

**Appendix E**  
**to the CFTPA's submission to**  
**Broadcasting Notice of Public Hearing**  
**CRTC 2006-5**



# **The Creation of Regulated Terms of Trade Between Producers and Broadcasters in the U.K.**

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for:

Canadian Film and Television  
Production Association

September 2006

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## 1 Introduction

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In 2003, the United Kingdom (U.K.) passed a *Communications Bill* that introduced a number of significant changes to the industry. Among these changes was the establishment of collective terms of trade between independent producers and the conventional television broadcasters.<sup>1</sup> These collective terms of trade, enshrined in separately agreed Codes of Practice, addressed concerns over the relative lack of bargaining power by independent producers in their dealings with the major conventional television broadcasters, which at the time, accounted for 90% of total television program buys in the U.K.

The creation of these terms, along with other changes in the industry – such as the establishment of the BBC’s independent quota, and the multichannel explosion resulting in a number of new buyers for television programming in the U.K. – have transformed the U.K. production industry from what has been called “a cottage industry” to a well-financed, internationally competitive and powerful industry.

While these other changes have been important, most major production companies, attribute the establishment of collective terms of trade as the beginning of the change in their fortunes. In addition, the terms of trade have prepared the industry for the future, as the precedents established in the years following the introduction of the *Communications Act* have also informed a more recent agreement between the producers and broadcasters in the U.K. on the terms of trade regarding new digital platforms.

While the broadcasting industry in the U.K. in many ways looks different from the Canadian industry, these differences – such as the well-funded public broadcasting sector in the U.K. and direct competition from American television signals in Canada – do not negate the similarities. In Canada in 2005, broadcasters’ revenues were strong and margins remained higher than those of producers<sup>2</sup>, and the emergence of new digital platforms has left broadcasters and producers in a state of uncertainty about how to capitalize on these platforms and how to share in the returns.

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<sup>1</sup> In the U.K., the BBC, Channel Four, Channel Five, and ITV are typically referred to as “the public broadcasters” since they carry public service requirements. For the purposes of this document, however, they are referred to as “conventional television broadcasters” as they are the U.K. equivalent of Canada’s conventional TV broadcasters.

<sup>2</sup> *Analysis of Broadcaster Financial Performance and Programming Expenditures*, prepared by Nordicity Group Ltd. in September 2006 and submitted by CFTPA to the CRTC’s review of its policy for over-the-air television (Broadcasting Notice of Public Hearing CRTC 2006-5).

Considering these similarities, the Canadian Film and Television Production Association commissioned Nordicity Group Ltd. (“Nordicity”) to document the story of the establishment of regulated and collective terms of trade in the U.K. To carry out this project, Nordicity reviewed a series of critical documents, including U.K. regulators’ reviews of the sectors. Nordicity also interviewed key persons involved in the development of terms of trade in the U.K., including the CEO of the Producers Alliance for Cinema and Television (PACT) – the U.K. trade association that represents and promotes the commercial interests of independent feature film, television, animation, and interactive media companies – and a senior economist involved in the process at Ofcom, the U.K. broadcast regulator.

The focus of this report is on the U.K.; analysis in this report did not include an assessment of the current situation of terms of trade in Canada. However, based on our assessment of the developments in the U.K., it is evident that there are several key lessons Canada can learn from the process of the U.K.’s terms of trade:

- **A Regulator Can Enforce Collective Terms of Trade:** In the U.K., Ofcom effectively enforced collective terms of trade for television programming first, enshrined in the Codes of Practice, and second, pertaining to New Media rights. Ofcom itself did not take the initiative in the first instance, but instead was tasked by the government – as set out in the *Communications Act* of 2003 – to publish guidelines and monitor Codes of Practice. Its effectiveness in regulating such Codes paved the way for its effective involvement – short of clear regulatory intervention – in the settling of the New Media terms.
- **Regulated Terms of Trade Can Strengthen an Industry:** While there have been a number of factors influencing the change in the industry, the regulated and collectively agreed Codes of Practice that set out terms of trade have clearly had a positive impact on the strength of the U.K. independent production sector.
- **The Settlement of New Media Terms of Trade have Enabled the U.K. to Progress on New Platforms:** The threatened intervention of Ofcom has enabled broadcasters and producers to come to reach an agreement that will enable them to forge ahead and innovate on new platforms.

## 2 The U.K. Television Industry

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The U.K. television industry generates annual revenues in excess of £9 billion (the equivalent of \$19.14 billion Canadian). It spends almost £5 billion on programming and approximately £2.6 billion on original programming.<sup>3</sup> This level of original domestic television content is the second highest in the world, next to the United States.

### 2.1 The Shape of the Industry Today

The major buyers of first-run original programming in the U.K. are the five conventional television broadcasters in the U.K. – the BBC (four television channels, two digital), S4C (the Welsh broadcaster), Channel Five, Channel 4, and ITV. Figure 1 charts the relative proportion of expenditure on first-run original productions from 1999 to 2004. The BBC and ITV are the biggest purchasers of original content, although the multichannel services are seeing significant increases year-on-year.<sup>4</sup> The main terrestrial channels accounted for 87% of total first-run expenditure in 2004, with their share down from 95% in 1999. Overall, 56% of original programs are produced by in-house production units, primarily within BBC and ITV (see Figure 1). For this reason, Channel Five and Channel Four were the largest commissioners of external hours of first-run original programming. In 2005, 56% (£1.5 billion) of original production output was produced in-house by the broadcasters, and 44% (£1.1 billion) by external producers. Overall, the amount of original television production has grown at an average of 4% per year over the past five years.<sup>5</sup>

In the U.K. there is no major support program for television production like the Canadian Television Fund. There are, however, limited national funds in Scotland and Wales to encourage production in those areas, as well as regional funds in areas such as the NorthWest of England that carry the same objective.

