

## State aid law and the BBC Charter review: contestable funding by the back door

*The Government's Green Paper on the renewal of the BBC's Royal Charter proposed reforms to the governance of the BBC. Nicholas Francis examines the proposals in the light of the European Union's rules on State aid, and finds a conflict. Despite the high degree of subsidiarity that is recognised in the application of State aid law to public service broadcasting, the halfway house reflected in the proposals is unlikely to be compatible with State aid law. This could set the BBC on a collision course towards a contestable funding model — an outcome completely at odds with the Government's stated policy.*

### Summary

<sup>1</sup> In March 2005 the Government published a Green Paper on the renewal of the BBC's Royal Charter.<sup>1</sup> The Green Paper proposes the creation of a new body, provisionally called the BBC Trust. The BBC Trust would be accountable for the use of licence fee income, and would hold the BBC to account for service delivery.

<sup>2</sup> Were the Green Paper's proposals to be taken forward, there could be a significant change in the way that European Community law constrains the activities and funding of the BBC. This change could spell the end of the BBC as we know it.

<sup>3</sup> Specifically, to secure continued compliance with the State aid rules, the proposed governance model could make it necessary for BBC editors and programme-makers to become more like contractors, with all important decisions on service delivery resting with the BBC Trust. It may also be necessary for the BBC Trust to consider engaging third parties, such as Sky, to deliver some services funded by the licence fee.

<sup>4</sup> This conclusion holds despite the fact that European Community law has long recognised that decisions about media regulation and public service broadcasting should not be taken in Brussels — a form of subsidiarity that was enshrined in a protocol to the Treaty of Amsterdam.

### EC law constrains State funding to enterprises

<sup>5</sup> European Community law means that the UK does not have a free hand in providing State funding to enterprises, even within the public sector.

<sup>6</sup> Article 87 of the Treaty establishing the European Community (as renumbered by the Treaty of Amsterdam)

defines a concept of State aid, and gives exclusive powers to the European Commission to decide whether any such aid is "compatible with the common market" — i.e. permissible.

<sup>7</sup> The Treaty, and case law under it, provides various ways in which State funding to an undertaking providing a public service may be allowed.

<sup>8</sup> First, not all State funding counts as State aid within the meaning of Article 87(1) of the Treaty.

<sup>9</sup> Second, even when State funding constitutes State aid under Article 87(1), it might be justified by Article 86(2) of the Treaty. Article 86(2) limits the application of the Treaty's competition rules in the case of "undertakings entrusted with the operation of services of general economic interest" (public services). This allows State aid insofar as it is necessary for the undertaking to deliver the public service that it has been entrusted with.

<sup>10</sup> Other grounds of justification are provided in the Treaty, including cultural objectives and the economic regeneration of disadvantaged regions. But these do not seem wide enough to justify the range of the BBC's activities. Any reason for allowing current funding must therefore be found under Article 87(1) or Article 86(2).

### Public services can be funded in different ways

<sup>11</sup> This paper develops the argument that the proposed reform of BBC governance changes the way that State funding to the BBC is assessed under the Treaty. To do so, it is necessary to distinguish between two models for the funding of a public service with State resources:

(a) **Procurement of outputs.** An undertaking is burdened with a public service obligation and provided with a certain amount of State funding as remuneration for that burden. The intention is that the State funding is the minimum necessary to enable the undertaking to meet the obligation.

(b) **Entrustment of public service.** An undertaking is entrusted with the provision of a public service and given State funding. The undertaking has discretion to interpret the public service entrustment. Both the amount of State funding and the outputs delivered may depend on choices made by the undertaking.

<sup>12</sup> Under the procurement model, the State funding provided to the undertaking would not count as State aid if, and only if, the undertaking receives no more State funding than is objectively necessary to meet the public service obligation.

<sup>1</sup> Department for Culture, Media and Sport (2005) *Review of the BBC's Royal Charter: a strong BBC, independent of government.*

<sup>13</sup> The *Altmark* judgment indicates that there is no State aid under the procurement model if compensation for the public service obligation is determined by a competitive tender to find the least-cost provider, or if State funding is set at a level consistent with the outcome of a hypothetical tender process.<sup>2</sup>

<sup>14</sup> State aid law works differently under the entrustment model. In this model, the State gives an undertaking broad public purposes but no detailed specification of the public service to be provided. The relationship between the undertaking and the State does not correspond to a market supplier-purchaser relationship, and the *Altmark* tests cannot apply.

