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1. **Executive Summary**

1.1 **Background**

Ernst & Young LLP ("EY") has been commissioned by the BBC Trust (the “Trust”) to provide an independent review of the separation and transfer pricing arrangements between the BBC’s Public Service ("BBC PS") divisions and the BBC’s commercial subsidiaries. The subsidiaries in question are BBC Worldwide ("WW"), BBC Global News Limited ("GNL") and BBC Studios & Post Production ("S&PP").

The BBC Trust is responsible for setting the strategic objectives of the BBC, and making sure the BBC fulfils its public purposes. As part of its functions, the Trust has a duty to have due regard to the competitive impact of the BBC’s activities on the wider market and to ensure that the BBC observes high standards of openness and transparency. It is also required to adopt a statement of policy on Fair Trading ("FT") and to hold the BBC Executive to account for compliance with that policy. One of the Trust’s roles is therefore to oversee the relationship between the Public Service activities (funded by the licence fee) and the BBC’s commercial subsidiaries, ensuring they are similarly aligned with the public purposes of the broadcaster.

As part of the Trust’s development of the BBC’s commercial framework, the Trust committed to commissioning an independent review of the BBC’s separation and transfer pricing practices. The Trust has commissioned EY to carry out this review (referred to as “the Review” below). The Review looks in depth at the transfer pricing arrangements and the levels of transparency and compliance in transactions between the BBC PS and the BBC’s commercial subsidiaries. These transactions include, but are not limited to, instances when the subsidiaries buy rights to BBC content; pay to use BBC premises or services; and contract with the BBC to provide services.

In conducting this Review, EY has been asked by the BBC Trust to:

- Describe the current process and governance of the BBC transfer pricing regime – including the approach to setting transfer prices and the procedures and controls relevant to price-setting.

- Seek a sample of views from representative external stakeholders to establish any areas of concern, and to assist in the benchmarking of the BBC’s activities against established market practice.

- Assess the performance of the transfer pricing regime – reviewing current procedures and processes that are in place and, for a sample of case studies, assess whether this results in an outcome that is in line with market practice (whether prevailing market practice, or what we expect might be market practice in the event that a market were to exist).

- Identify options for making improvements to the current arrangements for separation and transfer pricing.

- Provide an independent report setting out the findings of the Review.

In line with the scope of work agreed with the BBC Trust, this report does not consider the commercial efficiency of the BBC’s commercial subsidiaries or the impact of these subsidiaries on their respective markets.

1.2 **Process and governance**

Within the Fair Trading Policy set by the Trust, the BBC Executive produces a set of Fair Trading Guidelines (“FTGs”). A fundamental part of this Review is to understand whether the transfer pricing processes which are outlined in the FTGs and the associated internal procedures are being applied correctly in practice.
EY has not been asked by the Trust to review the appropriateness of the FTGs and we have therefore not taken a view as to whether the FTGs are compliant with State aid and competition law.

This report provides a description of the transfer pricing procedures as currently documented by the BBC. Overall, in relation to process and governance, we note the following:

► **The Fair Trading Policy and Guidelines govern the BBC’s approach to transfer pricing, and there exist internal procedures designed to ensure the policy and guidelines are met:** Under the Fair Trading Policy set by the BBC Trust, the BBC Executive is obliged to produce, publish and adhere to its Fair Trading Guidelines. The key points in the FTGs relating to transfer pricing include: requirements for the BBC PS and commercial subsidiaries to have formal, documented agreements in place for transactions; for transfer pricing to be conducted at prices comparable to those in the market; or for cost-based pricing to be used only where market practice is not available. In addition to the FTGs, the BBC has established a Fair Trading Team (“FTT”), which has created a set of internal procedural guidance.

► **The BBC’s Fair Trading Team (alongside the BBC PS Divisions) also administers Fair Trading training designed to ensure that all BBC PS staff understand the relevant procedures that need to be followed:** There is a tiered approach to training, ensuring that all BBC PS staff receive a basic level of training, whilst those in more senior and more relevant positions receive more thorough training. For example, all personnel receive core Fair Trading training as part of their BBC PS staff induction process, and more intensive training is repeated by the necessary personnel (for instance, those in more senior positions and those who are involved in sign-off of relevant BBC projects) every three years.

► **Systems are in place to ensure transfer pricing processes are triggered for relevant transactions:** For instance, referral to the Fair Trading Team is required for “significant, novel or contentious” transactions (for instance where there are non-standard contractual terms), for high-value transactions relating to spare capacity deals (deemed to be those above a value of £50,000), and for any transactions where incremental cost pricing is being used. However, EY notes that a definition for what precisely constitute “significant” and / or “contentious” transactions is not currently contained within the BBC’s procedures. Therefore, the BBC has discretion in how it applies and interprets the FTGs for individual transactions where a degree of ambiguity exists. This creates some potential risk, to which we return in our recommendations below.

► **Fair Trading quarterly returns are obligatory for BBC’s commercial subsidiaries:** These returns report issues including significant transfer pricing activity, the relevant fair trading issues associated with the group or division, data demonstrating the volume of Fair Trading queries raised, and training statistics. For the BBC’s Public Service areas, formal returns are signed off biannually following a meeting between the FT adviser, Head of Fair Trading and Competition Law and the FT representative. In the alternate quarters, a briefing note is sent by the FT adviser to the FT representative.

► **A range of relevant external controls are in place:** For instance, there is an annual Fair Trading Audit, and the Fair Trading compliance systems undergo independent assessment to maintain ISO 9001:2008\(^1\) accreditation.

► **Any breaches of internal procedures would be recognised by the annual Fair Trading Audit:** They are subsequently reviewed by the Executive Fair Trading Committee (“EFTC”) and the BBC Trust. A breach of the FTGs in relation to transfer pricing may constitute a breach of State aid law, and would illicit more severe repercussions for both the individual and the BBC.

\(^1\) ISO 9001 is a globally-recognised quality management system accreditation.
That said, it is notable that there appears to be limited understanding by external stakeholders of the range and nature of procedures and controls in place: during EY’s interviews with third parties, several stakeholders noted what they considered to be a lack of transparency in relation to the BBC’s transfer pricing arrangements. Concerns were raised, for example, in relation to a perceived lack of information on how group overheads are allocated; how the commissioning process works for content (for both News-related programmes and for wider programme rights deals); and what internal measures are taken to ensure the FTGs are followed. Such concerns contribute to an industry perception that there may be unfair market practices at the BBC. EY does note that third parties can use Freedom of Information (“FOI”) requests to obtain information about the BBC’s transfer pricing arrangements, and that the Fair Trading complaints process also allows third parties to seek explanation and justification of the BBC’s approach to such issues.