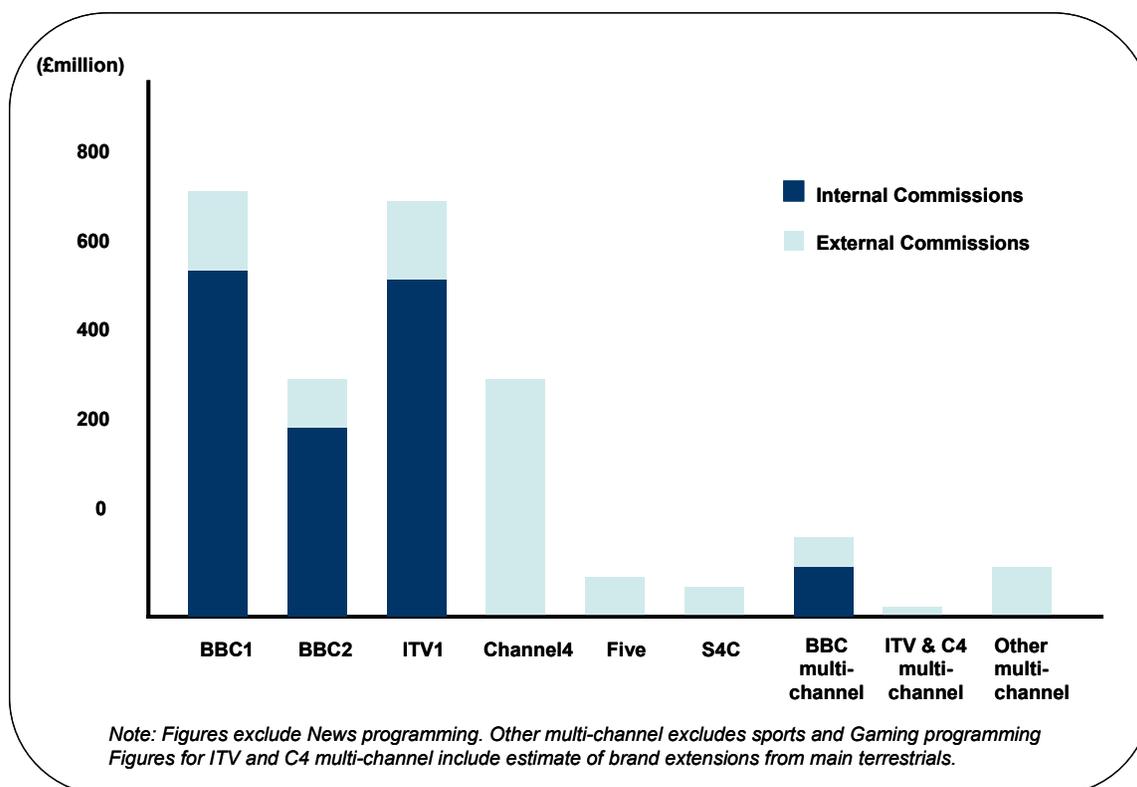
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<sup>3</sup> Ofcom Review of the television production sector: Consultation document; 10 January 2006, page 1.

<sup>4</sup> Ibid, page 48.

<sup>5</sup> Ofcom (2006) *Review of the Television Production Sector*, page 50.

**Figure 1: Major U.K. Channels – 2004 First-Run Original Programming Expenditure**



Source: Ofcom, *Review of the Television Production Sector, 2006*, page 48.

The independent production sector is currently made up of approximately 800 U.K.-based, non-broadcaster aligned companies that supply original TV programming to U.K. and international broadcasters. Today, there are seven companies with revenues in excess of £30 million, and there are four significantly sized companies listed on the stock exchange.<sup>6</sup>

As this report details, the state of the industry was not always this shape. The independent sector has undergone significant change from its inception in the 1980s to its current state. The creation of new and collectively agreed terms of trade between broadcasters and producers is an essential component of the story of the sector's evolution.

<sup>6</sup> Mediatique (2005), page 3.

## 2.2 The Independent Production Sector and Terms of Trade in the 1980s and 1990s

The U.K. independent production sector was essentially created with the launch in 1982 of Channel 4, a public broadcaster specifically set up as a “publisher-broadcaster” to outsource all its content from external suppliers. At that time, the broadcasting landscape was dominated by broadcasters BBC and ITV whose sole source of supply was in-house production units.

With the establishment of Channel 4, the production sector started with small companies, winning a few commissions per year and living hand-to-mouth by essentially covering expenses.<sup>7</sup> The industry grew substantially in the 1990s once PACT won its lobby to introduce an independent production quota at the BBC, ensuring that a minimum of 25% of commissioning hours was allocated to independent producers rather than in-house units. By the early 1990s, there were approximately 1,000 independent production companies in the U.K.

In the 1980s and 1990s, the relationship between the commissioning broadcasters and the independent production sector was what Mediatique’s report *From the Cottage to the Industry* called “unbalanced”<sup>8</sup>. Terms of trade were based on a “cost-plus” model, whereby broadcasters paid the full cost of the production, often the cost of development of the program, as well as an additional 10-15% of the production cost to producers. This production fee was virtually the only source of revenue for producers<sup>9</sup>, yet even still producers would often cede a portion of this fee as part of the budget negotiations with broadcasters. Producers did this in hopes that they could undercut competitors and secure a commission in this intensely competitive industry.

Producers were cushioned in some respects, in that they received full licence fees for programs and often were assured that broadcasters would cover cost overruns. However, the downside is that they were prevented from exploiting the value of their productions. Approximately 95% of deals struck using the “cost-plus” model were “all rights deals”, meaning that the broadcaster took all rights – primary, secondary, and tertiary. The only broadcaster that was not automatically retaining rights was ITV. While some producers preferred to work with ITV for this reason, the broadcaster offered such a small percentage of total commissions that a producer could not survive by only supplying ITV.

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<sup>7</sup> *From the Cottage to the City: The Evolution of the U.K. Independent Production Sector*, by Mediatique, commissioned by the BBC; September 2005.

<sup>8</sup> *Ibid*, page 4.

<sup>9</sup> *Ibid*.

As most rights belonged to the broadcasters during this time, they were building up large, well-funded international distribution arms to exploit the rights they owned. In the late 1970s, the BBC placed its commercial operations under BBC Enterprises later to become BBC Worldwide, Channel 4 established its own international distribution arm when the channel was established, and ITV's Granada International was established and became highly active internationally.

While these distribution arms of the major broadcasters were not the only distribution companies, they were dominating the distribution business. Some major production companies, such as RDF and Fremantle, had set up distribution arms; however, because most broadcasters held all the secondary rights, they could only handle the rights of their own productions from ITV or handle distribution for foreign producers.

During this period of time, the broadcasters were clearly the dominant players in the U.K. television industry.

### 3 The Creation of Regulated Terms of Trade Between Broadcasters and Independent Production Companies

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In the late 1990s, the U.K. government acknowledged that the convergence of technologies was changing the shape of the communications industry. The fact that there were eight disparate regulators monitoring the industry was being questioned, the role of the conventional television broadcasters was being debated, and there was a call for relaxed media ownership rules. Following years of debate, a *Communications Bill* was drafted in 2002 to address these issues, and the *Communications Act* was passed in 2003. Guidelines regarding the relationship between producers and broadcasters also fell under the remit of this Act.

