



EUROPEAN COMMISSION

Brussels, 22.05.2002

C(2002)1886fin

Subject: State aid No N 631/2001 – United Kingdom

*BBC licence fee*

Sir,

**1. PROCEDURE:**

1. By letter dated 19 September 2001, registered on 01 October 2001 the UK Government notified the approval by the Secretary of State for Culture, Media and Sport to the BBC to run 9 new digital services. By letter of 7 November 2001 the Commission services requested additional information. By letter of 10 January 2002, registered on 14 January 2002, the UK authorities provided additional information. The Commission services asked further information by letter of 4 February 2001, to which the UK authorities responded by letter of 22 March 2002, which was registered on 26 March 2002.
2. This decision deals only with the approval by the Secretary of State to the BBC to run the nine new digital services. The UK authorities underlined that they considered notification, strictly speaking, not to be necessary. The UK authorities consider the creation and financing of the new service not to be an alteration of existing aid, but as part of the existing public service remit. The remit is funded by the licence fee and set out in the Royal Charter of May 1996 (hereinafter referred to as the Charter) and the Agreement between the BBC and the Secretary of State of May 1996 (hereinafter referred to as the Agreement).

**2. DETAILED DESCRIPTION OF THE MEASURE**

3. On 13 September 2001 the Secretary of State for Culture, Media and Sport gave the approval to the BBC to run 9 new digital services. The new services are to be provided under the public service mission set out in Article 3(a) of the Charter. The BBC sought the agreement for the new channels on the basis of Article 2.3 of the Agreement.
4. The nine new digital services include both radio and television channels. Two new television channels for children will be launched -one aimed at children aged 6 to 13 and another for under the six years olds. BBC 4 - a

television service intended to create a 'forum for debate' and aimed at 'anyone interested in culture, arts and ideas' - will replace BBC Knowledge. Also five new digital radio services are going to be launched, aiming separately at a young specialist audience (Network X), an Asian audience (Asian Network), sports lovers (Five Live Sports Plus) an archive music channel (Network Y) and an archive voice channel (Network Z). Furthermore, an extension of the BBC World Service to the UK was approved.

5. The proposals for the nine digital services was assessed by the Secretary of State in accordance with guidelines, which look at the effects of any approval from the point of view of both the public and industry.
6. The total net costs of the nine digital services for 2002-2003 are 90 million pounds, whereas the total public service costs of the BBC are forecasted to be around 2.9 billion pounds.

### **Background information**

7. The BBC was established by Royal Charter in 1926. The BBC was the sole broadcaster until 1955 when ITV, a commercially funded terrestrial broadcaster, started broadcasting. The market was further opened with the introduction of Channel 4. Commercial cable and satellite broadcasting were introduced in the early 1980s.

### **Legal basis for the measure**

8. The legal bases for the measure are the Wireless Telegraphy Act 1949, the Charter and the Agreement. The Charter and the Agreement lay down the public service obligation of the BBC, whereas the funding provision are laid down in the Agreement, the Wireless Telegraphy Act 1949 and subordinate legislation made under that Act.
9. That Charter has from time to time been replaced up until the current Charter of 1996 and has consistently conferred to the BBC the function of providing broadcasting services for general reception in the United Kingdom.
10. According to Article 3(a) of the Charter the public service remit of the BBC is to provide, as public services, sound and television broadcasting services (whether by analogue or digital means) and to provide sound and television programmes of information, education and entertainment for general reception in Our United Kingdom of Great Britain and Northern Ireland, the Channel Islands and the Isle of Man and the territorial waters thereof, and on board ships and aircraft (such services being hereinafter referred to as "the Home Services").
11. The Agreement defines the content of the "Home Services" in Article 3(2). Amongst others, this Article requires that the "Home Services"
  - b) stimulate, support and reflect, in drama, comedy, music and the visual and performing arts, the diversity of cultural activity in the United Kingdom;