1.3 Overview of case studies

EY has conducted an in-depth assessment of 12 case studies, focusing particularly on the adherence to the current procedures, and the final method adopted for the transfer price of the assets and services in question.

EY selected the case studies to reflect the breadth and depth of the transfer pricing arrangements currently in place between BBC PS and the commercial subsidiaries, whilst also seeking to select cases where third parties have previously raised concerns.

To ensure that the case studies were as representative of the transfer pricing regime as possible, EY adopted the following criteria to be used in choosing the 12 case studies:

► To ensure the breadth of transfer pricing agreements were covered, case studies were selected that cover a similar transfer pricing agreement across each of the three commercial subsidiaries – for example case studies relating to each subsidiary’s use of the BBC brand. In assessing similar transactions across subsidiaries, we do not necessarily expect an identical approach to be taken for all cases. Rather, we have considered whether the actual approach adopted is appropriate and reflects the circumstances of the specific deal. Similarly, for the S&PP case studies (7 and 8), although these are comparable in terms of the services being purchased, the approaches adopted for each of them are different, but have been assessed according to the requirements of each deal. In these cases EY considers that there is an onus on the BBC PS to demonstrate that the BBC has reviewed all the options, taking advice where necessary, to reach the appropriate decision.

► To ensure the depth of transfer pricing agreements were covered, case studies unique to each commercial subsidiary were selected, enabling EY to carry out detailed analysis of a specific transfer pricing agreement.

► To address concerns previously raised by third parties, primarily:

► Belief that the BBC commercial subsidiaries are benefitting from subsidies from the licence fee in one form or another that commercial businesses would not receive.

► The perceived lack of transparency and clarity over how transfer pricing arrangements operate.

► To ensure that the Review addresses the relevant industry concerns, transfer pricing arrangements with a significant financial value were selected – based on the assumption that the greater the value of the arrangement, the greater the possibility of market distortion if the transfer price is set too low.

We note that, although every care was taken when selecting case studies against the above criteria, it was not practical to look at every transaction that falls under the transfer pricing regime. Further, we are not able to confirm the percentage of overall transfer pricing agreements that are covered by the Review, as this information is not tracked by the Fair
Trading team. However, we consider that the breadth and depth of the case studies chosen make the selection representative and appropriate to enable robust conclusions to be drawn.

Based on the above criteria\(^2\), EY worked with the BBC Trust and the BBC Executive to identify a list of potential case studies. From this list, EY then independently selected the relevant case studies to remove potential bias in selection.

In reviewing these case studies, EY has combined data collected from the BBC with information gathered through the stakeholder interview process and EY’s research and analysis of relevant market practice. On this basis, EY sought to answer the following questions in relation to each of the case studies:

1. Was there a sufficiently documented agreement between the PS and the commercial subsidiary, as required by Section 3.10 of the FTGs?
2. What was the transfer price?
3. How was the transfer price determined?
4. Was the choice of transfer pricing methodology rational?
5. Was the methodology applied with a satisfactory degree of accuracy and rigour?

On this basis, we set out our overall assessment as to whether the transfer pricing transactions reviewed were in line with the FTGs; whether they were conducted on an arm’s length basis; and whether a fair market price was paid.

Our key case study findings are summarised in Table 1 below.

\(^2\) For further information on the application of EY’s case study criteria, see Table 3 in Section 4.
### Table 1: Summary of transfer pricing (“TP”) case studies