#### 3.1 A Review of the U.K. Program Supply Market

In 2002, once the Communications Bill had been drafted, a Joint Scrutiny Committee united the House of Commons and the House of Lords to scrutinize the draft Bill. PACT lobbied this committee to pause and investigate the state of the television production sector and its relationship with broadcasters before passing the Bill. The Committee agreed, and the ITC (the Independent Television Commission), the television regulator at the time, embarked on a four-month analysis of the sector.

Their findings, included in the *Independent Television Commission Program Supply Review*<sup>10</sup>, indicated that there were concerns over competition in the sector. The review reported that the conventional television broadcasters – BBC, ITV, Channel 4, and Channel Five – accounted for 90% of all program commissions. The Expert Panel that conducted the review was concerned that the significant buying power of broadcasters was forcing unfair terms on suppliers.<sup>11</sup> The findings revealed that due to the “all-rights deals” being struck and the fact that distribution was dominated by the broadcasters, “most of the value in the broadcasting/production chain was being captured by broadcasters and not the producers”<sup>12</sup>. As a result, the review identified, the independent production sector was “fragile”.<sup>13</sup> Overall from a competition-policy

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<sup>10</sup> Independent Television Commission (2002), *A Review of the U.K. Program Supply Market*, page 3.

<sup>11</sup> Ibid, page 9.

<sup>12</sup> Ibid.

<sup>13</sup> Ibid.

perspective, the Expert Panel, including several economists, was concerned that the industry was not healthy.

According to the review and discussions with industry players, the fragility of the independent production sector was caused by several interrelated factors:

- **Producers had no access to the returns of rights exploitation:** As already mentioned, the review concluded that the “cost-plus” model leading to all-rights deals was benefiting only the broadcasters who held the rights.
- **The distribution industry lacked competition:** The fact that the broadcasters held the rights for exploitation was also fuelling, according to some interviewees, an inefficient and ineffective distribution industry that failed to deliver any returns to producers. Broadcasters’ distribution arms would promise revenue-sharing agreements with producers for the exploitation of their product, but such agreements would be on a net basis, and often resulted in very little returns to producers. According to interviewees, some producers in the industry argued returns were limited because the broadcasters’ distribution arms lacked the incentive to maximize the value of the rights they did own – independent producers could not take their business elsewhere if they were not satisfied, and broadcasters’ revenues were so strong that they did not necessarily need the extra rights revenue for survival. Others in the industry went so far as to speculate that creative accounting eliminated any net gains for producers.
- **Exploitation of rights was an after-thought:** As most U.K. broadcasters were commissioning for the domestic market only, most producers were creating content intended for U.K. audiences only. There was little incentive for either party to create programs that were exportable. Programs that happened to be popular abroad were exploited, but international success was rarely explicitly a goal; marketing was an afterthought and not factored into development. Despite this, the U.K. still experienced the second highest level of television program exports next to the U.S.<sup>14</sup> But, international buyers were expressing concerns about the suitability of particularly U.K. drama series for international audiences. Commercial stations overseas found U.K. drama “dark and slow” and the look and feel, running times, and series length were not suitable overseas.<sup>15</sup> The industry was not opening up the full potential of international markets.
- **Producers were not able to attract financing:** The consequences of the factors identified above were that producers were not able to attract investment financing. In the U.K., the financial industry was not interested in this sector as

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<sup>14</sup> Television Research Partnership (2005), *Rights of Passage – British Television in the Global Market*, page 4.

<sup>15</sup> *Ibid*, page 5.

most producers did not have assets to exploit. The limited assets that were owned by producers did not promise to be highly lucrative as there was no guarantee of success in other markets overseas and returns appeared limited. A lack of financing then meant that producers did not have the leverage to counter the “cost-plus” model imposed by broadcasters; they needed their licence fees, however minimal, to make it to the next payroll.

Overall, producers were not able to escape what was essentially a hand-to-mouth situation. Although British broadcasters were at least paying the cost of producing the program and then some, the ITC review concluded that the industry was not thriving as it could.

### **3.2 Collective Terms of Trade Enshrined in The Codes of Practice**

The opinion of the regulator at the time was that a full-blown competition inquiry was not needed – yet. If the broadcasters agreed to implement Codes of Practice that would govern their behaviour towards independent producers, the regulator – and the government – would be satisfied that a competition inquiry was not necessary. In the words of the ITC’s review,

*“all public service broadcasters should be required... to develop Codes of Practice which set out high level principles regarding the commissioning process and a framework for agreeing terms of trade with independent producers”.*

These new Codes were to set “a transparent basis for commissioning deals to mitigate the exercise of broadcasters’ negotiating strength”.<sup>16</sup>

However, the Joint Scrutiny Committee and the Department for Culture, Media and Sport (the U.K. Ministry of Culture) agreed that the broadcasters should not just be left to their own devices in setting these Codes of Practice and that in fact, the new regulator, Ofcom, should put forward principles that would govern the setting of these Codes of Practice in the form of published guidelines. These Codes of Practice would, in turn, guide the contractual agreements struck between broadcasters and producers.

According to interviewees Nordicity spoke with, including the BBC, the idea of the Codes of Practice was well received by all parties. However, at the time of implementation, some high-level executives in the industry were quite vocal about their concerns. In response to PACT’s case for new terms of trade, Greg Dyke, Director General of the BBC, declared that the purpose of the BBC was categorically “not to make a lot of

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<sup>16</sup> Ofcom Television Production Sector Review, 2006, page 6.

independents very rich”.<sup>17</sup> Another major industry player apparently launched a legal suit against the regulator for intervening to the extent it was. However, the *Communications Act* was clear, and a Code of Practice was developed with agreement from PACT. Each broadcaster established their own Codes of Practice, which were negotiated and agreed to with PACT, yet the principles underlying the Codes shared a common thread.

### 3.3 The Guidelines and the Principles Underlying the Codes of Practice

Through the drafting of the Communications Bill and the ICT review, PACT had argued that producers should be able to exploit their own program rights. Ofcom, after consulting PACT, the broadcasters, and reviewing the review results of the legacy regulator, the ITC, agreed with PACT. It subsequently issued guidelines to ensure the new Codes of Practice transferred rights ownership to the producers.