- c) contain coverage of news and current affairs in the UK and throughout the world;
  - d) provide wide-ranging coverage of sporting and other leisure interest;
  - e) contain programmes of an educational nature;
  - f) include a high standard of original programmes for children and young people.
12. Article 2.2 of the Agreement lays down the number of radio and television programme services by which the BBC has to provide the "Home Services". On the basis of Article 2.3 of the 1996 Agreement the BBC is allowed to vary the number of its national television and sound programme services subject to the prior agreement of the Secretary of State.
  13. The Home Services of the BBC have always been funded through the licence fee. The current legal basis for the licensing of television receivers and the payment of the licence fee is set out in the Wireless Telegraphy Act 1949 and the subordinate legislation made under it.
  14. According to Article 16(1)(a) of the Charter BBC is authorised to collect the licence revenue and to receive all funds, which may be paid by the Secretary of State out of money provided by the Parliament and to apply and administer such funds.
  15. The details of the funding system are laid down in the Agreement. According to Article 10(1) of the Agreement, for the purpose of the "Home Services" the State has to pay BBC a sum equal to the whole of the net licence revenue<sup>1</sup> or to such percentage as the Treasury may determine. This Article also provides that the Secretary of State may from time to time direct that such sums may also be used for other purposes, but that such sums shall not be used without prior approval of the State for services funded by advertisements, subscription, sponsorship, pay-per-view system or other alternative means of finance.
  16. According to Article 7(g) of the Charter the BBC has to ensure that the Commercial Services are funded, operated and accounted for separately from the Public Services. The financial requirements and the requirements with regard to its annual report and accounts are laid down in Article 16, 17 and 18 of the Charter. Article 18 (1) requires that the accounts of the BBC be audited annually by an auditor to be appointed by the BBC with the prior approval of the Secretary of State. Article 18(3) requires that its annual reports, accounts or accounts and balance sheet be submitted to the Secretary of State and presented to the Parliament.

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<sup>1</sup> Article 10.4 of the Agreement states that net licence revenue means licence revenue received by the Secretary of State from the BBC less the amount of expenses made by the Secretary of State on refunds, on the administration of the licensing system, on investigate complaints on reception problems, made by the Secretary of State.

### 3. ASSESSMENT

#### State aid in the meaning of Article 87(1)

17. In order to ascertain whether the measure constitutes aid in the meaning of Article 87(1), the Commission has to assess whether the measure:
- is granted by the State or through state resources;
  - is capable of distorting competition;
  - by favouring certain undertakings or the production of certain goods;
  - affects trade between Member States.

#### *Presence of state resources*

18. Firstly, it should be assessed whether or not the funding system of the BBC can be regarded as state resources. Not only aid granted directly through the state budget falls within the definition of Article 87(1) of the Treaty, but also aid granted by public or private bodies designated or established by the State, if the acts of these bodies can be attributed to the authorities.
19. The Commission notes that the cost to the BBC of providing the nine digital services is covered by the television licence fee. An increase in the television licence fee of the retail price index plus 1.5% for each year in the period 2000-2006 was introduced by the Secretary of State in February 2000. The Wireless Telegraphy Regulations 2001 gave effect to this policy. In return for the television licence fee the BBC would have to deliver, amongst other things, the development of interactive and digital services.
20. Taking into account the characteristics of the funding for the nine new digital channels, it is clear that the funding out of the licence fee system has to be regarded as state resources. According to Article 16(1)(a) of the Charter, the Secretary of State pays the licence fee revenue to the BBC out of money provided by the Parliament. It can be added that, even if the revenue, after collection by the BBC, would stay within the BBC budget the aid character would not change, as the revenue remains under public control, and therefore available to the competent national authorities. This is sufficient for it to be categorised as state resources<sup>2</sup>.

#### *The favouring of certain undertakings and distortion of competition*

21. Secondly, the Commission has to assess whether or not the aid distorts or threatens to distort competition by favouring the BBC. Leaving aside the public service obligations of the BBC, the UK authorities give a financial advantage to the BBC that competitors do not receive. The BBC competes with other broadcasters and programme producers. Therefore, without taking into account the public service obligations, there is no doubt that the licence

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<sup>2</sup> Case C-83/98 Ladbroke Racing and T-358/94 Air France.

fee, providing an economic and financial advantage to the BBC compared to competitors not receiving the same funds, has to be regarded as distorting competition by favouring the BBC in the meaning of Article 87(1) EC.

