

INDEPENDENT ACCESS STEERING COMMITTEE

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Rt. Hon Nigel Lawson, MP
The Chancellor of the Exchequer
The Treasury
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HM TREASURY - MCU	
RECD	13 JAN 1988
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4 January 1988

Dear Chancellor of the Exchequer

INDEPENDENT TELEVISION PRODUCERS

During the Prime Minister's seminar on Broadcasting on 21st September you very kindly said that I might write to you at a future date about the implications for independent producers of the current tax and Levy arrangements governing ITV. As you may know in recent weeks talks between the independent producers represented by my committee and the ITV companies initiated by the IBA and aimed at establishing a voluntary basis for implementing Government policy on 25% access for programmes made by independents have broken down. Similar talks on business guidelines for the period before a genuine competitive market in the supply of television programmes is established have now been brought to a satisfactory conclusion with the BBC. These two events mark something of a watershed for the voluntary implementation of Government policy. This therefore seems an appropriate moment at which to write to you.

ITV must be almost unique in British industry in that the companies within it thrive through making one thing but selling another: they make television programmes, but sell advertising air-time. Where they do sell programmes, overseas or to Channel Four, this remains despite the increasing attention paid to it, an essentially secondary activity. In any case the basis for such programme sales by ITV companies is firmly rooted in the artificial financial regime of their primary function as broadcasters and privileged holders of the right to exploit a public asset - the right to sell advertising air-time.

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The Review of the ITV Levy Structures undertaken by officials from the Home Office, the Treasury and the IBA, published in February 1986, recognised that the Levy, as then structured, might act as a dis-incentive to cost-consciousness within the ITV companies. Even as reformed in the subsequent Budget the Levy structure still provides a degree of disincentive to ITV cost consciousness and certainly results in independent producers (widely recognised as a good deal more cost effective than ITV companies) being at a trading disadvantage in dealings with Channel Four and in competing for overseas markets. One of the annexes to the Review of the ITV Levy Structures contained an illustrative calculation of the effects of the Levy as then structured on the programme making decisions of one ITV company based on real figures seen by the committee. We asked accountants to rework this calculation on the basis of the current reformed Levy structure. The illustration posits the production of a major programme, such as a drama series costing £2m to produce and, in our re-working, assumes overseas sales of £1.3m, a realistic figure in our experience. The 'UK Sales' could either be to Channel Four, or for an ITV company the sum paid or credited to it by the other companies under the network 'pool' system established to facilitate the trade and exchange of programmes between the companies in the network.

Please see photocopy of calculation attached.

As the Annex to the original report upon which the above calculation is based notes, 'the "gross margin" does not include benefits the ITV company receives from the programme. In particular there is no mention of the advertising revenue that might be generated directly or indirectly by a major drama series. Neither does it take into account the cost of buying in an alternative programme to fill up the schedule.' Despite this, the company made a margin of £182,500 above direct costs, even though without the Levy costs exceed revenue by £200,000. An independent producer, of course, enjoys none of the hidden advantages mentioned in the note to the original Annex, but because of the Levy, is placed at a considerable disadvantage vis-a-vis an ITV company when it comes to competing for a Channel Four commission, an overseas sale or establishing international co-production arrangements. In practice the value of the 'UK Sale' to the ITV company may be higher than that shown if the programme is either one made by one of the 'big five' network companies (evidence elsewhere in the report suggests that the illustration was based on figures supplied by one of the regional stations) or is sold by the ITV company to

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Channel Four. In dealings with Channel Four ITV companies offering major programmes, such as the one in the illustration, accept payment by Channel Four of 75% to 80% of the cost in return for granting the Channel the right to one or two showings of the programme. An ITV company, unlike an independent, dealing with Channel Four will normally be allowed by the Channel to retain all rights and 100% of the income from subsequent overseas exploitation of any programme. Clearly this places an ITV company at a considerable advantage vis-a-vis an independent, in that through operation of the Levy the ITV company remains much less dependent on overseas sales than an independent.

Fortunately independent producers are a great deal more efficient than ITV companies and so manage to stay in business. A number of recent calculations of the true total cost of production of network television programmes, taking into account not only the profit margin added by independent producers but also the permanent staff, studio and production related overhead costs of the broadcasters (ITV and BBC), suggest that for every £100 an independent spends on a production, the BBC spends £120 and an ITV company £170. These figures perhaps explain why the independent producers are particularly happy to embrace the Government's commitment to introducing competition into programme supply in television, but are unhappy that the operation of the ITV Levy has the effect of stacking the cards against them. It also accounts for our lack of surprise over the ITV companies opposition to the introduction of competition in the form of independent access as evidenced by their delaying tactics and ultimate refusal to enter into meaningful discussions with the independent sector on establishing business guidelines for dealings between the companies and the independents pending the establishment of real competition and a genuine market in programme supply.