<sup>15</sup> Under the public service entrustment model, State funding will be State aid. The State aid will be compatible with the Treaty if it is justified by Article 86(2). That requires the undertaking to receive no more State funds than is necessary for it to provide the public services that it offers in order to deliver on its public service entrustment.

### The BBC's funding is State aid

<sup>16</sup> The BBC receives resources from the State including the income from the licence fee and grant-in-aid from the Foreign and Commonwealth Office in respect of BBC World Service.

<sup>17</sup> The basis on which the BBC provides a public service is the BBC's 1996 Royal Charter and the 1996 Agreement between the BBC and the Secretary of State, as amended in 2003. The Charter deals with the BBC's objectives, incorporation and governance. The Agreement sets broad aims and limits for the provision of broadcasting and related services by the BBC.

<sup>18</sup> In addition to these documents, the Secretary of State for Culture, Media and Sport has, on several occasions, given specific approval for the BBC to provide other services, such as its public service website *bbc.co.uk*.

<sup>19</sup> Taken together, these documents direct and constrain the BBC's public service provision. But they do not come close to a detailed specification of the services that the BBC provides. There is nothing that could be seen as creating a procurement contract between the State and the BBC.

<sup>20</sup> Because of this, the BBC does not fall within the procurement model described above.

<sup>21</sup> Thus, when the BBC uses State funds to support the provision of particular services there is probably State aid within the meaning of Article 87(1), insofar as the BBC acts as an "undertaking" (a term given specific meaning in Community competition law).

<sup>22</sup> The question of when and where the BBC acts as an undertaking is beyond the scope of this paper. We proceed on the reasonable assumption that a significant

amount of the BBC's State funds is used by the BBC in the capacity of an undertaking providing a service.

### State aid to the BBC will often be justified

<sup>23</sup> The nature of the BBC Charter and Agreement mean that there is a wide scope to justify State aid to the BBC under Article 86(2).

<sup>24</sup> Article 86(2) entitles the BBC to use State funds to support the provision of a BBC service if:

- (a) the provision of the service is part of the public service that the BBC is entrusted with the provision of; and
- (b) it uses no more State funds than necessary to provide that service.

<sup>25</sup> Point (a) will generally be satisfied. The Charter and Agreement entrust the BBC with the provision of a public service, and allow the BBC considerable discretion as to what particular content to offer.

<sup>26</sup> Even so, the BBC cannot use State funding to support its commercial businesses. And it is unlikely that all conceivable provision of media content, for free, would be compatible with the BBC's entrustment.

<sup>27</sup> Point (b) requires that aid be kept to a minimum whilst respecting Member States' right to determine and ensure the delivery of public services.

<sup>28</sup> It is necessary at this stage to mention the European Commission's 2001 *Communication on the application of State aid rules to public service broadcasting*. This document might be seen to further restrict the way in which State funding to the BBC would be compatible with the Treaty. It states, for example, that without a "clear and precise definition" of the public service obligations imposed on broadcaster receiving State aid, "the Commission would not be able to carry out its tasks under Article 86(2) and, therefore, could not grant any exemption under that provision" (paragraph 37).

<sup>29</sup> But this document does not have the force of law and creates a risk that the State aid rules will be misinterpreted in such a way as to underestimate the scope for State funding to the BBC to be compatible with the Treaty.

<sup>30</sup> The wide extent of that scope is demonstrated by the outcome of the three previous European Commission investigations: for BBC News 24 (1999); for nine new digital-only TV and radio channels (2002); and for the BBC Digital Curriculum (2003).<sup>3</sup> In none of these cases did the Commission find the State funding to the BBC to be incompatible with the Treaty. In the News 24 and Digital Curriculum decisions, the Commission found that there was State aid but that it was justified by Article 86(2).

<sup>31</sup> In the digital-only channels decision, the Commission found that there was no State aid. This aspect of the

<sup>2</sup> Case C-280/00, *Altmark* [2003] ECR I-07747.

