

Review of the BBC's *Fair Trading Commitment and Commercial Policy Guidelines*

In its response to the Davies panel's report on the future funding of the BBC, the Government announced that it would, jointly with the BBC, invite an independent expert to carry out a review of the BBC's Fair Trading Commitment and Commercial Policy Guidelines. The review was undertaken by Richard Whish, Professor of Law at King's College, London. His report was published in May 2001.

The full text of the report is attached. Its main conclusion was that 'the BBC's Fair Trading Commitment and the Guidelines are appropriate to ensure that the BBC does not distort competition in commercial markets. It made no substantive recommendations for change. A number of clarifications were suggested and were taken into account when the BBC revised the Guidelines in 2003/04.

Review of the BBC's *Fair Trading Commitment* and *Commercial Policy Guidelines*

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Contents

- 1 Introduction**
- 2 Conclusions and recommendations**
- 3 The adequacy of the BBC's Fair Trading Commitment**
- 4 The adequacy of the specific requirements in the BBC's Commercial Policy Guidelines and whether any further specific requirements should be included**
- 5 The consistency of the BBC's fair trading policies with upholding EU competition law**
- 6 Comparison of the BBC's policies with those of other relevant organisations**
- 7 The position of the BBC Board of Governors in relation to fair trading issues**
- 8 Review of and comment upon existing correspondence from stakeholders to the BBC and the DCMS as to the adequacy of the BBC's Fair Trading Commitment**
- 9 General recommendations**

Appendix A – Terms of Reference

Section 1: Introduction

1.1 The Davies Panel on *The Future Funding of the BBC* (August 1999) recommended that steps should be taken, both in the short term and on a longer time-scale, to provide the necessary assurance that the BBC's accounts are sufficiently transparent and that its fair trading commitment is adequate. The importance of each of these is obvious: as a publicly-funded organisation, the BBC must ensure that it does not use public funds to subsidise its commercial ventures and to distort competition in commercial markets. The BBC must tread a fine line between ensuring value for money for the general public that pays the licence fee, including by raising additional revenue where possible, while refraining from anti-competitive commercial activities.

1.2 I was invited by the Secretary of State for Culture, Media and Sport, by letter of 19 December 2000, to conduct a review of the BBC's fair trading policies and to advise the Secretary of State and the BBC Board of Governors of any recommendations. The terms of reference for this review are set out in Appendix A. Specifically they require me to report having:-

- 'i reviewed the adequacy of the BBC's Fair Trading Commitment;**
- ii considered and commented on the adequacy of each of the specific requirements contained in the BBC's Commercial Policy Guidelines and whether any further specific requirement should be included;**
- iii considered to what extent the BBC's fair trading policies are consistent with upholding EU Competition Law;**
- iv commented on how the BBC's policies compare with those of any other relevant organisations;**
- v commented on the processes through which the BBC Board of Governors are made aware of fair trading issues and the nature of the information provided to them to enable the Governors to be satisfied that all significant issues facing the BBC are appropriately set out in the *Annual Report and Accounts*; and**
- vi reviewed existing correspondence from stakeholders to the BBC and DCMS about the adequacy of the BBC's Fair Trading Commitment, and to comment on the validity of the points made and highlight any other perceived shortcomings.**

The expert is also requested to make any general recommendations for improving the BBC's commitment to fair trading'.

After setting out my conclusions and recommendations in section 2, I shall comment on each of these matters in sections 3 to 9.

1.3 The letter from the Secretary of State specifically states that my rôle 'is not intended to be an auditing exercise of how effectively the internal processes [of the BBC] function': that process is the subject of a separate review being carried out by the British Standards Institute, whereby the BBC is seeking BSI kitemarking for its fair

trading processes under the BS9001 standard. It has been recommended that the Kitemark be awarded.

1.4 To place this review in context, it may be helpful to explain the other actions that have been taken pursuant to the recommendations of the Davies Panel. The kitemarking of the BBC's internal compliance processes was referred to in paragraph 1.1. In addition to this:-

— Pannell Kerr Forster have undertaken a *Review of the Transparency of the BBC's Financial Reporting*, and this report was published on 3 October 2000.