#### *Affecting trade between Member States*

22. For state measures to fall under the provision of Article 87(1) they should have a real or potential effect on trade between member States. Trade between Member States can be affected in a number of markets in which broadcasters are active<sup>3</sup>. The BBC competes in the market of the acquisition and sale of programme rights, which takes place at an international level. Furthermore, the ownership structure of its commercial competitors may extend to more than one Member State<sup>4</sup>. The Court of Justice confirmed that when aid strengthens the position of an undertaking compared with other undertakings competing in intra-Community trade the latter must be regarded as affected by that aid<sup>5</sup>. It has to be concluded that the aid strengthens the position of the BBC compared to other broadcasters that compete in intra-Community trade and therefore may cause a distortion of trade between Member States.
23. From the above, it has to be concluded that, leaving aside the public service obligations imposed upon the BBC, the measure involves state aid in the meaning of Article 87(1) EC.

#### **Proportionality of compensation for the public service costs**

24. According to recent jurisprudence of the Court of Justice, the aid qualification of funding for the compensation of public service obligations depends on the question whether or not the funding goes beyond the net extra costs of the public service obligation<sup>6</sup>. In such a case no real advantage would be granted to the BBC compared to its competitors and therefore the measures would not qualify for State aid in the meaning of Article 87(1).
25. The principles and methods for assessing the proportionality of a funding in the field of public broadcasting are laid down in the Communication from the Commission on the application of state aid rules to public service broadcasting<sup>7</sup>. In order to be able to examine in the present case whether or not the funding goes beyond the net extra costs of the public service obligations of the BBC, the Commission has to assess whether or not<sup>8</sup>:

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<sup>3</sup> The acquisition and sale of programme rights often takes place in an international market. Also the advertising market can have a cross border effect, especially for homogeneous linguistic areas across national boundaries.

<sup>4</sup> For example BSkyB

<sup>5</sup> Cases 730/79, *Philip Morris Holland v Commission* [1980] ECR 2671, paragraph 11; C-303/88, *Italy v Commission* [1991] ECR I-1433, paragraph 17; C-156/98, *Germany v Commission*, decided on 19.09.2000, paragraph 33.

<sup>6</sup> Case C-53/00 *Ferring*, not yet published in ECR, paragraph 27.

<sup>7</sup> OJ C 320 of 15.11.2001, page 5

<sup>8</sup> See paragraph 29 of the Communication on the application of state aid rules to public broadcasting

- the nine new digital services are a service of general economic interest and clearly defined as such by the Member State (definition);
- the BBC is officially entrusted by UK authorities with the provision of that service (entrustment);
- the funding does not exceed the net costs of the public service, taking also into account other direct or indirect revenues derived from the public service mission.

#### The definition

26. In order to ensure that no abuse is made in the definition of the public service, the Commission has to control whether the nine new digital channels are clearly defined as a public service and whether or not the definition contains any manifest errors.
27. With regard to the broadcasting of programmes through digital means by public service broadcasters the Commission considers that public service broadcasters can develop and diversify their activities in the digital age, as long as they are addressing the same democratic, social and cultural needs of the society<sup>9</sup>. Furthermore, the Resolution on public service broadcasting of the Council and Government Representatives of the Member States of 25 January 1999 states that public service broadcasters need to undertake the development and diversification of activities in the digital age<sup>10</sup>.
28. In the case at hands, it should be assessed whether or not the new digital channels can be regarded as a service of general economic interest and whether or not any manifest errors are present in the definition of the public service. The new digital channels are not defined as a new separate public service, but have to be provided under the public service remit of the BBC, as laid down in Article 3(a) of the Charter (defined as "Home Services") and specified in Article 3(2) of the Agreement.
29. The Commission considers that the new digital channels can, in fact, be considered as sound and television programmes of information, education and entertainment provided by digital means. Therefore, these services can be regarded as a public service within the meaning of Article 3(a) of the Charter. By seeking the prior agreement of the Secretary of State for the extension of number of channels, the BBC has fulfilled the requirement of Article 2.3 of the Agreement to seek such agreement before varying the number of its national television and sound programme services.
30. It should in this respect be noted that the new digital programmes can't be received by the whole population yet, although the Charter requires the BBC to provide as "Home Services" programmes for general reception<sup>11</sup>. This

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<sup>9</sup> Point 34 of the Communication on state aid to public service broadcasting.