<table>
<thead>
<tr>
<th>Question</th>
<th>Case Study 1-3: Steria Contracts with Commercial Subsidiaries</th>
<th>Case Study 4: Brand Agreements with WW</th>
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<tbody>
<tr>
<td>1. Agreement?</td>
<td>• A signed Service Level Agreement (“SLA”) has been in place since 2010 between BBC PS and both BBC Worldwide (“WW”) (updated in 2015) and BBC Studios &amp; Post Production (“S&amp;PP”).&lt;br&gt; • GNL sub-contracts Steria services through WW. As such there is no agreement between PS and GNL. This has been confirmed in the interviews with BBC PS staff and by GNL’s Head of Finance.</td>
<td>• A Brand Licence Agreement (updated and signed in 2015) grants WW the use of the BBC Brand for commercial use. It covers how the brand can be used by WW and by BBC WW’s international subsidiaries.</td>
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<td>2. Transfer Price?</td>
<td>• A “recharge” calculated by BBC PS consisting of a fixed cost element and a volume generated variable cost element.&lt;br&gt; • Under the SLA the commercial subsidiary makes a payment based on an annual forecast. At the end of the financial year a reconciliation cost is applied to ensure the correct amount is paid.</td>
<td>• Under the Brand Agreement, WW pays to PS a set percentage of its pre-tax revenue, depending on its source:&lt;br&gt; • ≈% of the pre-tax revenue raised by WW from all commercial activity generated from using the Master Brand.&lt;br&gt; • ≈% of all other pre-tax revenue raised by WW (excluding dividends from the 50% ownership of UKTV, income from BBC Advertising and “Any other revenue agreed as excluded in writing between the BBC and Worldwide from time to time”.&lt;br&gt; • WW pays this to the BBC separate to the Corporate Dividend.</td>
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<td>3. How is it determined?</td>
<td>• As set out in the SLA, a “pass through costing” approach was used to determine the correct amount that should be paid by the commercial subsidiaries for the use of Steria’s financial and accounting services.&lt;br&gt; • The commercial subsidiaries pay for all variable costs that are attributed to their activities and staff. They then pay a proportion of the fixed costs, which is calculated from their proportion of the total variable costs.&lt;br&gt; • WW is charged the full amount for services provided to both WW and GNL. WW then has a separate agreement with GNL for how it pays its share. As such there is no transfer pricing arrangement between BBC PS &amp; GNL.</td>
<td>• A “market rate” approach was used to determine the correct ‘Brand Licence Royalty’ (BLR) that should be paid by WW for the various uses of the BBC brand by WW and its commercial subsidiaries.&lt;br&gt; • The benchmarking review was conducted by PwC in 2011.</td>
</tr>
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<td>4. Rational methodology?</td>
<td>• Yes. Costs are allocated between BBC PS and the subsidiaries based on usage, i.e. costs are paid in proportion to relative consumption.&lt;br&gt; • It is common market practice to have centralised and out-sourced back office service provision, with each subsidiary paying part of the overall cost.</td>
<td>• Although the Brand Licence Royalty was supported by the PwC market research and case studies, EY has seen no formal documentation explaining why ≈% was considered by the BBC PS to be the appropriate point within the range identified by PwC, other than to state it was the intention to use the PwC recommendation in negotiations between BBC PS and WW.</td>
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<tr>
<td>Question</td>
<td>Case Study 1-3: Steria Contracts with Commercial Subsidiaries</td>
<td>Case Study 4: Brand Agreements with WW</td>
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<td>5. Applied with accuracy?</td>
<td>• Yes. The contracts between the BBC PS and WW, and BBC PS and S&amp;PP for accounting and finance services provided by Steria all followed the above methodology.</td>
<td>• Yes. The transfer pricing process and mechanism for this specific transaction were conducted according to the FTGs and the use of the PwC report was appropriate.</td>
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<tr>
<td>EY Assessment</td>
<td>• All transactions were conducted on an arm’s length basis and BBC PS negotiated a fair market price.</td>
<td>• The transaction was conducted on an arm’s length basis and BBC PS negotiated a fair market price.</td>
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| Question | Case Study 5: Brand Agreements with BBC Global News Limited (“GNL”)
|———|———|
| 1. Agreement? | A Brand Licence Agreement that covers the transfer of the BBC Brand and all relevant logos, icons and marks for use in GNL programmes – primarily used on the BBC News channel and related communications. The Brand Licence Agreement was first signed in 2003 and last updated in 2011. However, it has not been updated to include bbc.com following the restructuring of commercial subsidiaries. EY has not seen the Brand Licence Agreement, nor the underlying data behind the agreement. EY considers that the reputation of the BBC brand is worth a nominal royalty rate of 5% of the company’s net profit on non-BBC business. EY has not seen the underlying data as to what method was used by Interbrand to calculate the royalty fee. EY recommends that a new brand agreement is drawn up. |
| 2. Transfer Price? | Interbrand was hired by BBC PS in 2002 to calculate the correct payment that GNL should pay for use of the BBC brand. Interbrand assessed relevant market benchmarks and determined the value of the BBC brand for GNL is worth >5% of its intangible earnings. No further benchmarking analysis was conducted for the 2011 amendment. According to the BBC, S&PP pays the BBC a nominal royalty rate of >5% of the company’s net profit on non-BBC business. EY asked whether S&PP had made payments for use of the brand, in lieu of being able to see the Agreement. There was a payment made in the financial year 2008/09, however no further payments have been made in the last five years as S&PP has continued to make a net loss. The PwC report states that the royalty fee was calculated by Interbrand in 1998 and that the royalty fee takes into account the fact that the brand is only exploited by the BBC on non-BBC revenue. |
| 3. How is it determined? | A “market rate” approach was used to determine the amount that should be paid by GNL for use of the BBC brand. The royalty rate used in the brand agreement is based on benchmarking analysis from 2002, and is paid once GNL is profitable. This agreement was reviewed by PwC in 2010 although no further benchmarking was undertaken. S&PP only pays for use of the brand on non-BBC revenues, as transactions between BBC PS and S&PP do not exploit the use of the BBC brand by S&PP. Under normal market conditions it is common for the licensee to pay a royalty to the owner of the brand, most commonly a proportion of revenue or – if appropriate – profits, in return for being able to exploit the intellectual property. The BBC PS stated that it believes S&PP is technically not exploiting BBC IP, as being owned by the BBC does not attract a premium for services it provides. However, EY considers that the reputational benefit of use of the BBC brand is sufficient to require a brand agreement to be put in place between the two entities. |
| 4. Rational methodology? | Yes. The transfer pricing process and outcome for this transaction was conducted according to the FTGs at the time of the agreement in 2003. S&PP only pays for use of the brand on non-BBC revenues, as transactions between BBC PS and S&PP do not exploit the use of the BBC brand by S&PP. Under normal market conditions it is common for the licensee to pay a royalty to the owner of the brand, most commonly a proportion of revenue or – if appropriate – profits, in return for being able to exploit the intellectual property. The BBC PS stated that it believes S&PP is technically not exploiting BBC IP, as being owned by the BBC does not attract a premium for services it provides. However, EY considers that the reputational benefit of use of the BBC brand is sufficient to require a brand agreement to be put in place between the two entities. |
| 5. Applied with accuracy? | Although correctly applied at the time, under normal commercial agreements it would be unusual for the owner of a piece of intellectual property to allow exploitation by a third party in return for no payment over a prolonged period. EY cannot fully comment on the application of the transfer pricing process for this specific transaction because: EY has not seen the Brand Licence Agreement. EY has not seen any of the underlying data as to what method was used by Interbrand to calculate the royalty fee. |
| EY Assessment | The fact that no payment has been made in the thirteen years since the original agreement was signed in 2003 does not align with market practice, as it is unusual for brand payments to continue to be based on share of profit when a company has not been profitable for a prolonged period. EY has not seen the Brand Licence Agreement, nor the underlying data behind the royalty fee calculations. It is a concern that the Brand Licence Agreement does not appear to be available. Given that the agreement has not been found, and in any case that the royalty fee was set in 1998, EY recommends that a new brand agreement is drawn up. |
• EY also recommends that the agreement is updated to reflect the subsequent restructuring of GNL since the agreement was last updated in 2011.

\[ \text{Payment to BBC PS for the use of the BBC brand by GNL} \]
\[ \text{Payment to BBC PS for the use of the BBC brand by S&PP} \]

\[ \text{BBC.com is the international website, run by GNL, which can be accessed outside of the UK and hosts BBC content e.g. BBC News content} \]