— Separate external auditors have been appointed for fair trading purposes and for the BBC's financial audit. Ernst & Young have been appointed to conduct the fair trading audit, and its first report is understood to be imminent. One function of the external auditors will be to consider how the prices that the BBC charges for its services compare with those in the external market: see paragraph 3.19 of the *Commercial Policy Guidelines*. The BBC's financial audit has been and will continue to be carried out by KPMG.

— The BBC's *Annual Report and Accounts* contains a statement on fair trading: the Report for 1999/2000 contains such a statement at pages 22-23; in future years, the external auditors' report will also be included in this Report.

— A quarterly bulletin is published on fair trading matters, outlining external challenges to the BBC and, where appropriate, the decisions of the Governors; this can be accessed on the Internet.

— The BBC also maintains an internal audit function.

1.5 I wish to emphasise that my review is essentially a 'paper exercise', to comment on the BBC's Fair Trading Commitment and the *Commercial Policy Guidelines* (hereafter 'the *Guidelines*') and related matters. It is not my rôle to comment on particular complaints that have been made about the behaviour of the BBC, although I am of course aware of several complaints that have been made in relation to various matters. I was not asked to engage in a public consultation as to the BBC's behaviour in the market place, and I have not sought representations on this. I have reviewed relevant correspondence in the possession of the BBC and the DCMS in relation to the BBC's Fair Trading Commitment, as I was specifically requested to do by my terms of reference. Some of the correspondence relates to the level of the licence fee: I have not been asked to, and will not, comment on this.

Section 2: Conclusions and recommendations

2.1 I am satisfied that the Fair Trading Commitment and the *Guidelines* are appropriate to ensure that the BBC does not distort competition in commercial markets. I am aware that this conclusion will disappoint some interested third parties, who have serious concerns about various aspects of the BBC's commercial behaviour. However, for the purpose of this review, the relevant question must be whether any conduct complained about was anti-competitive and yet of a kind condoned, or at least not prohibited, by the BBC's Fair Trading Commitment or the

Guidelines. If this were to be the case, it would be appropriate to question each of these instruments. My view is that they do adequately address the fair trading issues that are relevant to the BBC.

- 2.2 In my opinion, the crucial issue is whether the BBC has implemented and will continue to implement an adequate compliance policy to ensure that infringements of the competition rules do not take place. A commitment to fair trading must be supplemented by adequate measures to ensure that compliance is maintained. However the issue of compliance is beyond my terms of reference: see further paragraph 3.3.
- 2.3 I have made some comments on the *Guidelines* in section 4 below. I note that the *Guidelines* will be kept under constant review and amendments brought forward from time to time (see paragraph 5.26). I recommend that the comments in section 4 are taken into account when the next review of the *Guidelines* takes place.

Section 3: The adequacy of the BBC's Fair Trading Commitment

3.1 The BBC's Fair Trading Commitment was adopted in 1995; the key principles are set out in paragraph 3.6 of the *Guidelines*. The key principles in the Fair Trading Commitment are that:-

- commercial activities should comply with clear criteria of what is appropriate for the BBC as a public service broadcaster;
- there should be clear separation between publicly-funded and commercial activities in terms of their operation and accounting;
- commercial subsidiaries or operations must pay fair charges for any goods or services received from the BBC;
- prices charged by commercial activities to their customers should be a fair reflection of both costs incurred and the market practice;
- no public funds must be used, or put at risk, by commercial activities; and
- the BBC's publicly-funded services may not be used unfairly to promote BBC commercial goods and services.