The principles of the guidelines were quite rigid in their approach to rights ownership and broadcaster payment. The guidelines outlined that broadcasters should strike terms of trade that allocated a licence fee for a first run (or on some channels, for more than one run) and that, in the words of the guidelines, “producers should retain rights in their programs unless these are explicitly sold to broadcasters and other parties”.<sup>18</sup> Explicitly, negotiations for primary rights would be conducted separately from secondary and tertiary rights.<sup>19</sup> Also, arrangements were to be made about the duration and exclusivity of those rights. In practice, this means that broadcasters negotiated a “holdback period”, wherein a broadcaster would restrict the secondary and tertiary exploitation of rights by the producer until this period was over.

The guidelines also specified that each broadcaster must publish a range of agreed tariffs for the primary rights. The published Codes of Practice from broadcasters specified that these tariffs would vary depending on genre, day part, and production values – such as additional payment for the use of computer-generated imagery – and broadcasters reserved the right to amend these tariffs depending on all these factors. While broadcasters fell short of categorically determining a minimum price for programming, the principle was to establish near-minimum prices. In the words of Channel 4’s Codes of Practice, “...Whilst Channel 4 expects the majority of projects to fall within [the published tariff range] lower prices may occasionally be offered for

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<sup>17</sup> Mark Thompson, Chief Executive of Channel 4, MacTaggart Lecture, 2004, [http://web.channel4.com/4producers/resources/updates\\_edin\\_02.pdf](http://web.channel4.com/4producers/resources/updates_edin_02.pdf).

<sup>18</sup> [http://www.ofcom.org.U.K./tv/ifi/guidance/cop\\_prog\\_ind/indies](http://www.ofcom.org.U.K./tv/ifi/guidance/cop_prog_ind/indies).

<sup>19</sup> “Guidelines for broadcasters in drafting codes of practice for commissioning programs from independent suppliers”, OFCOM website: [http://www.ofcom.org.uk/tv/ifi/guidance/cop\\_prog\\_ind/indies](http://www.ofcom.org.uk/tv/ifi/guidance/cop_prog_ind/indies).

specified projects”. In the U.K., in most genres, this tariff typically covers close to 100% of the full production cost. There are exceptions, however, such as in high-end specialist factual programming, *such as The Life of Mammals*, where budgets of up to £7 million are shared among other broadcasters, such as Discovery.

Following these guidelines, PACT and individual broadcasters agreed to the Codes of Practice, which established the principles behind the individual terms of trade. The principle behind the collectively agreed terms of trade, enshrined in the Codes of Practice, was that for each production, new terms would not have to be established. Such a process would prove unwieldy for particularly small production companies, without the business affairs capacity to devote significant time to each and every contract. It should be noted, however, that certain producers – namely the large top tier of “super-indies” such as Endemol – did not agree to the terms of trade and some are still negotiating with broadcasters to determine their own terms of trade.

In 2004, the Codes of Practice were published and, now armed with the ownership of their assets, the independent production sector continued to strengthen.

## 4 The Impact of the Regulated Terms of Trade

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Many changes have occurred in the independent production sector in the U.K. over the last five to ten years. Not all of these changes can be attributed solely to the change in terms of trade. Mediatique's report on the industry identified the following drivers – historical and pending – which are critical to the current and future growth of the sector:

- The number of channels commissioning independent programs has dramatically increased, particularly with the launch of digital television;
- In 1990, the BBC was subject to an independent production quota whereby 25% of qualifying hours<sup>20</sup> were to be produced by independent producers; and
- Soon, the BBC will open up an extra 25% to a WOCC (Window of Creative Competition), allowing independent producers to bid for these hours.

These drivers have all contributed to an independent production sector that is increasingly healthy, and that is projected to strengthen even further. However, the establishment of the regulated and collectively agreed terms of trade through the Codes of Practice had a number of specific impacts on the industry that have helped to fuel growth. While PACT will be publishing data in January 2007 that will offer a comparative view of the industry pre- and post-terms of trade to investigate the impact of the terms of trade on the sector in more depth, available documents and insight from interviewees indicate several of the key impacts of the new terms of trade, as discussed below.

### 4.1 The Creation of an Open and Competitive Distribution Industry

The new terms of trade established that primary rights are taken by the broadcaster, but secondary and tertiary rights belong to the independent producer. Producers now had the opportunity to exploit their own rights, which meant they could take those rights to any distributor of choice rather than automatically working with the distribution arm of the broadcaster that had purchased primary rights.

Because of this change, competition in the distribution industry flourished. More independent producers such as RDF and Fremantle are growing their international distribution arms and increasingly handling a lot of the business previously handled by the broadcasters' distribution arms. As stated on the website of RDF's distribution arm,

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<sup>20</sup> The 25% is applied to the total of qualifying hours across all four channels. Qualifying hours exclude News and a certain amount of Current Affairs programming.

RDF Rights, it has become “one of the U.K.’s fastest-growing international distribution companies benefiting greatly from the recent regulatory changes in the U.K. that have given independent producers the right to work with their distributor of choice”.<sup>21</sup>

Broadcaster distribution arms now have to compete for business, and this in turn is driving greater efficiency and effectiveness in organizations such as BBC Worldwide. There is significantly more transparency in the deals being struck compared to the opaque revenue-sharing agreements that were in place prior to the new terms of trade. Distributors are now held more accountable, and many in the industry believe that this is having a positive impact on their effectiveness.

## 4.2 Increase in Exports

Many in the industry believe that the proportion of revenues coming from ancillary rights and international sales for independent producers is growing at a significant rate, particularly since the new terms of trade were established. Fremantle estimates that independent producers’ net revenues have increased by approximately £2 million or £3 million since the Codes of Practice, mainly from the exploitation of their own rights overseas as well as the rights they have handled for other producers. With the ability to exploit program rights, many of these larger producers seeking to maximize value began to aggressively pursue markets overseas.

The increase in exports can be partly attributed to a strengthened distribution sector, but also to the type of product now being created. With ownership of their secondary and tertiary rights in hand, producers have now begun to factor future distribution of their content into the development process. They are now thinking creatively about how to respond to broadcasters’ demands to meet public service obligations, appeal to the British public, yet also appeal to audiences overseas. The result is a tranche of new programs that achieved great success not only in the U.K., but also became hits in the U.S. and elsewhere. U.K. dramas like *Spooks* (also known as *MI5*) and *Hustle* finally shed the formerly negative “gritty” image of British drama and succeeded in overseas markets, while also earning high marks on the public service and U.K. content scale. However, interviewees indicate there is speculation within the industry that the type of content commissioned from independent producers will change, as the first-run revenue will become an increasingly smaller proportion of independent producers’ overall revenue and subsequently content will become increasingly tailored for international audiences rather than to U.K.-specific tastes and public-service requirements.