My committee suggested to the ITV companies business guidelines and working structures every bit as flexible as those recently agreed with the BBC. The ITV companies comprehensively rejected such proposals. In this context it is perhaps worth picking out some of the salient features of the arrangements agreed with the BBC. Fundamental to the agreement is the acceptance by both sides of what has come to be known as the 'Runway Principle': that is to say that it anticipates, and provides for, the phasing out of centrally agreed parameters for operating margins and shares of profit from overseas sales as genuine competition in programme supply is established. The guidelines on operating margins and levels of participation in overseas sales income were developed from the existing Channel Four system, but are more flexible and realistic than under that system. Margins are computed not only on

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the size of the production budget, but by assessment of market forces and the exigencies of the specific production. The agreement protects the BBC's right to editorial control over programme content and what it broadcasts, but also recognises and protects the vital intellectual or creative capital for an independent represented by a programme idea. Both sides recognise their shared interest in maximising profits from overseas and other sales. The guidelines also establish that while an independent may use BBC resources and facilities, if available, on a proper businesslike basis, agreement to use BBC facilities or staff must not be a condition of contract.

Of course the ITV companies have recently commissioned some independent production and claim to have quite a lot more 'in the pipeline'. However, just what productions, from what 'independent' producers and in how long a 'pipeline' are all matters over which ITV has so far been less than forthcoming. Of commissions about which something is known, a great many appear to be being made by companies that would not qualify as independents or under conditions imposed by the ITV companies which negate the objective of establishing a separate and competitive third force in programme supply. In order to gain contracts with ITV companies independent producers have frequently had to surrender their rights in the programme's concept or script, have been denied participation in a programme's subsequent overseas exploitation or refused an adequate operating margin. Independents have had to face ITV companies with whom they were trying to negotiate contracts who, often at the last moment, made it a condition of contract that the independent use the ITV company's studios and crews. Even so independents have accepted such contracts, the alternative being the possibility of winding up, liquidation or antagonising a powerful potential future customer.

Such is the background to the failure of talks with the representative body of the ITV companies - the ITV Association. Given the subsequent agreement with the BBC, and assuming that that agreement is successfully implemented, a basis would now seem to exist for the introduction of an element of genuine competition in programme supply into that side of the broadcasting duopoly. However the prospects for the successful implementation of Government policy on the ITV side look much less good. Whereas the experience of my Committee in talking to the BBC in recent months has been of the Corporation's willingness to enter into serious negotiations aimed at the flexible and practical implementation of independent access our experience of ITV has been one of prevarication and rigidity. My Committee is therefore of the view that if Government policy is to be implemented something beyond

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exhortation and leaving it to the IBA is now called for. If Government policy is to be implemented on anything like the timescale suggested by various Government statements then, because of the length of time still to run under the current ITV franchises, some faster acting inducement than the enactment of a new Broadcasting Bill is needed. I would ask you therefore to consider amending the structure of the ITV Levy in the forthcoming Budget.

The purpose of such amendment would be simultaneously to stimulate cost consciousness in ITV and provide an inducement to ITV companies to commission programmes on a realistic basis from genuine independent producers. To this end we would propose that the right to offset the total cost of programme making by ITV companies against their liability to Levy be removed and restricted to costs incurred as a result of certain limited categories of programme production or acquisition. Among the kinds of programme activity for which costs could continue to be offset would be the cost of commissioning or acquiring programmes from genuine independent producers and activities clearly connected with the companies public service broadcasting obligations, such as their financial contribution to the funding of national network news. Alternatively differential rates could be established, calculated to counterbalance the trading disadvantage which the current Levy structure produces as regards the competitive position of independents. The right of ITV companies to offset the cost of making programmes which they sell to Channel Four could also be terminated as this too does nothing to ensure cost-consciousness and has the effect of giving an ITV company an unfair advantage when competing for commissions with independent producers. While Channel Four was a net drain on ITV profits the right to offset their Channel Four programme costs may have been justified, but as the companies now make a net profit from Channel Four the justification no longer seems valid. While legislation will probably still be needed to secure competition in programme supply over the longer term, action of this kind through the Budget would seem to hold out the prospect of being both administratively straight forward and producing quick results.

Please forgive the length of this letter. If there is further information or ideas that I or my colleagues can provide we would be very willing to do so.

Yours sincerely



MICHAEL DARLOW
Head of Negotiations