3.2 In my view, these are the correct principles to be complied with by an undertaking in the position of the BBC. Its position is not unlike that of utilities such as telecommunications and postal operators and energy companies which may enjoy a legal or *de facto* monopoly in relation to certain activities and which are usually subject to universal service obligations of various kinds prescribed by law or by agreement with the state. Such undertakings are often subject to sector-specific regulation, and may also be subject to the general provisions of competition law. The BBC is not subject to sector-specific regulation by an independent regulator in the way that telecommunications, postal and energy undertakings are in the UK, although it is of course subject to the requirements of the Board of Governors; the BBC is fully subject to both EU and UK competition law. The principles adopted by the BBC in its Fair Trading Commitment are broadly similar to those that are

applied to these other sectors, in particular that there should be operational and accounting separation of publicly-funded and commercial activities and that cross-subsidy of commercial activities from public funds should be prevented. It is worth adding that the obligation to avoid cross-subsidy between the BBC's publicly-funded and commercial activities is also a requirement of the BBC's Royal Charter and of the Agreement between the BBC and the Government of 1996.

- 3.3 I do not consider that anything needs to be added to the key principles set out in the BBC's Fair Trading Commitment. It seems to me that the crucial issue is whether the BBC is successful in ensuring that the principles in the Fair Trading Commitment (and the guidance provided by the *Guidelines*) are followed in practice. This is an issue of compliance, which is beyond the scope of this review and on which I shall not, therefore, comment. I would have been very concerned if compliance issues were not reviewed following the recommendations of the Davies Panel. However they have been addressed, for example through the BSI kitemarking initiative and the appointment of external auditors referred to in section 1 above; I shall comment in section 7 on the involvement of the Board of Governors and the Fair Trading Audit Committee in relation to compliance.

Section 4: The adequacy of the specific requirements in the BBC's Commercial Policy Guidelines and whether any further specific requirements should be included

- 4.1 In evaluating the adequacy of the *Guidelines*, it seems to me that three questions must be asked. The first is whether the *Guidelines* adequately reflect, and are consistent with, the BBC's Fair Trading Commitment; the second is whether compliance with the Guidelines would prevent the BBC from engaging in anti-competitive behaviour attributable to its position as a publicly-funded organisation; and the third is whether the *Guidelines* are ambiguous or require refinement in order to ensure that they achieve their objective.
- 4.2 As to the first of these questions, the *Guidelines* do reflect and are consistent with the Fair Trading Commitment. It is stated clearly in the Preface that, when trading in commercial markets, the BBC must not use public funds to support commercial activities. This point is frequently repeated throughout the *Guidelines*, for example at paragraphs 1.4, 1.10, 3.3, 3.9, 3.14, 3.17 and 3.27-3.20; Chapter 3 of the *Guidelines* explains the implications of the key principles in the Fair Trading Commitment.
- 4.3 As to the second of the questions posed in paragraph 4.1, my view is that compliance with the *Guidelines* should have as its consequence that the BBC would avoid anti-competitive conduct attributable to its position as a publicly-funded organisation. It seems to me that a transgression of the principles of the Fair Trading Commitment is much more likely to occur because of a failure in compliance than because of any inadequacy in the Fair Trading Commitment or the *Guidelines* themselves. As I have said in paragraph 2.2, my view is that compliance is the key issue in ensuring proper behaviour on the part of the BBC.
- 4.4 The third question to be asked in relation to the *Guidelines* is whether any alterations are required in order to eliminate any ambiguities or to improve them. In considering this question I have taken into account that the *Guidelines* are not, and

should not be, presented in a form which is unduly legalistic or prescriptive. The purpose of the *Guidelines* is to enable the employees of the BBC to understand the essential features of the Fair Trading Commitment and to be able to recognise the circumstances in which fair trading issues might arise; they should also be aware of those situations in which advice should be taken from the Controller, Fair Trading and the Regulatory Legal Department.