<sup>10</sup> OJ C 30, 5.2.1999, p. 1.

<sup>11</sup> See in this respect also point 59 and 60 of Commission Decision of 14 December 1999 in Case NN 88/98 'Financing of a 24-hour advertising-free new channel out of the licence fee by the BBC'.

might raise doubts as to whether or not the new digital services can be regarded as a public service in the meaning of Article 3(a) of the Charter. However, in the present case the Commission considers that the explicit wider policy goal of the UK government to promote digital take-up leading to switchover by the whole population justifies these temporary technical constraints.

31. In line with the requirements of Article 3(2) of the Agreement the new digital channels stimulate the diversity of cultural activity in the United Kingdom, contain coverage of news and current affairs in the UK and throughout the world, provide wide-ranging coverage of sporting and other leisure interest, contain programmes of an educational nature and include a high standard of original programmes for children and young people.
32. The Commission considers that the content of the new digital television channels, as well as the radio programmes and the extension of BBC World services to the UK all are in accordance with the programme content requirements as set out in Article 3(2) of the Agreement.
33. The fact that each channel is specialised and covers only one or certain requirements for the programme content as laid down in Article 3(2) of the Agreement, doesn't change this conclusion, as Article 3(2) doesn't require that all channels contain the whole spectrum of programme contents.
34. Taking into account the above considerations, the Commission concludes that the digital services form a logical part of the public service remit of the BBC, which is officially defined in Article 3(a) of the Charter and the Article 3(2) of the Agreement. The new digital channels can be considered to meet – in the wording of the Protocol – the “*democratic, social and cultural needs of each society*” and therefore do not contain any manifest errors. In view of the interpretative provisions of the Protocol and given the specific nature of the broadcasting sector, the rather qualitative definition of the public service remit of Article 3(a) of the Charter and Article 3(2) of the Agreement, under which the new digital channels are to be provided, can be considered as legitimate services of general economic interest within the meaning of Article 86(2) EC. Consequently, the new digital channels can be considered as services of general economic interest within the meaning of Article 86(2) EC.

#### Entrustment

35. The letter of the Secretary of State of 13 September 2001 informs the BBC that the Secretary of State decided to approve their proposals for new digital television and radio services. Furthermore, the Annexes of the letter set out the conditions for each specific service that was approved. Therefore, the letter of 13 September 2001 can be regarded as the document entrusting the BBC to perform the nine new digital services.
36. However, the Commission regrets that the conditions of the entrustment of the new digital channels haven't been precisely and clearly defined in the relevant legal documents, being the Agreement and the Charter, which

describe the public service obligations of the BBC<sup>12</sup>. The Commission considers that a clear and precise identification of the activities covered by the public service remit, and the conditions under which such activities have to be performed, is important for non-public service operators, so that they can plan their activities. A formalisation of the letter of approval of 13 September 2001 in the above mentioned legal documents would increase the transparency of the activities covered by the public service remit of the BBC.

37. Not only should the public service broadcaster be formally entrusted with the provision of a well-defined public service, it also should be assured that the public service is actually supplied as foreseen in the official entrustment. It is within the competence of the Member State to choose the mechanism to ensure effective supervision of the fulfilment of the public service obligations. The Commission considers that the role of such a body would seem to be effective only if the authority is independent from the entrusted undertaking.
38. Article 7 of the Charter lays down the responsibilities of the Board of Governors, which has to assure that the activities of the BBC are carried out as foreseen in the Charter, the Agreement and (with regard to their non-public service activities) the Fair Trading Commitment. For this purpose, the Board of Governors has to establish and maintain an Audit Committee. The Commission considers that the control by the Board of Governors, who are appointed by the Government, should ensure in principle the effective supervision of the fulfilment of public service obligations with regard to the new digital channels.