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<sup>21</sup> <http://www.rdfmedia.com/rdfmedia/about/>.

### 4.3 The Development of Business Acumen

In order to succeed in this new world of rights exploitation, production companies needed to start taking on new skills in-house. In the 1980s and 1990s, many of the newly established independent production companies were started by former employees of the in-house production units of the BBC and ITV. These producers were first and foremost creators. But with the establishment of terms of trade, many medium-sized producers began to recognize that they needed the business acumen of the larger independent production companies to compete in the new world. The new business skills needed included:

- **Integrating market intelligence into the development process:** Previously, a program was developed for a broadcaster and U.K. audiences in mind. If the program happened to have international potential, that was a positive outcome; however, it was not the intent from the outset. This began to change as foreign markets were considered, and international adaptations were considered in development.
- **Commercial rights exploitation:** Production companies have begun taking on-board top business affairs executives. In the past, such executives were only needed within the major independent production companies.
- **New media and new platforms expertise:** In addition to these other skills brought in-house, many independent producers starting taking on new media skills in-house as companies began to realize the need to develop a means of exploiting content on new platforms in the future.

The growth of these skills in-house has led to a new breed of business-savvy independent production companies in the U.K.

### 4.4 The Rise of Financial Industry Interest

In many countries, including Canada, the lack of investment financing is a significant barrier preventing independent production companies from completing projects and also maintaining the rights to their projects. In the U.K., prior to the introduction of regulated terms of trade, the ability to secure financing for a particular production was an issue threatening project completion because broadcasters always covered the cost of the production. However most independent producers were never able to grow their companies as limited “cost-plus” program financing arrangements did not allow them to diversify and innovate as businesses.

However, with the new terms of trade, the U.K. financial community began to see value in investing in independent production companies. While there were a spate of independent production companies that carried private equity deals in the late 1990s (RDF Media, for example), such deals were few and far between. Now that producers owned their creative assets, however, distributors were becoming increasingly successful at exploiting these assets and delivering returns, and international successes for the few companies able to break through all-rights deals and retain intellectual property were proving lucrative. The financial community also recognized that there was what Mediatique termed, “an increased professionalism” in the industry, as producers began to develop business acumen.

In the last few years, there has been a spate of mergers, investments from private equity firms, and market listings. There are now three independent production companies with revenues higher than £100 million (HIT Entertainment, All3Media, and Endemol), and at least five are publicly traded.<sup>22</sup> RDF Media was floated on the Alternative Investment Market (AIM) in the U.K. in 2005 and in its prospectus appealed to investors by stating that, “Indies now have the right to retain and exploit (their) intellectual property....This is of particular value to an Indie such as RDF with its own in-house capacity to retain and exploit its Intellectual property.”<sup>23</sup> RDF also stated that “the licence fee arrangement introduced by the New Terms of Trade is expected to have a positive impact on RDF’s production margins.”<sup>24</sup>

The high-powered growth of the industry in recent years can therefore be directly linked to the creation of collective and regulated terms of trade.

#### **4.5 Consolidation and a Change in the Balance of Power**

The changes outlined above have resulted in a stronger independent production industry and have ultimately had an impact on the balance of power in the industry. The broadcasters still dwarf the producers in terms of revenues – for example, the mid-size Channel 4 has revenues of approximately £895 million, and each of the largest independent production companies (All3Media, Endemol, and HIT Entertainment) are likely to post revenues in excess of £100 million in 2005.<sup>25</sup> However, independent producers are now in a much better negotiating position than they were before due to their increased size.

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<sup>22</sup> Mediatique, page 11.

<sup>23</sup> Investec (2004), *RDF Media Group plc prospectus*, page 3.

<sup>24</sup> *Ibid*, page 11.

<sup>25</sup> *Ibid*.

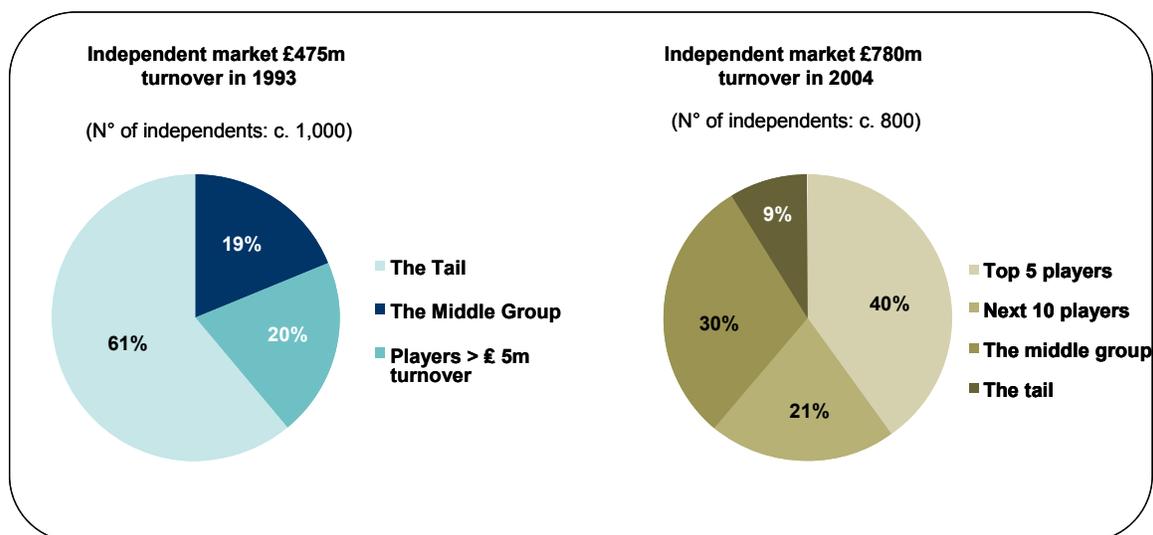
Companies are growing as mergers in the independent production sector have heated up in the last several years. Leading up to the regulated terms of trade, there was increased consolidation in the sector, and the new terms of trade will only continue to augment this as smaller companies seek to align themselves with independent producers that have the business acumen and distribution arms necessary to excel in the new regime.