- 4.5 As a general proposition, the *Guidelines* are written in a clear and comprehensible style. Chapter 3 deals specifically with fair trading. The core principles of the Fair Trading Commitment are set out in paragraph 3.6: it might be useful to head this paragraph 'Fair Trading Commitment' rather than 'Core Principles', since it is the former rather than the latter term that is used subsequently in the *Guidelines*.
- 4.6 At paragraph 3.16 I wonder if some guidance should be given as to whether there are any circumstances in which the BBC would be required to supply goods or services to third parties, and if so on the need to do so on non-discriminatory terms.
- 4.7 The first and second indents of paragraph 3.17 refer to 'incremental costs' and to a 'reasonable contribution to ... overheads, and to the ... cost of any shared assets'. It would be helpful if this guidance could indicate the relevant time period by reference to which the incremental costs should be calculated (long-run average incremental costs), and also if some guidance could be given on what is meant by 'reasonable'.
- 4.8 The third indent of paragraph 3.17 could be read to suggest that the BBC should align its prices with those of its competitors; if it were to do so, this could be viewed as horizontal price fixing or, at the very least, as tacit collusion. I am sure that this indents not intended to have this meaning but rather to warn that, if the BBC's prices are seriously out of line with the rest of the market, they might be regarded as abusive: hence the terms of paragraphs 3.18 and 3.26. A future revision of the *Guidelines* might benefit from some refinement of this indent to reflect the ambiguity I have referred to in this paragraph. However I do not consider that this needs to be a specific recommendation of this review
- 4.9 The same point can be made about the first indent of paragraph 3.23.
- 4.10 In paragraph 3.23, it might be appropriate specifically to state that a margin squeeze should be avoided.
- 4.11 The *Guidelines* are written very much with the issue of cross-subsidy and the possibility of the BBC charging predatory (below-cost) prices in mind: understandably so, given that a major concern is that the BBC will use licence money to promote commercial activities. However it might be useful to add an additional paragraph (perhaps at paragraph 3.26A) to warn against other abusive practices, such as long-term exclusivity deals, tie-ins, loyalty and other rebating practices and refusals to supply, which might also have anti-competitive effects. These are obliquely referred to in paragraph 3.46, but the *Guidelines* would benefit from a more specific reference to this point.
- 4.12 The wording at the beginning of paragraph 3.39 is misleading: it suggest that the BBC is subject to relevant Competition Law because of the Fair Trading Commitment; it should be amended to make clear that the BBC is subject to

Competition Law, and that the Fair Trading Commitment sets out principles which should help to ensure that it does not act in breach of that law.

Section 5: The consistency of the BBC's fair trading policies with upholding EU competition law

5.1 Subject to the comments that I have made in section 4, my view is that the BBC's fair trading policies are consistent with the principles of EU (and UK) competition law. As I have said in paragraph 2.2, it seems to me that the critical issue is whether the BBC's compliance policies are effective enough to prevent behaviour that could amount to an infringement of the competition rules. The BBC's compliance policies are the subject of separate review, by the BSI and by the BBC's internal and external auditors of its fair trading policies.

Section 6: Comparison of the BBC's policies with those of other relevant organisations

6.1 I am familiar with the compliance policies of many public and private sector undertakings, including several that occupy positions not dissimilar to that of the BBC. In my view the fair trading policies of the BBC compare favourably with those of other undertakings. Indeed, I am not aware of any organisation that is subject to as much scrutiny - internally and externally - to ensure compliance with Competition Law

Section 7: The position of the BBC Board of Governors in relation to fair trading issues

7.1 I am aware of scepticism on the part of some third parties in relation to the BBC's commitment to fair trading, in particular given that the Board of Governors exercises both regulatory functions over its activities while at the same time having responsibility for its strategy. It is manifestly beyond my terms of reference to enter into the debate as to how best the BBC should be regulated. However I am asked to comment on 'the processes through which the BBC are made aware of fair trading issues and the nature of the information provided to them to enable the Governors to be satisfied that all significant issues facing the BBC are appropriately set out in the *Annual Report and Accounts*'.

7.2 The Board of Governors has established a sub-committee, the Fair Trading Compliance Committee ('the FTCC'). The FTCC consists of three members, and is currently chaired by Gavin Davies, who chaired the *Davies Panel* review and who is deputy Chairman of the Governors of the BBC; the other members currently are Heather Rabbatts and Roger Jones.