#### Proportionality

39. With regard to the proportionality of the financing, it should be prevented that the financing goes beyond the net costs of the public service obligation and therefore risks to cross-subsidise the non-public service activities of the BBC.
40. The Commission has to take several aspects into account when assessing possible overcompensation.
41. Firstly, a public service broadcaster that receives state financing for the operation of its public services, is subject to the provisions of the Transparency Directive, insofar it also carries out non-public service activities. The Transparency Directive requires Member States to ensure that the internal accounts corresponding to public service and non-public service activities are separate and that costs and revenues are correctly allocated.
42. In this respect the Commission notes that the BBC complies with the obligation of the Transparency Directive in keeping separate accounts for its commercial and public service activities. The non-public service activities

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<sup>12</sup> Such as article 2.2 of the Agreement where the number and coverage of the channels are defined

are performed by separate commercial subsidiaries of the BBC<sup>13</sup>. The accounts of these subsidiaries are published in accordance with the UK Companies Acts and have to show the sources and amount of the income derived from the non-public service activities. The Office of Fair Trading in the UK regulates the non-public activities of the BBC.

43. In case of an ex-ante assessment, such as the present notification, the Commission is not in a position to assess whether or not the separation of accounts is carried out correctly. In such a case it has to be assured that the legal acts clearly include provision to prevent cross-subsidisation and abuse of the compensation. Furthermore, the provision should include mechanisms to control that the aid is used correctly according to the legal provisions.
44. Article 7(1)(g) of the Charter provides that the non-public service activities have to be funded, operated and accounted for separately from the public services. Furthermore, the accounts of the BBC are controlled by an auditor and submitted to the Secretary of State and the Parliament.
45. Secondly, the net benefits of the commercial exploitation of the public service activities have to be taken into account when calculating the net public service costs. The UK authorities regard all the sound and television programmes of the Home Services as covered by the public service remit, while at the same time allowing for the sale of these programmes.
46. According to article 7(1)(b) of the Charter the activities of the BBC have to be in accordance with the Corporation's fair trading commitments. The BBC's Fair Trading Commitment commits the BBC to ensure that public funds are not diverted to commercial activities. Furthermore, the BBC has adopted detailed commercial policy guidelines, which apply to all commercial activities of the BBC.
47. The Fair Trading Commitment and the Commercial Policy Guidelines require that the commercial subsidiaries have to pay fair charges for inputs (such as programme rights, facilities and resources, presentation and promotion services and accommodation), they receive from the public service entities of the BBC organisation<sup>14</sup>. These charges should be in line with the external market price for such inputs. The BBC has to provide evidence from time to time that the charges made by the BBC are in line the prices prevailing in the external market.
48. The Commission considers that the above mechanisms in principle safeguard that, in line with point 57 of the Communication on Broadcasting, the advantages derived from the public service mission are taken into account properly, when calculating the net public service costs. Such mechanisms, on condition that they will be properly applied and controlled on an ex-post basis, prevent in principle that cross-subsidisation can take place from the

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<sup>13</sup> BBC Worldwide Limited, BBC Technology Limited and BBC Broadcast Limited

<sup>14</sup> Charges must always cover the incremental costs incurred by the BBC in supplying the goods or services to the commercial subsidiaries, reflect a reasonable contribution to the relevant department overheads and long-term replacement costs of shared assets.

public funded parts of the BBC to its commercial entities, by means of for example transfer at low price of programmes for commercial exploitation.