Mediatique's assessment of the industry identified essentially three categories of independent production companies:

- The top tier – the large, integrated and professional independent production companies.
- The middle tier (the “bulge”) – generating reasonable revenues and relatively consistent, although low, profit margins.
- The lower tier (the “long tail”) – small talent-based companies surviving on a limited number of commissions.

Mediatique has noted that the “long tail” is increasingly being eliminated as merger activity has risen (see Figure 2). It is anticipated by Mediatique as well as the industry players Nordicity interviewed that consolidation will increase.

**Figure 2: The Elimination of the Long-Tail in the Independent Production Sector**



Source: Mediatique (2005), page 8.

As independent production companies consolidate and financial investment flows in, it is likely that fewer independent production companies of substantial size will produce the majority of programming in the U.K. In 2005, Mediatique forecasted that of £820 million expended by U.K. broadcasters on qualifying independent production in 2005, 30% would be generated by two companies – Endemol U.K. and All3Media<sup>26</sup>. As these “super-indies” become major suppliers, they will also be in an increasingly stronger negotiating position *vis-à-vis* the broadcasters. And as these “super-indies” band together with the other production companies under the strong and influential PACT, the broadcasters will likely have less unmitigated power than they were seen to have before.

#### 4.6 The Impact on Broadcasters

Throughout the terms of trade process, there is little mention of how the new terms of trade may have had a negative impact on the broadcasters. One interviewee mentioned that one analyst they had spoken with had guessed that Channel 4’s revenues decreased by about £10 million, mainly from a loss of international distribution sales. But with total overall revenues of well over £800 million annually, producers call this £10 million merely “a drop in the bucket”. However, despite early comments from the BBC’s former Director General, interviews indicated that the broadcasters now all broadly support the terms of trade and Codes of Practice.

<sup>26</sup> Mediatique, page 3.

Overall, the regulation of terms of trade is seen to have had a positive impact on the U.K. independent production industry. The regulation also paved the way for the second wave of collectively established terms of trade, which has set the U.K. on the front foot in bringing the industry together to deliver program content across multiple platforms.

## 5 The Second Wave: New Media Terms of Trade

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In its assessment of the independent production sector, Mediatique predicted that, following the implementation of the first wave of terms of trade through the Codes of Practice, there would likely be significant growth in ancillary revenue streams from non-traditional sources, particularly from new business such as mobile and interactive TV.<sup>27</sup>

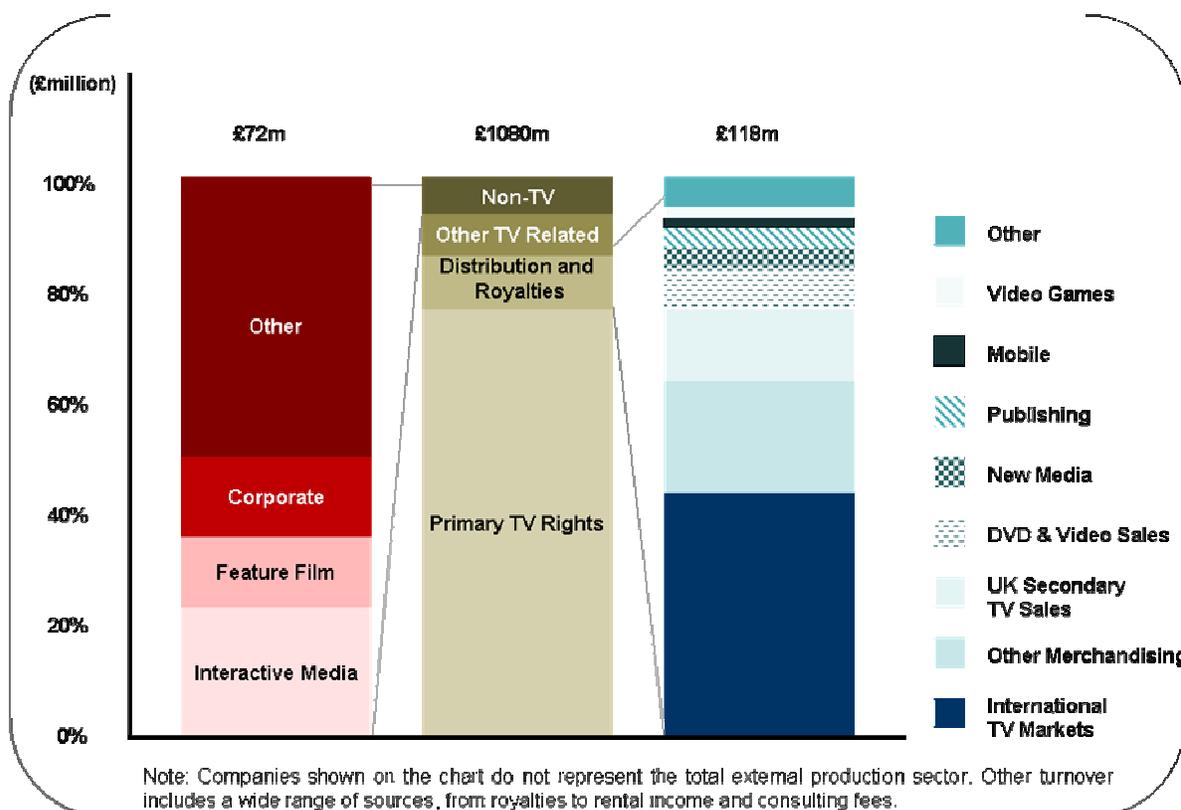
Currently, primary TV rights remain the largest source of revenue for independent producers, accounting for 79% of total reported production turnover.<sup>28</sup> In 2004, Mediatique reported £118 million in revenue from TV-related distribution and rights exploitation turnover, and 44% of this amount was accounted for by international sales. Interactive media production accounted for 18% of £72 million of reported non-TV production revenue (see Figure 3).

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<sup>27</sup> Ibid, page 17.

<sup>28</sup> Ofcom (2006), *Review of the Television Production Sector*, page 9 and 21.

**Figure 3: Production Revenue in 2004**



Source: Ofcom Pact Census, documented in Ofcom's Review of the Television Production Sector, 2006, page 38.

While we now realize that the industry will likely see increased revenues from new platforms, when the *Communications Act* was developed, the Internet was about communication, text-based sites, and online shopping; business models featuring rich audiovisual content had not yet been realized. Therefore the original Codes were loose in their inclusion of rights on new platforms. Yet recently, as new platform distribution initiatives and business models were emerging, it became evident that the terms of trade for distribution via new technologies needed to be clarified and agreed.