7.3 The FTCC normally meets on a quarterly basis. In addition to the members of the Committee, its meetings may be attended by several other people including the

BBC's Director, Public Policy; Director, Finance & Business Affairs; Head of Internal Audit; Controller, Fair Trading; a representative of the external auditors of the BBC's fair trading policies may also be in attendance. I have reviewed the minutes of recent meetings of the FTCC. A wide range of matters is discussed at the FTCC meetings. A quarterly report is received of relevant activities within the BBC; specific projects and proposals, and their compatibility with the Fair Trading Commitment and the *Guidelines*, are discussed. Reports are received from the internal and external auditors of fair trading. Specific complaints are dealt with, such as IPC Media's complaint about the trailing of BBC Worldwide's Eve and Star magazines.

7.4 The FTCC is advised by the BBC's Controller, Fair Trading, whose rôle is explained at paragraphs 5.15 to 5.17 of the *Guidelines*. The Controller reports directly to the Governors. The Controller is independent of the management of the BBC and functions separately from it. All subsidiaries and commercial operators within the BBC report, through the Controller, Fair Trading, to the FTCC on a quarterly basis. Each divisional Board within the BBC has responsibility for ensuring compliance with the *Guidelines*. The responsibilities of the divisional Boards are set out at paragraphs 5.7 to 5.13 of the *Guidelines*. Each division must appoint a Commercial Policy Representative with specific responsibility for fair trading matters (paragraph 5.7), who must meet the Controller, Fair Trading, at least on a quarterly basis (paragraph 5.13). The Controller, Fair Trading where appropriate, takes external advice from counsel or economic experts prior to reporting to and making recommendations to the FTCC.

7.5 These processes seem to me to be adequate to ensure that the Governors are kept abreast of relevant fair trading issues and to enable them, through the FTCC, to take action where it is needed to address specific complaints. The one issue that I have reflected upon in conducting this review is whether it would be appropriate to require that an external expert in competition law and policy should sit on the FTCC. This might be considered to be helpful in assuaging those critics of the current system that the BBC is, in a sense, judge and jury in its own cause. However, I am not persuaded that the addition of an external member of the FTCC would be helpful. The Controller, Fair Trading functions independently of the management of the BBC, and opposes projects and proposals that could give rise to fair trading problems. He or she will take independent advice from counsel or other external entities where appropriate. The external auditors of the BBC's fair trading policies are present at the meetings of the FTCC. The FTCC hears complaints and, where appropriate, takes action to deal with them. This scrutiny through the FTCC of the BBC's behaviour is without prejudice to the application of the competition rules by the OFT and the European Commission. I am not persuaded that the appointment of a further person to the FTCC, to add further external 'weight', would be likely in practice to make any relevant difference to the current position.

Section 8: Review of and comment upon existing correspondence from stakeholders to the BBC and the DCMS as to the adequacy of the BBC's Fair Trading Commitment

8.1 I have reviewed the correspondence that is relevant to this review. Many issues are raised in the correspondence, ranging from a critique of the entire regulatory system

for the BBC and the licence fee as state aid to specific complaints about such matters as News 24 and BBC Online. However the correspondence does not call into question the principles of the Fair Trading Commitment or the *Guidelines* themselves.