\[ \text{Profit before interest, tax and any other payments, less a charge for tangible assets} \]
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<th>Question</th>
<th>Case Study 7: S&amp;PP and EastEnders&lt;sup&gt;10&lt;/sup&gt;</th>
<th>Case Study 8: S&amp;PP and Holby City&lt;sup&gt;11&lt;/sup&gt;</th>
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| 1. Agreement? | • There is a contract between BBC EastEnders and S&PP for the provision of studios, shooting and production, and associated post production services for EastEnders.  
• The Agreement was signed in April 2015 and lasts for five years. It went through a number of internal boards for approval including the Executive Board. The contract does not have a review provision regarding costs and pricing; however there are a number of KPIs which need to be met.  
• A contract has been in place since 2013.  
• S&PP won these contracts in an open market tender.  
• The contract started on 1 January 2013 and lasts for a minimum of two years. The contract can be extended by up to 24 months, 12 months at a time. After this period a new contract will be signed. |
| 2. Transfer Price? | • Under this Agreement BBC EastEnders pays £<x> pa for a minimum of 208 episodes of 30 minutes each year for the duration of the contract.  
• Although the amount paid to S&PP is commercially sensitive, by hosting an open tender process for the provision of services, BBC PS ensured that the decision to award the contract to S&PP was in line with prevailing market practice and the use of market rates.  
• The open tender process ensured that the price offered by S&PP was benchmarked against relevant market competitors. |
| 3. How is it determined? | • For this Agreement a number of options were considered by BBC PS, and procurement and legal advice was sought, before opening negotiations with the incumbent.  
• Whilst there was no competitive tender for the services, a negotiation took place between the parties to determine a fair transfer price for the contract and the price is considered a reflection of market rates.  
• As noted above, the contract was awarded via an open tender process.  
• By the close of the process there had been offers from eight separate companies across all three Lots, with S&PP the only company to bid on multiple Lots – bidding on all three (and winning two). |
| 4. Rational methodology? | • Yes. It is normal market practice to negotiate contracts of this nature and to introduce as much competitive tension as possible to achieve best price and value for money for the Licence Fee Payer.  
• A review of external rates was performed where applicable. Here the BBC team reviewed comparable rates, for example, crew rates used on other BBC shows and in-house knowledge to test rates offered, for example the Dock 10 agreement with BBC North.  
• Yes. An open tender process is a common market practice, and the transaction was completed under normal market conditions, with S&PP effectively acting the same as its competitors. |
| 5. Applied with accuracy? | • Yes. Based on the data and documents received, the transfer pricing process and outcome for this specific transaction was conducted according to the FTGs, as well as BBC PS achieving a “fair market price” for the services involved in this transaction.  
• Yes. Due care was taken by the BBC to ensure that there was no unfair or external influencing factors that resulted in S&PP’s selection. |
| EY Assessment | • The transaction was conducted on an arm’s length basis and BBC PS negotiated a fair market price.  
• The transaction was conducted on an arm’s length basis and BBC PS negotiated a fair market price. |

<sup>10</sup> Review of the Agreement between BBC EastEnders and S&PP for services provided by S&PP in the production of EastEnders  
<sup>11</sup> Review of Agreement between BBC Drama and S&PP for Post Production services
<table>
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<th>Question</th>
<th>Case Study 9: GNL and BBC PS programme transactions&lt;sup&gt;12&lt;/sup&gt;</th>
<th>Case Study 10: WW content rights – Large commission&lt;sup&gt;13&lt;/sup&gt;</th>
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| 1. Agreement? | • An SLA is in place between GNL and BBC News, amended and signed in June 2015 for the 15/16 financial year.  
• The SLA only lasts for one financial year before it expires, requiring a new signed amendment each financial year. | • Signed Joint Co-Production (“JCP”) Agreement between PS and WW outlining the production, signed in 2015 |
| 2. Transfer Price? | • The transfer prices for all three programmes are based on cost of producing the programmes, rather than use of market rates and benchmarks. | • The combined investment from BBC WW and BBC America/AMC totalled over £<<.  
• In addition, BBC PS invested £<< in the programme. |
| 3. How is it determined? | • For GNL commissioned programmes there are no suitable market benchmarks, according to the PwC report<sup>14</sup>, as such based on the FTGs Section 3.16, a cost plus approach has been used as a proxy for the production of Our World and the Travel Show. However, a discount has then been applied, using the decision flow tool created by FTT, which results in a reduction to the cost for GNL, equivalent to the cost of the overheads and margin.  
• For BBC News content, specifically Hard Talk, the GNL payment is set at incremental cost. | • BBC PS uses a variety of sources, for example offers on previous titles; and offers from the Open Offer Process in an attempt to ensure that its benchmark estimate of the value of the content is in line with the market (see Section 3.5.1 for more detail).  
• Once it has an estimate of what it believes the content to be worth, this forms the basis of negotiations with WW.  
• Throughout the negotiation process, BBC PS was also able to leverage << to secure a better price. |
| 4. Rational methodology? | • The rationale for the pricing method chosen is based on advice from the Fair Trading Team (“FTT”) and BBC Legal, as well as external economic advice from PwC.  
• For the transactions between GNL and BBC PS for Our World and the Travel Show, there are no suitable market benchmarks. As such, a cost-plus approach is in line with the FTGs and is a rational approach to take. That said, the payment of overheads and margin by BBC News for this content is not consistent with the payment method adopted by GNL for purchase of BBC News content.  
• For the transaction between GNL and BBC PS for Hard Talk, based on a narrow interpretation of the market and based on a strict interpretation of the FTGs, this would imply that incremental cost pricing is not appropriate. EY notes, however, that PwC also considered a wider interpretation of the market (with third parties who were not directly comparable) which suggested incremental cost pricing followed market practice. However, the PwC report did not use this interpretation in its final conclusions. | • Yes. It is normal market practice to negotiate contracts of this nature and to introduce as much competitive tension as possible to obtain the best price possible for the rights on offer.  
• BBC PS uses benchmarks to ensure the offer is appropriate to what the market would likely be. |
| 5. Applied with accuracy? | • The current methodology has been applied rigorously across the SLA, with a decision flow tool, used to decide which cost methodology should be applied. | • Yes. The deal was conducted on an arm’s length basis and BBC PS negotiated a market price using a variety of benchmarks. |