## 5.1 The Rise of Multiplatform Distribution

After the House of Commons enacted the *Communications Bill*, PACT began to lobby for the establishment of fair and collectively agreed terms of trade across new digital platforms. At this time, broadcasters, as well as telecommunications companies and

Internet properties, had begun to explore the delivery of television content on new platforms in earnest. As activity intensified in this area, PACT began to realize that terms were not going to be easily agreed to by all the parties involved.

### 5.1.1 The Conventional Television Broadcasters

Beginning in the late 1990s, the U.K.'s conventional television broadcasters began exploring various forms of delivery across new platforms, such as mobile phone and the PC Internet. However, certain initiatives began to gain momentum at the beginning of the new century. While these initiatives were in early stages, it became evident that clear and agreed terms with independent producers would have to be established in order to fully deliver these new projects.

For example, the BBC had begun the following two initiatives:

- **The BBC's Creative Archive:** In 2002, the BBC began exploring the possibility of releasing a certain amount of its content online under a Creative Archive Licence. Similar to the Creative Commons Licence in the rest of the world, this licence would allow content to be used by the public for non-commercial use in their own creations.
- **The BBC's IMP – the Interactive Media Player:** The debate around the Creative Archive and rights hastened a wider debate about the BBC's overall on-demand strategy, which in 2004 was labelled the Interactive Media Player and later, in 2005, became MyBBCPlayer. The plan was for content on this Player to be released under two windows – first, a seven-day “catch-up” (e.g., if a viewer missed an *East-Enders* episode, they would have seven days to view it for free) followed by a period where a viewer would have to pay to view the program.

In addition, Channel 4 was exploring its own on-demand strategy, and since all of Channel 4's content is from independent producers, its buy-in would be critical for launch.

In developing pilots and the plans for these initiatives, broadcasters were insisting to independent producers that they be able to use content commissioned for the television broadcast for “public service use” online – meaning, they wanted to distribute the content online without paying extra. Revenue models had not yet been established, and the broadcasters insisted they needed to trial a variety of options first. Meanwhile, other buyers of content were offering slightly better deals.

### 5.1.2 The New Buyers of Content

In addition to broadcasters, the telecommunication companies, including mobile phone networks, and to a limited extent portals and search engines, were beginning to purchase and deliver content through their networks and online properties. Producers were beginning to enter into discussions with these new buyers of content, and unlike the conventional television broadcasters, most of these new buyers were proposing revenue-sharing deals for the first window of distribution.

Some producers, such as “super-indie” Fremantle, refused to sign any deals with buyers that did not at least offer a minimum revenue guarantee, even if the overall deal was a revenue-sharing one. For this reason, telcos and online properties did not look favourably upon the conventional television broadcasters’ attempts to obtain the rights to distribute content across new platforms for no additional charge.

According to PACT, the telcos and the online platforms sided with PACT when they argued to Ofcom and to the conventional television broadcasters that all multi-platform distribution deals should be struck on a commercial basis. They believed the broadcasters should not be allowed special terms simply because of the legacy of their involvement in the sector. Equally, PACT believed that commercial terms should be struck in order to ensure that producers realized revenues from new digital platforms.

## 5.2 Ofcom’s Threat to Intervene

While PACT, the telcos, and online companies were arguing for commercial deals, the broadcasters were pushing back on this, as they had not established guaranteed streams of revenue for these new platforms, and wanted room to manoeuvre in the future. The discussions between PACT and the broadcasters, therefore, were not leading to any agreement, but both sides realized they needed an agreement to progress with multi-platform distribution. In Ofcom’s 2006 report reviewing the U.K.’s television production sector, Ofcom noted that it had been requested by broadcasters as well as the production sector to provide more clarity, but also potentially a regulatory response, on the distribution of TV programs on alternative distribution platforms.<sup>29</sup> Both sides were evidently frustrated with the lack of progress.

Ofcom, therefore, decided to get involved. However, Ofcom’s role was different than its role in the establishment of the Codes of Practice in that it did not regulate the setting of

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<sup>29</sup> Ofcom (2006), *Review of the Television Production Sector*, page 9.

the terms of trade; it merely threatened to regulate such terms. Ofcom stated categorically that they believed a solution should be a matter of commercial negotiation between broadcasters and producers, rather than for regulatory intervention.<sup>30</sup> The regulator did stipulate, however, that if a negotiated solution was not found within what was deemed to be a reasonable timeframe, it would have to intervene. In this regard, Ofcom proposed a possible approach to assist stakeholders in what they called “stimulating debate”. It then gave broadcasters and independent producers two months to agree on a way forward on new media rights before it stepped in with new rules.<sup>31</sup>

### 5.3 The Suggested Approach and the Agreed Terms

Ofcom specified that more clarity was needed surrounding the terms to be agreed to between broadcasters and producers for the distribution of television programs on platforms other than the traditional broadcaster platforms. Specifically, a key issue was the extent to which rights for such distribution should be included within the primary rights licence. Ofcom indicated terms needed to be clarified over the following categories of rights:

- Simulcast distribution of the program on digital channels across different platforms (e.g., Internet, mobile, as well as traditional broadcast platforms);
- Time-shifted distribution on traditional broadcast and alternative distribution platforms;
- On-demand services via free-to-view, pay-per-view, or subscription; and
- Re-purposing and re-versioning of content.<sup>32</sup>

Ofcom initially proposed an approach for two “rights windows” (the period of time during which broadcasters retain exclusive broadcast rights for a program before the rights to exploit the program revert to the producer). It has since evolved to, in essence, three rights window terms.

- **The first window:** In the primary window, the rights acquired by a broadcaster apply across any distribution platform. For any program commissioned by a broadcaster, the primary licence gives the broadcaster the right to air the program on television. The broadcaster is also permitted to air that program on an on-demand basis for a fee within a certain period of time following the on-air

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<sup>30</sup> Ibid, page 10.

<sup>31</sup> “Ofcom’s new media rights ultimatum”, 11 January 2006, Association of online publishers, <http://www.U.K.aop.org.U.K./cgi-bin/go.pl/legal/article.html?uid=797>.

<sup>32</sup> Ofcom (2006), *Review of the Television Production Sector*, page 82.

broadcast. For the BBC, the period of time is seven days<sup>33</sup> and for Channel 4 it is 30 days. Producers will receive either a share of revenue or a royalty payment if the service is offered free, and the two parties will have the option to agree to rights for a longer period. The revenues from the on-demand service are then shared 50-50. As no public service broadcaster in the U.K. has plans to launch an online service supported only with advertising, no terms were struck for this kind of distribution. However, if they were to, terms would be struck for this kind of service, where possibly the independent producer would receive a royalty fee for use of the program, potentially 12 pence per click or something similar.