Section 9: General recommendations

20.1 I do not consider it necessary to make any general recommendations.

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6 April 2001

Appendix A: Terms of Reference

Terms of reference

- 1. In their report, *The Future Funding of the BBC* (August 1999), the independent review panel chaired by Gavyn Davies recommended that steps should be taken, both in the short term and on a slightly longer time-scale, to provide the necessary assurance that the BBC's accounts are sufficiently transparent and that the Corporation's fair trading commitment is adequate. The panel considered that greater transparency would help to give the public greater confidence in the existing arrangements. The two short-term recommendations were for reviews of the BBC's accounts and processes, specifically:
 - i the BBC documentation *Fair Trading Commitment* and *Commercial Policy Guidelines* and how the BBC ensures compliance with its fair trading policy; and**
 - ii the transparency of the BBC's financial reporting culminating in its *Annual Report and Accounts*.****
- 2. This study relates to the first review. The second was undertaken recently for DCMS by Pannell Kerr Forster and their report was published on 3 October.**
- 3. The background is the BBC's Fair Trading Commitment (as set out in Chapter 3 of the BBC's document *Commercial Policy Guidelines* - copy at Annex A) and the conclusions on fair trading set out in the Secretary of State for Culture, Media and Sport's letter of 21 February to the Chairman of the BBC (Annex B). These were:
 - DCMS jointly with BBC to invite an independent, eminent figure to review the BBC's fair trading policies and to advise the Secretary of State and the BBC Board of Governors on any recommendations. This is the current study.**
 - BBC, in consultation with the Secretary of State, to appoint separate audit firms for fair trading purposes and for its financial audit, and BBC to****

publish the audit firm's full report on compliance and risk in relation to fair trading.

- **BBC Fair Trading Compliance Committee to publish a more wide ranging annual review of fair trading, detailing initiatives and activities mounted during the year and airing some of the policy questions dealt with.**
- **BBC to seek BSI kitemarking of fair trading processes (BS9001).**
- **BBC to publish quarterly bulletin on fair trading (and transparency) issues as it currently does for programme complaints.**
- **BBC to issue a fuller report from the external auditors reviewing the background to the formal annual opinions on fair trading (and transparency).**
- **DCMS to appoint consultants periodically to examine the systems and controls in place to ensure compliance with fair trading policies.**

BBC Fair trading

4. **As a publicly funded organisation, the BBC is required to ensure that no legitimate concerns could arise from its participation in the commercial world. In particular, the BBC must not use public funds to subsidise its commercial ventures and distort competition in commercial markets. The BBC's Fair Trading Commitment is designed by the BBC to ensure that its commercial activities are consistent with the BBC's overall programming purpose, are conducted in a transparent manner and do not involve cross-subsidies from public funds. Essentially it is a commitment to the action necessary to demonstrate that the BBC does not divert any public funds to commercial ventures, or use access to public funds, to compete unfairly against commercial companies.**
5. **The BBC has set out six key fair trading principles which govern its commercial activities:**
 - **commercial activities should comply with clear criteria of what is appropriate for the BBC as a public service broadcaster;**
 - **there should be clear separation between publicly-funded and commercial activities in terms of their operation and accounting;**
 - **commercial subsidiaries or operations must pay fair charges for any goods or services received from the BBC;**
 - **prices charged by commercial activities to their customers should be a fair reflection of both costs incurred and the market practice;**
 - **no public funds must be used, or put at risk, by commercial activities; and**
 - **the BBC's publicly-funded services may not be used unfairly to promote BBC commercial goods and services.**

- 6. The independent, eminent figure is required to report to the Secretary of State and the BBC Board of Governors having:**
- i reviewed the adequacy of the BBC's Fair Trading commitment.**
 - ii considered and commented on the adequacy of each of the specific requirements contained in the BBC's Commercial Policy Guidelines and whether any further specific requirement should be included;**
 - iii considered to what extent the BBC's fair trading policies are consistent with upholding EU Competition Law.**
 - iv commented on how the BBC's policies compare with those of any other relevant organisations;**
 - v commented on the processes through which the BBC Board of Governors are made aware of fair trading issues and the nature of the information provided to them to enable the Governors to be satisfied that all significant issues facing the BBC are appropriately set out in the *Annual Report and Accounts*; and**
 - vi reviewed existing correspondence from stakeholders to the BBC and DCMS about the adequacy of the BBC's Fair Trading Commitment, and to comment on the validity of the points made and highlight any other perceived shortcomings.**

The expert is also requested to make any general recommendations for improving the BBC's commitment to fair trading.

**DCMS
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October 2000**