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<sup>12</sup> Review of the transfer pricing arrangements on three programmes broadcast by GNL: Travel Show; Our World; HardTalk  
<sup>13</sup> Programme title: Undercover  
<sup>14</sup> “A Review of the transfer pricing methodology applied to the relationship between BBC Public Service and BBC Global News Ltd”, PwC, October 2015
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<th>Case Study 10: WW content rights – Large commission</th>
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<tr>
<td>EY Assessment</td>
<td>• The transfer pricing process and price paid for the transactions reviewed followed the internal procedures currently in place. &lt;br&gt; • However EY notes that: &lt;br&gt; - There appear to be some differences in the way that content is paid for between GNL-commissioned content and BBC News commissioned content, as well as co-commissioned content. EY would expect to see consistency between these pricing approaches unless there is evidence to show a different approach is justified. &lt;br&gt; - Regarding prevailing market practice PwC did not reach a conclusion as to which interpretation of the market – wide or narrow – was appropriate. If market practice is based on a market where comparators are close competitors then there is no prevailing market practice on which to base incremental cost pricing. On this basis, use of incremental cost pricing would appear to be inconsistent with the FTGs. &lt;br&gt; - EY also notes that, whilst this case study has focused on particular programmes, the conclusions drawn above about Hard Talk are also applicable to all BBC News content supplied to GNL at incremental cost.</td>
<td>• The transaction was conducted on an arm’s length basis and BBC PS negotiated a fair market price.</td>
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<td>Question</td>
<td>Case Study 11: WW content rights – Returning series&lt;sup&gt;15&lt;/sup&gt;</td>
<td>Case Study 12: WW content rights – Factual genre&lt;sup&gt;16&lt;/sup&gt;</td>
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<tr>
<td>1. Agreement?</td>
<td>A JCP Agreement between WW and BBC PS outlining the conditions upon which both parties have agreed to jointly produce “The Wrong Mans: Series 2”; signed in 2014.</td>
<td>A JCP Agreement between WW and BBC PS outlining the conditions upon which both parties have agreed to jointly produce “Special Forces: Ultimate Hell Week”, signed in 2014.</td>
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<td>In accordance with WW’s new “Additional Commercial Hours” strategy, WW put in an offer for a selection of factual genre titles. As part of this offer, WW would fund a greater proportion of the budget for the package of titles, on the condition that it secured the content rights for these titles.</td>
<td>EY was also provided with the three papers prepared for the WW Content Investment Group for “Special Forces: Ultimate Hell Week”, following the various rounds of negotiations, which is required if the investment is over £.&lt;sup&gt;1&lt;/sup&gt;</td>
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<tr>
<td>2. Transfer Price?</td>
<td>The investment from BBC WW was £.&lt;sup&gt;1&lt;/sup&gt;.</td>
<td>In accordance with WW’s new “Additional Commercial Hours” strategy, WW put in an offer for a selection of factual genre titles. As part of this offer, WW would fund a greater proportion of the budget for the package of titles, on the condition that it secured the content rights for these titles.</td>
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<td></td>
<td>In addition, BBC PS invested £.&lt;sup&gt;1&lt;/sup&gt; in the programme.</td>
<td>The eventual agreement was for £.&lt;sup&gt;1&lt;/sup&gt;.</td>
</tr>
<tr>
<td>3. How is it determined?</td>
<td>EY received confirmation that PS benchmarked the value of the programme against a variety of sources, in line with benchmarks used by other genres, but also including previous series investment as a baseline to ensure the offer received from WW is valued at market price.</td>
<td>EY received confirmation that PS benchmarked the value of the programme against a variety of sources to inform their negotiations with WW before entering into the agreement described above.</td>
</tr>
<tr>
<td></td>
<td>BBC staff have confirmed that the negotiation process that takes place is the same, regardless of whether they are dealing with WW or with a third party distributor.</td>
<td></td>
</tr>
<tr>
<td>4. Rational methodology?</td>
<td>Yes. It is common market practice for content producers to negotiate with distributors to secure investment in return for content rights.</td>
<td>Yes. It is common market practice for content producers to negotiate with distributors to secure investment in return for content rights.</td>
</tr>
<tr>
<td>5. Applied with accuracy?</td>
<td>Yes. EY has not seen any evidence to suggest that the BBC PS has any incentive to favour WW in negotiations. The agreement between the BBC Comedy content team and WW for the “Wrong Mans: Series 2” content rights, was conducted according to the FTGs and met the BBC’s internal procedures. The deal was conducted on an arm’s length basis and BBC PS negotiated a market price using a variety of benchmarks.</td>
<td>Yes. The agreement was conducted according to the FTGs and met the BBC’s internal procedures. As discussed above, WW was prepared to fund a greater proportion of the programme based on securing a package of titles. However due to the “Additional Commercial Hours” strategy, WW’s investment in “Special Forces: Ultimate Hell Week” was more than would normally be expected for this type of content.</td>
</tr>
</tbody>
</table>

<sup>15</sup> Programme title: *Wrong Mans Series 2*

<sup>16</sup> Programme title: *Ultimate Hell Week*
### Question

Case Study 11: WW content rights – Returning series

- The transaction was conducted on an arm’s length basis and BBC PS negotiated a fair market price.

Case Study 12: WW content rights – Factual genre

- The transaction was conducted on an arm’s length basis and BBC PS negotiated a fair price that reflected the demand for this content by WW at the time of negotiation, which may have been greater than the outcome of a tender process, but which reflected the value WW placed on it at the time.

- However, we raise a potential concern that paying more for bundled rights, in order to secure access to content, could create negative competitive effects in the market for this content, possibly pushing prices above competitive levels, or restricting further access. This could become a particular issue if this type of strategy becomes more prevalent.
1.4 Conclusions and options for change

Our assessment, as set out in Section 1.2 and in Table 1 above, concludes that the majority of the case studies reviewed show that the transfer pricing processes and governance procedures in place are adequate, and that they have been applied correctly, resulting in satisfactory outcomes in terms of a fair transfer price being paid. However, there are exceptions to this, as we discuss in more detail below.

Before considering areas for improvement, we note that our review of the case studies and BBC procedures has identified a number of areas of good practice in relation to transfer pricing:

► There is a substantial set of policies and procedures in place at the BBC to govern the transfer pricing arrangements. This includes a tiered approach to training, ensuring that all BBC PS staff receive a basic level of training (Tier 1), whilst those in more senior and more relevant positions receive more thorough training via Tiers 2 and 3.

► EY’s assessment, based on our review of case studies, is that there are no fundamental inconsistencies between the outcomes of the transfer pricing relationships and the Fair Trading Guidelines. That said – and as discussed further below – there are a number of areas for possible improvement when considered against the case study questions set out previously.

► The majority of the case studies adhere to the procedures and processes currently in place: for example, relevant agreements are in place, sign-off procedures are followed, and relevant fair trading advice is sought where this is required. That said, EY notes that documentation is lacking in some cases.

► Appropriate methodologies have been adopted in the majority of the case studies, including all those involving BBC WW. Where there is relevant market practice available, market prices have been used, and benchmarking has been conducted. That said, in some cases – for example in the S&PP and GNL branding agreements – this benchmarking is of variable quantity and quality.

