-TA-2010-0438+0+DOC+XML+V0//EN#def_1_1 (last accessed 27 April 2011).

73 House of Lords, Select Committee on Communications, *The Governance and Regulation of the BBC* (London: The Stationery Office), HL Paper 166.

74 In the *BBC Jam* case, the BBC Trust refused to renew a permission for the BBC to continue with a service on the basis that complaints by commercial operators would trigger the need for a full review: "A complex and costly review, in addition to the full review of the service to which the Trust was in any case committed, is not a commonsense way of securing value to licence fee payers." BBC Trust Press Release "BBC Trust suspends BBC Jam", 14 March 2007, available at www.bbc.co.uk/bbctrust/news/press_releases/2007/march/14_03_2007.shtml (last accessed 28 July 2011).

competitors rather than asking, it is submitted, the overriding question of the net welfare effects on consumers.

This article has been concerned with the underlying rationale for PSB in the context of new media markets. It is not concerned with how those values should be pursued; in the alternative to state funding, there may be other ways of regulating markets in the public interest so as to ameliorate the effects of market failure.

Ultimately, everything turns on the justification for PSB. Market failure is not and should not be seen to be the exclusive justification for intervention. Even if it were, however, market failures still remain. Tendencies towards concentration, a lack of diversity, and the undersupply of programmes crucial to democracy and a culturally rich society are all still present in the digital environment. Whichever rationale is correct, media markets cannot be disembedded. This is as true now as it has ever been. Going forward, we need a confident vision of PSB where the market is subordinate to the public interest.