<sup>3</sup> Cases NN 88/98, N 631/2001 and N 37/2003; links available from <http://go.reckon.co.uk/bbc>.

decision is almost certainly wrong, reflecting the fact that the Commission did not have the benefit of the *Altmark* judgment when it prepared its decision. In any event, the Commission also states that had State aid to the digital-only channels been found, this would have been justified by Article 86(2).

### The BBC fits well within the State aid rules

<sup>32</sup> We assume that the BBC does not wish to place the UK in breach of the Treaty. If so, the main constraints that the State aid rules place on the BBC relate to:

- (a) **Inappropriate services.** The BBC must not use State funds to provide services that it is not entrusted by the State to provide.
- (b) **Wasteful expenditure.** The BBC must not use, or receive, more State funding than it needs for the provision of a particular set of services.

<sup>33</sup> In keeping with the tradition of the BBC as an institution, the Charter and Agreement clearly envisage a BBC with significant scope for discretion in how it interprets and provides public service broadcasting. Indeed, one might go so far as to say that UK broadcasting policy has reflected the view that “we don’t know exactly what public services we want in the broadcasting sector, but we know we want the BBC”.

<sup>34</sup> This approach is compatible with the EC State aid rules through Article 86(2), and the constraints listed above do not seem to represent any undue impediment to the BBC. Subsidiarity is working.

### The Green Paper proposes a new model

<sup>35</sup> We now turn to consider the Government’s plans for the next BBC Charter.

<sup>36</sup> It is not possible to set out in full here the proposals in the Green Paper, which are in any event not sufficiently detailed to present a full and consistent picture. But we can draw from the Green Paper (e.g. pages 11 and 72–74) assumptions about a BBC governance model in which:

- (a) The BBC Trust is a separate entity from the BBC.
- (b) The Trust is responsible for spending the licence fee.
- (c) The Trust issues detailed service licences to the BBC, against which it holds the BBC to account.

<sup>37</sup> We assume that it would be the responsibility of the Trust to spend the licence fee income by agreeing service licences with BBC for the delivery of particular services. Service licences would presumably not detail, say, the schedule and programming of a particular BBC channel. But they would include a budget, a well-specified remit, and a series of quantitative performance targets in terms of content output and audience reach.

### The new model introduces new State aid risks

<sup>38</sup> The BBC would be separate from the Trust. The Trust would be responsible for the licence fee income. The BBC would thus receive State funding from the Trust.

<sup>39</sup> Service licences would seem close to the spirit, perhaps even the letter, of procurement contracts between the Trust and the BBC. The procurement model described above would seem to reflect the basis on which the BBC receives State funding from the Trust.

<sup>40</sup> This would mean that the provision of State funding to the BBC may not be State aid, but instead a market-like State purchasing decision based upon service licences. There would be no State aid if the money provided by the Trust to the BBC is no more than necessary to meet the obligations placed on the BBC by its service licences. This may suggest a reduction in the risk of infringement.

<sup>41</sup> But there is a flipside. The model described above gives no guarantee that there is no State aid. There would be State aid if the amount of money received by the BBC cannot be robustly justified by obligations incorporated in service licences. And, if there is State aid, it is unlikely that Article 86(2) would justify the aid in question. This is because the Article 86(2) justification arises from the entrustment of an undertaking with public service responsibilities, and the relevant entrustment would be of a far more limited nature than under current arrangements.

<sup>42</sup> Specifically, the separation between the Trust and the BBC would mean that the Trust would take on the duty of interpreting the public service objectives derived from the BBC Charter and Agreement, whilst the BBC would only be entrusted with the provision of a public service to the extent that it fulfils the obligations of a service licence.

<sup>43</sup> Thus, the BBC would not be entrusted with discretion to provide a better or broader service than the strict requirement of its service licences. So State aid rules would not allow the BBC more funding than the amount necessary (or reasonably expected to be necessary) to meet the strict requirement of its service licences.

### The BBC would lose its bottom-up creativity

<sup>44</sup> Under current arrangements, there is a wide scope for discretion and creativity throughout the echelons of the BBC. Individual editors and programme makers can try out new ideas, services and concepts without the say-so of a minister or governor. This distributed creativity is one of the core features of the BBC.

<sup>45</sup> State aid law does constrain the BBC. But, as noted above, it only really prevents the BBC from using State funds to provide services inconsistent with the Charter and Agreement or from wasting licence fee income in the delivery of the services that it had chosen to deliver.