However, the case study analysis has identified a number of potential risks and areas for improvement which run through the subsidiaries. These fall into the following categories:

Procedural improvements

Our review of procedures and processes has identified a number of areas in which the BBC has discretion in how it applies and interprets the FTGs and transfer pricing processes. For instance:

► The BBC divisions decide which transactions are sufficiently “significant” to be referred to the Fair Trading team for further review. Although we have not identified examples of potentially significant transactions that have not been referred, there is sufficient ambiguity to suggest that there is a risk that cases could be inappropriately overlooked. EY notes that in this regard it would provide greater clarity if “significant” was defined in the internal procedures which set out the triggers for referral, particularly as no cross-checks are in place to ensure that the full range of relevant transactions are reviewed. In addition, we consider that the BBC Fair Trading team should conduct “dipstick” tests of randomly selected transactions (which otherwise have not been referred to the Fair Trading team) in order to assess whether appropriate procedures have been followed.

► Further, we note that, in selecting case studies, we were unable to assess the percentage of overall BBC transfer pricing agreements that are covered by the Review, as this

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17 The use of the decision flow tool in case study 9 – GNL and BBC PS programme transactions – is a useful tool in determining the payment required given the complexity of the process. As such EY would recommend that this (or a similar) tool could be used for other transactions which are complex in nature, in order to help ensure alignment with the FTGs.
information is not tracked by the Fair Trading team. Given that information on transfer pricing is collated by the BBC’s finance teams, we consider that there would be merit in transfer pricing activity being tracked more systematically by the Fair Trading team and the BBC Trust. This would enable the BBC to gain a better understanding of the full scale of transfer pricing activity, which could be used to help define further triggers, and would also aid any future reviews similar to this study.

► We have noted concerns around documentation and record-keeping – in particular, it is of concern that the S&PP brand agreement has not been found.

► As discussed in Section 1.3, EY adopted a set of criteria in order to select the 12 case studies. The first criterion was designed to consider breadth of transfer pricing agreements, including similar transactions across subsidiaries (for example shared services and access to the BBC brand). EY notes that, whilst the majority of these similar transactions meet the FTGs, the approach taken to negotiate the outcomes were managed separately, for example in the S&PP contracts for EastEnders and Holby City (case studies 7 and 8). EY would recommend that the BBC considers adopting an overarching framework to similar transactions in future, to ensure that the approaches are either consistent or that differences in approach are appropriate to the circumstances of the particular deal.

► Our analysis has also highlighted areas where transfer pricing arrangements have departed from a strict interpretation of the FTGs. For example, we note in Case Study 9 (in relation to GNL programme transactions) that there is lack of evidence of market practice in using incremental cost – which implies that the use of incremental cost pricing for the supply of BBC News content to GNL is inappropriate. EY therefore considers, in such cases, that these pricing arrangements should be subject to further review by the Trust.

**Benchmarking and contract review period**

► In some cases – such as the brand agreement with GNL – the BBC PS and commercial subsidiaries engage in open-ended contracts with limited (if any) scope for review of pricing and other contractual arrangements. We consider that there should be regular review of contracts and relevant pricing benchmarks, so as to ensure the terms continue to be in line with market practice.

► EY also notes that the lack of contractual review in some cases creates the risk of entrenching behaviour that may not be consistent with market practice. For instance, we note that GNL has never made a royalty payment for use of the BBC brand, but the contractual arrangements have not been reviewed in order to enable the BBC PS to recover a payment for use of the brand (for instance, by revising the royalty terms to reflect a payment based on revenue). EY would expect that where there has been significant change in the market, for example with the creation and restructuring of GNL, such that review is subsequently required.

► More generally, we consider that, where there are transfer pricing arrangements in place, there is merit in reviewing benchmarking analysis more regularly, and ensuring that arrangements are reviewed whenever there is material change to underlying relationships (e.g. when there is restructuring of the commercial subsidiary in question). In addition to this, the FTGs state that, under the cost-based pricing approach, “an appropriate contribution for reinvestment in the BBC’s Public Service Activities” (often referred to within the BBC as a “margin”) is required. However, there is currently very little detailed guidance as to what level this “margin” should be set at. As such EY would recommend that more detailed internal guidance is provided to BBC staff, in order to ensure a consistent approach regarding what is considered an appropriate contribution.

18 EY has found in the internal guidance published for the use of overhead contributions the following, “the appropriate contribution for reinvestment can be set in line with market benchmarks or with reference to other suitable benchmarks, but should not be excessive”. 
Transparency

► There are areas where details of the transactions suggest that improvements to transparency are also required. For instance, the reasoning behind some of the arrangements for WW’s brand payment is not clear, and some evidence of bundled rights deals by WW may inhibit the transparency associated with the pricing of individual programmes.

► As noted in Section 3, the BBC Trust is taking steps to improve the transparency of the BBC’s transfer pricing arrangements. In the BBC Trust’s Review of Fair Trading Policy\(^\text{19}\), the BBC Trust states its intention to “…ask the Executive to commission a more thorough fair trading audit this year, with a greater focus on whether the outcomes of individual cases are compliant, as well as whether processes have been followed correctly. We will also be more transparent and publish more information about the results of the audit in the Annual Report.”

Potential actions for consideration

In light of the above assessment, we suggest a number of options for consideration by the BBC Trust when seeking to resolve these issues:

► Some stakeholders highlighted the need for greater regulatory scrutiny and enforcement in relation to the relationship between the BBC PS and its subsidiaries. For instance, it was argued that there should be more active regulatory review of these relationships – backed by formal information gathering powers, and the potential to enforce sanctions if the FTGs are breached. Stakeholders commented that such scrutiny and enforcement would help to hold the parties to account in relation to transfer pricing activity, and would provide greater comfort for external parties.

► Further, there is a lack of understanding in industry about the nature and extent of the governance framework that oversees the transfer pricing relationships, due to a lack of transparency regarding the procedures in place. EY considers that the BBC Trust should consider appropriate steps to pro-actively promote transparency, as this may help to allay some of the concerns expressed by external stakeholders. For instance, whilst it was acknowledged by external stakeholders that commercial confidentiality inevitably limits the amount of transfer pricing (and other related) information that can be made available externally, it was argued that the current approach to confidentiality leads to insufficient information being provided to market participants.

► One way to help increase regulatory scrutiny and transparency would be to publish an annual monitoring report on the arm’s length agreements between the BBC PS and its subsidiaries to review whether they are in line with the FTGs. The report should be within the boundaries of confidentiality, and it would be a matter for the BBC’s regulator to determine whether this was published by the regulator itself, or by the BBC under obligations enforced by the regulator. Further, the act of collecting the relevant data, whether or not it is eventually redacted from the published report, would be a transparency benefit in and of itself.