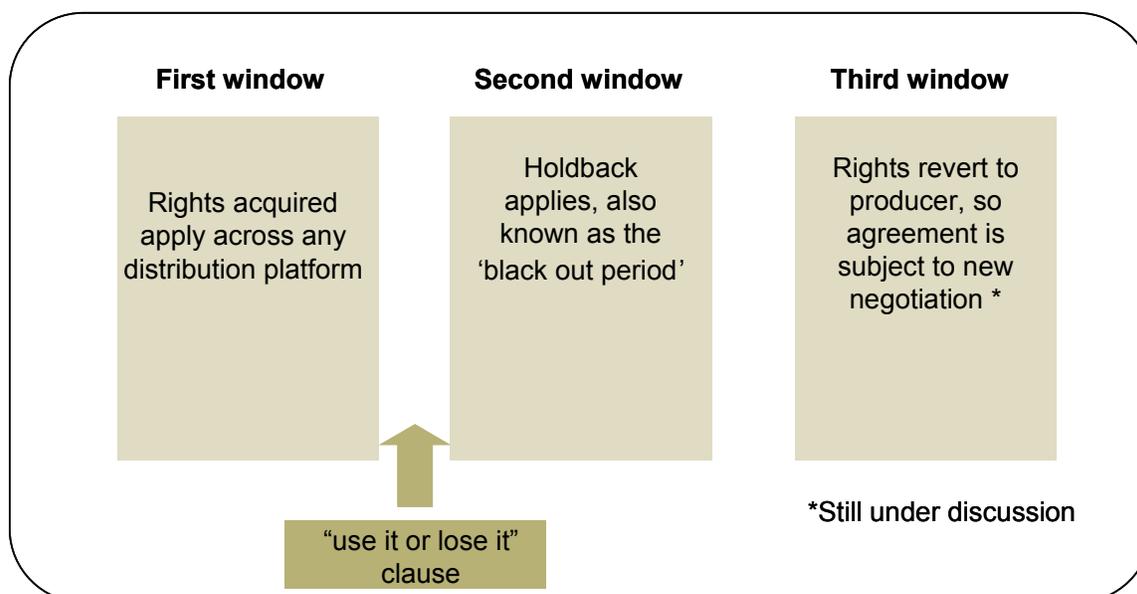
- **The second window:** This window is the “holdback period” in which the broadcaster is able to apply a restriction on the exploitation of rights by the producer. Some call this window “the blackout period” as the content is not in use anywhere during this time.
- **The third window:** In this phase, the rights automatically revert to the producer. If the broadcaster wants to continue using the content, they must strike an agreement with the producer on commercial terms. Some producers believe that this is still a very grey area, and that overarching terms should be struck for this area to prevent broadcasters from taking advantage of producers who might not be in strong negotiating positions at this stage. The key is that should the broadcasters wish to continue offering the program via the download service, they must negotiate a commercial deal for it. Such a clause brings the broadcasters on a level footing with mobile and telecom operators, who from the outset must strike a commercial deal for content.

There is also a clause included in the terms that has been dubbed a “use-or-lose-it” provision. If the broadcaster commissions a program, airs it via linear TV, but then hesitates to put the program onto a new platform, all rights revert back to the producer and the broadcaster misses its chance to use the program. This clause protects the producer from the broadcaster “hoarding” programs that could be exploited by producers.

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<sup>33</sup> This period is still being negotiated.

**Figure 4: The New Platforms Terms of Trade Windowing Framework**



The specific terms struck with Channel 4 demonstrate how this windowing framework has been applied.<sup>34</sup> Channel 4 will have the exclusive right to distribute its programs on its soon-to-be-launched Video-on-Demand service on a free, pay-per-view, or subscription package basis for 30 days after the program's first TV broadcast on Channel 4. The deal keeps Channel 4 commissioned programs off rival VoD services for a further five months after the initial 30-day window has lapsed (the "blackout period").

All stakeholders involved acknowledge that the future demand of broadband-delivered programming is uncertain, and there is a question mark hanging over the issue of which business models will win out at the end of the day (for example, on-demand pay-per-view, or streaming/on-demand paid for by advertising). For this reason, in the spring of 2007, a year after the deal was struck, PACT, Ofcom, and the individual broadcasters will sit down and conduct a review to determine how successful the initiatives have been and how the terms have worked for both producers and broadcasters.

Since these terms have been struck, Channel 4 now plans to proceed with its on-demand strategy and the BBC plans to deliver its on-demand service. While Canada has already forged ahead in this area, most broadcasters have only secured certain

<sup>34</sup> Webdale, Jonathan, "Channel 4, Pact end new media deadlock", [C21Media.net](http://www.c21media.net/news/detail.asp?area=4&article=30754), June 7, 2006, <http://www.c21media.net/news/detail.asp?area=4&article=30754>.

rights to distribute content over new platforms. In the U.K., virtually everything seen on-screen will also be available across new platforms, and both broadcasters and producers will share in the revenues.

## 6 Conclusion

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In sum, it is evident that the first wave creation of collective terms of trade strengthened the U.K. production industry, and achieved the goal set by the Expert Panel of the initial ITC production review to create a healthier industry. In its recent review and subsequent consultation of the television production sector in the U.K., regulator Ofcom concluded that the Codes of Practice introduced as a result of the 2003 *Communications Act* had an overall positive impact on the industry. Ofcom explicitly stated:

“They (the new terms of trade) have been described as instrumental in shaping a more mature industry.... It is also felt that the new environment (resulting from the new terms of trade) will make more production companies more attractive to investors. As such, the Codes have helped to underpin growth in the sector.”<sup>35</sup>

Buoyed by the success of the first wave of collective terms of trade and wary of heavy intervention by the regulator, the industry has now accepted the second wave of terms for new platforms with little resistance. Armed with clear agreements in place, broadcasters and producers can now work together to achieve a mutually beneficial objective of creating successful business models for multi-platform distribution, rather than wasting valuable time and effort wrangling over project-by-project terms of trade.

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<sup>35</sup> Ofcom (2006), *Review of the Television Production Sector*, page 9.

## Interviews

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Krishan Arora, Independents Executive, BBC  
John McVay, CEO of Pact  
Jonathan Porter, Senior Economist, Ofcom  
Dan Allen, Chief Operating Officer, Fremantle Media Enterprises

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