49. Thirdly, another aspect should be taken into account when calculating the proportionality of the compensation for BBC's public service activities. A side effect of the public service compensation might be that other market distortions occur which are not necessary for the fulfilment of the public service mission. As a result of the state financing of public service programmes the public broadcaster might be in a position to act in an anti-competitive way, by undercutting competitors in the commercial markets.
50. As explained in the Communication from the Commission on the application of state aid rules to public service broadcasting, the Commission considers that the behaviour of public service broadcasters when commercially exploiting public service programmes should be in line with that of a commercial undertaking in similar circumstances, i.e. it should be aimed at recovering the costs normally associated with products or services of similar market value. Whenever a public service broadcaster undercuts prices in non-public service activities below what is necessary to recover the stand-alone costs that an efficient commercial operator in a similar situation would normally have to recover, such practice would indicate the presence of over-compensation of public service obligations<sup>15</sup>.
51. The (public service part of the) BBC sells programme related material to BBC Worldwide Ltd, which is responsible for exploiting this material to third parties. As already indicated above, all resources are transferred at market price, which implies that BBC Worldwide Ltd has to follow normal market behaviour in order to recover its costs. In addition the UK authorities informed the Commission with regard to the commercial pricing policy of the BBC that BBC's commercial policy guidelines require when exploiting programme related material that the prices have to be in line with the rest of the market. These guidelines also state that the BBC has to exploit its intellectual property with third parties if the commercial entities of the BBC are not able to receive the best maximum revenue from the commercial exploitation of its programme assets.
52. Internal and external auditors and the Board of Governors, through its Fair Trading Compliance Committee control the compliance by the BBC with the requirements of the Fair Trading Commitment. The Board of Governors and the external auditors each include in the Annual Report their opinion of whether the BBC has correctly applied the requirements of the Fair Trading Commitment and the Commercial Policy Guidelines.
53. Taking into account the above, the Commission concludes that provisions in the Charter, the Commercial Policy Guidelines and the Fair Trading Commitment, as well as the ex-post control by internal and external accountants and the Board of Governors in principle can be regarded as sufficient to safeguard that no cross-subsidisation takes place from public

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<sup>15</sup> Point 58 of the Communication on Broadcasting

funds to the non public service activities of the BBC. Furthermore, these provisions ensure that the commercial pricing policy of the BBC doesn't create market distortion, which could not be justified in terms of the need to perform the public service remit.

54. It has to be concluded that the compensation for the digital channels does not seem to constitute a measure disproportionate to the net public service costs of the BBC, and therefore does not constitute a real advantage. Accordingly the measure does not constitute state aid in the meaning of article 87(1) EC.
55. For the reasons explained above and in the light of the recent Case Law the Commission considers that such compensation does not constitute an aid. However, the Commission also notes that, even if the measure were to be considered as a state aid, it would be compatible on the basis of Article 86(2) EC. Indeed, this provision applies to measures that are essential for the fulfilment and continuation of a mission of general economic interest. The Commission considers that all the conditions for applying Article 86(2) EC, as explained in the Commission Communication on Public Service Broadcasting, are fulfilled in the present case:
- It has already been established in paragraphs 26-34 that the services at stake can be considered as services of general economic interest within the meaning of this provision.
  - It follows from paragraphs 25-38 that his service has been entrusted to the BBC by the Public Authorities of the Member State.
  - It also follows from paragraphs 39-54 that the compensation is proportionate to the net public service costs and that there is no risk of spillover to neighbour markets.
  - The Commission finally considers that, given the fact that the new services would be financed out of the current level of licence fees and given the guarantees against overcompensation and spill-over in other activities, the development of trade is not affected by this measure to an extent that would be contrary to the interest of the Community.

Therefore, even if the measure would be considered to be a state aid, the exception of Article 86(2) EC would apply, on the basis of which the measure would be compatible with the Treaty.

#### **4. DECISION.**

The Commission has accordingly decided:

- to consider the measure not to constitute state aid within the meaning of article 87(1) EC.

If this letter contains confidential information, which should not be disclosed to third parties, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you

will be deemed to agree to the disclosure to third parties and to the publication of the full text of the letter in the authentic language on the Internet site: [http://europa.eu.int/comm/secretariat\\_general/sgb/state\\_aids/](http://europa.eu.int/comm/secretariat_general/sgb/state_aids/). Your request should be sent by registered letter or fax to:

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Yours faithfully,

For the Commission

*Mario Monti*

Member of the Commission