► This report could include the results of dipstick tests conducted by the FTT; and further clarity on the internal processes undertaken by the BBC Executive to ensure compliance, for example the review of overhead allocation and how this is applied to cost plus transfer pricing arrangements. As discussed in the Fingleton Associates Fair Trading Policy Review report for the BBC Trust\(^\text{20}\), changes to the Fair Trading Policy document and FTGs to simplify the guidance and signpost to additional documents would be helpful in creating

\(^\text{19}\) [http://downloads.bbc.co.uk/bbctrust/assets/files/pdf/our_work/fair_trading/2016/review_fair_trading_policy.pdf]

better understanding outside the BBC. External stakeholders also noted that a workshop on Fair Trading Policy and the implementation of this would be welcome.
2. Background

2.1 Introduction and BBC Trust requirements

Ernst & Young LLP (“EY”) has been commissioned by the BBC Trust (the “Trust”) to provide an independent review of the separation and transfer pricing arrangements between the BBC’s Public Service (“BBC PS”) divisions and the BBC’s commercial subsidiaries. The subsidiaries in question are BBC Worldwide (“WW”), BBC Global News Limited (“GNL”) and BBC Studios & Post Production (“S&PP”).

In accordance with the BBC Trust’s Fair Trading Policy and Framework, “[t]he BBC’s Commercial Services should not receive from the BBC’s Public Service Activities an advantage which is not available to its commercial competitors”\(^{21}\). The impact of this is that the BBC Executive is required to ensure that there is:

► “Financial, operational and structural separation between the BBC’s Public Service Activities and its Commercial Services;

► Transparency and accountability in the dealings between its Public Service Activities and its Commercial Services – this means transactions will be conducted on the basis of contracts (including service level agreements) for all services and goods supplied. Each Commercial Subsidiary publishes its own accounts and these are independently audited; and

► Fair transfer pricing charged by the BBC’s Public Service Activities to its Commercial Services and third parties for the use of Public Service Activity Inputs always taking into account the BBC’s other obligations in the Charter and the Agreement such as ensuring value for money.”\(^{22}\)

Further to the publication of the BBC Trust’s Fair Trading Policy and Framework, the BBC Executive has responsibility for ensuring compliance with the BBC’s Fair Trading obligations, and it is held accountable for its compliance by the Trust. As part of the compliance process the Trust is informed by an annual independent Fair Trading Audit undertaken by external auditors. In addition, the BBC Executive publishes a set of guidelines, the Fair Trading Guidelines\(^{23}\) (“FTGs”), which set out how the BBC will comply with the Trust’s Policy on Fair Trading.

In its role of holding the BBC Executive to account for its compliance with the policies, guidelines and codes that it sets, the BBC Trust has decided to commission an independent review of the transfer pricing arrangements observed between the BBC Public Service activities and its commercial subsidiaries.

In conducting this Review, EY has been asked by the BBC Trust to\(^{24}\):

► Describe the current process and governance of the BBC transfer pricing regime, including the approach to setting prices and the procedures and controls relevant to price-setting.

► Seek a sample of views from representative external stakeholders to establish any areas of concern, and to assist in the benchmarking of the BBC’s activities against established market practice.


\(^{22}\) Ibid page 7


\(^{24}\) See also the full set of questions posed by the BBC Trust, as set out at Appendix A.
► Assess the performance of the transfer pricing regime – reviewing current procedures and processes that are in place and, for a sample of case studies, assess whether the outcome results in an outcome that is in line with prevailing market practice.

► Identify options for improvement to the current arrangements for separation and transfer pricing.

► Provide an independent report setting out the findings of the Review.

In line with the scope of work agreed with the BBC Trust, this report does not consider the commercial efficiency of the BBC’s commercial subsidiaries or the impact of these subsidiaries on their respective markets.

2.2 Key issues addressed by the Review

Before undertaking the Review, EY identified the following key areas in the BBC’s current separation and transfer pricing practices that need to be considered.

2.2.1 Process and governance

EY has sought to determine whether the transfer pricing processes which are outlined in the FTGs and the internal procedures in place – which are designed in an attempt to ensure transactions between BBC PS and the commercial subsidiaries are in compliance with State aid and Competition Law – are being applied correctly in practice. For example, EY has considered what safeguards or review process is followed in order to ensure compliance on an ongoing basis; how the best approach to pricing the transfer of assets is considered; what training is provided to ensure BBC PS staff are aware of the correct procedures; and what controls have been put in place to ensure that the agreement is compliant with the Law. EY has not been asked by the Trust to review the appropriateness of the FTGs and we have therefore not taken a view as to whether the FTGs are compliant with State aid and competition law.

2.2.2 Practice and methodologies

There is a variety of ways in which the relevant transfer price can be determined. The FTGs set out these methods, for example market pricing; bottom-up pricing; and incremental cost pricing (see Section 3.1 for detail on how and why these methods are chosen). As part of this Review, EY has considered the question as to whether in practice the most appropriate method is being used for transactions; whether the method was implemented accurately; whether this follows best practice; and how benchmarking is used to facilitate this process. A number of the BBC’s competitors, which EY interviewed, were concerned that the commercial subsidiaries receive an inappropriate subsidy from the BBC PS – consideration of this area is therefore central to the Review.

2.2.3 Transparency

Transparency is a particular concern for the BBC’s competitors. It has been raised in the past, and again more recently in the BBC Trust's review of the BBC's Commercial Framework. There is an inevitable trade-off between respecting commercial sensitivities (which may limit the amount of data that can be published), and the ability to provide a degree of comfort around

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25 Articles 87–89 of the Treaty establishing the European Communities and relevant implementing regulations, as may be amended from time to time.

26 (i) Article 81 and 82 of the Treaty establishing the European Communities; (ii) the Competition Act 1998 and the Enterprise Act 2003; (iii) other applicable national competition legislation and; (iv) relevant implementing regulations in relation to each of (i), (ii) and (iii), as may be amended from time to time and State aid Law.

27 http://downloads.bbc.co.uk/bbctrust/assets/files/pdf/our_work/commercial/commercial_framework/commercial_frame work.pdf
the way in which assets or services are priced in transactions between the Public Service to the BBC’s commercial subsidiaries.

## 2.3 Methodology

To further understand the issues at hand, EY reviewed a range of documentation (a list of the documents reviewed is set out in Appendix B), and conducted a series of interviews with BBC and external personnel, as set out in Table 2 below. The list of participants for external interviews was agreed with the BBC Trust and was created to represent the views of external stakeholders across all three commercial subsidiaries, however EY notes that not all those contacted agreed to participate.