<sup>46</sup> The constraints arising from the State aid rules would be much stricter under the proposals set out in the Green Paper. Because a service licence would be much more tightly defined than the Charter and Agreement, the BBC would have to lose its creative discretion if the UK is not to infringe the State aid rules. The Trust would, by legal necessity, become the nexus of decisions as to how BBC programming can best meet the purposes of the Charter and Agreement. The scope for bottom-up creativity within the BBC would be dramatically reduced.

### A service licence is an invitation to tender

<sup>47</sup> The model assumed above would not just reduce the discretion and the bottom-up creativity of the BBC. It could also pave the way for the introduction of contestable funding for the BBC’s licence fee income.

<sup>48</sup> BBC News 24 provides a good example of how this might happen. In a consultation paper on service licences, the BBC Governors have indicated that a service licence would need to be developed for that channel.<sup>4</sup>

<sup>49</sup> Suppose that, under the proposed governance arrangements, the Trust agrees with the BBC a service licence for a 24-hour news channel, and that this includes details on:

- (a) the aims of the channel;
- (b) delivery platforms;
- (c) expected programming outputs;
- (d) expected audience reach; and
- (e) budget.

<sup>50</sup> Now imagine that someone else — Sky, for the sake of argument — thinks it could provide such a news channel for a lower budget. It would be worth Sky’s while to make an offer to the Trust to provide the channel. If the offer is credible, the Trust could not simply laugh it off. The threat is that Sky complains to the European Commission that there is State aid in the form of the unnecessarily high budget (compared to Sky’s bid), and the UK would face a serious risk of infringement.

<sup>51</sup> It is possible that such a threat simply leads the Trust to reduce the budget of the service licence. But, amongst the various services on offer, it seems probable that, at some point, a competitive bid would reflect a real efficiency or skills advantage that the BBC could not match. The BBC would be unable to take on these services at a loss because State aid law would prevent it from plugging the gap with excess income from other services or other sources of State funding. The Trust might therefore feel compelled to appoint someone other than the BBC to deliver some licence-fee funded services.

<sup>52</sup> In short, State aid law means that the BBC governance arrangements proposed in the Green Paper could be susceptible to testing by parties keen to get their hands on a slice of the BBC’s licence fee income.

<sup>53</sup> The proposed arrangements seem to enable contestable funding through a back door. This seems in direct conflict with the Green Paper’s rejection of a contestable funding model for the licence fee income.

### State aid law shines a light on a halfway house

<sup>54</sup> The argument developed above might seem far-fetched. But remarkably little attention seems to have been paid to State aid law so far in the Charter review process, as illustrated in Table 1.

**Table 1: “State aid” in Charter review reports**

Report	Pages	Mentions of “State aid”
Charter review green paper	116	0
Lords select committee report	84	3
Commons select committee report	65	1
BBC response to green paper	103	0
Ofcom response to green paper	38	0
Burns panel reports	25 & 9	0

For references to the reports see <http://go.reckon.co.uk/bbc>.

<sup>55</sup> Where State aid law has been mentioned, this has mainly been in a discussion of the BBC’s commercial services: i.e. services the BBC provides to generate revenue rather than directly because of its public service entrustment. This is surprising, not least because none of the three previous European Commission decisions on BBC State aid have concerned commercial services.

<sup>56</sup> Whatever the focus of the debate so far, State aid law can provide a real constraint on the way in which State resources can be used to finance the provision of public services.

<sup>57</sup> There seems little tension between State aid law and the BBC in its current form. But at some point along the road towards a separation of service specification and service delivery, State aid law will bite.

<sup>58</sup> The law will bite because it is not compatible with a halfway house: if the BBC is set to become a bit like a contractor to a body responsible for spending licence fee income, then State aid law will push the BBC all the way towards a contestable funding model.

<sup>59</sup> Although the proposals on the reform of the BBC put forward in the Green Paper have already been widely criticised, the perspective offered by analysis of State aid law is somewhat starker. To put it bluntly: the BBC envisaged in the Green Paper is not possible.

Visit <http://go.reckon.co.uk/bbc> for related material or to comment on the issues raised by this article.

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<sup>4</sup> BBC Governance Unit (2005) *Preparing for the new BBC Trust: Service Licences and the Public Value Test*.