### Table 2: Stakeholder interviews conducted by EY

<table>
<thead>
<tr>
<th>Department/Company</th>
<th>BBC Public Service</th>
<th>BBC Commercial Subsidiaries</th>
<th>External Stakeholders</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Fair Trading</td>
<td>BBC Worldwide</td>
<td>Baker Mackenzie</td>
</tr>
<tr>
<td></td>
<td>Business Development</td>
<td>S&amp;PP</td>
<td>Deloitte – FT Audit team</td>
</tr>
<tr>
<td></td>
<td>News</td>
<td>GNL</td>
<td>Pinewood</td>
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<tr>
<td></td>
<td>Finance</td>
<td></td>
<td>PACT</td>
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<td></td>
<td>Digital</td>
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<td>ITV</td>
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<tr>
<td></td>
<td>BBC Drama</td>
<td></td>
<td>UK Screen</td>
</tr>
<tr>
<td></td>
<td>Controller of Business – Comedy</td>
<td></td>
<td>GMG</td>
</tr>
<tr>
<td></td>
<td>Controller of Business – Factual</td>
<td></td>
<td>Sky</td>
</tr>
<tr>
<td></td>
<td>Controller of Business – Drama</td>
<td></td>
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</tr>
</tbody>
</table>

EY is grateful for the time invested by BBC and external stakeholders in contributing to our interview programme. The interviews conducted were designed to:

- Further EY’s understanding of the procedures and practices involved in the relevant transfer pricing relationships.

- Answer specific questions on the case studies chosen for Section 4 of the Review.

- Assist in verifying the data used in the case studies to calculate the transfer price of assets.

- Provide a further understanding of external stakeholders’ views on (and, where relevant, concerns with) the current procedures and guidance for transfer pricing.

After identifying the key issues that needed to be addressed, EY’s overall approach to conducting the Review was as follows:
We adopted a case study based approach, selecting 12 case studies that seek to represent the depth and breadth of the transfer pricing arrangements currently in place between BBC Public Service and the commercial subsidiaries.

EY benchmarked a sample of the key BBC processes and pricing practices against the market, with this assessment based on interviews with the BBC and third parties, analysis of BBC and external information, and EY research and analysis.

A detailed description of the case study selection process is provided in Section 4.1.

### 2.4 Structure of this report

The remainder of this report documents our observations, analysis and recommendations to the BBC Trust:

**Section 3: Process and governance**

Section 3 provides a description of the BBC’s Transfer Pricing Procedures as currently documented by the BBC, and an assessment of the extent to which adherence to these processes is secured. Findings are supported by information gathered throughout the interview process and by documentation provided by the BBC and third parties, in particular the BBC’s Fair Trading team. As part of this assessment EY:

- Describes the current guidance, including internal procedures and processes, which are in place surrounding transfer pricing.
- Describes who is responsible for ensuring the procedures and processes are adhered to, and what the consequences are for non-delivery.
- Describes the overall training process for BBC personnel regarding transfer pricing and the guidelines that exist around this process.
- Describes the documentation that is required to meet the guidelines.
- Considers the opinion of the Fair Trading auditors regarding whether the procedures (relating specifically to transfer pricing) are being followed.

EY has reviewed the BBC’s overall compliance with the transfer pricing procedures against questions defined by the BBC Trust (as listed in Appendix A).

**Section 4: Overview of case studies**

EY has conducted an in-depth assessment of 12 case studies, focusing particularly on the adherence to the current procedures, the final method adopted for the transfer price of the assets in question and whether the outcome was consistent with market practice.

EY selected the case studies to reflect the breadth and depth of the transfer pricing arrangements currently in place between BBC PS and the commercial subsidiaries, whilst also seeking to select cases where third parties have previously raised concerns (see Section 4).

In reviewing these case studies, EY has combined data collected from the BBC with information gathered through the stakeholder interview process and EY’s research and analysis of relevant market practice, and sought to answer the following questions in relation to each of the case studies:

1. Was there a sufficiently documented agreement between the PS and the commercial subsidiary, as required by Section 3.10 of the FTGs?
2. What was the transfer price?
3. How was the transfer price determined?

4. Was the choice of transfer pricing methodology rational?

5. Was the methodology applied with a satisfactory degree of accuracy and rigour?

A summary of EY’s key findings from the case study analysis, benchmarking of rates and quantitative assessment of cost can be found in Section 4.

**Section 5: Conclusions and options for change**

Section 5 sets out EY’s conclusions in respect of the current transfer pricing arrangements, based on the procedures, interviews, outcome of the case studies and EY’s own additional analysis. We also set out options on how the transfer pricing regime could be improved, in particular to help address third party concerns. Any relevant decisions relating to the implementation or otherwise of EY’s suggested options for change to the current BBC processes will ultimately be made by the BBC Trust.

The BBC Trust also asked EY to consider whether any of the issues or recommendations identified as part of the current transfer pricing arrangements could be relevant to the BBC Executive’s proposals for a new commercial BBC Studios proposition. EY’s perspective on this issue is also set out in Section 5.
3. Process and governance

3.1 Introduction

EY has reviewed the current transfer pricing arrangements in place at the BBC, and the relevant arrangements are described in this section. In an attempt to ensure that the BBC’s transfer pricing regime is consistent with State aid law, the BBC has put in place a number of procedures and rules of governance in order to safeguard the process. The relevant procedures include:

► The Fair Trading Guidelines (“FTGs”).
► Associated training relating to Fair Trading.
► Internal procedures governing mandatory referral to the Fair Trading Team (“FTT”).
► Quarterly compliance meetings between the FTT and the Fair Trading Representatives (“FT Reps”) for each commercial subsidiary and biannual compliance meetings for each PS group division.

As discussed in Section 2, the BBC Trust publishes its Fair Trading policy and codes of conduct, which are based on EU State aid and UK competition laws, as well as the BBC’s Royal Charter and Agreement with the Department of Culture, Media & Sport (“DCMS”). The BBC Trust’s policy is then implemented by the BBC PS, via the BBC Executive which is obliged to produce, publish and adhere to its FTGs28.

The hierarchy that creates the FTGs is summarised in Figure 1 below.

Figure 1: Outline of Fair Trading Controls

The key chapter of the FTGs which is relevant to transfer pricing is Chapter 3 – Separation. This chapter provides guidance on how the BBC ensures separation between its sources of funding: namely the Licence Fee and commercial revenues.

28 Available at http://www.bbc.co.uk/aboutthebbc/insidethebbc/howwework/policiesandguidelines/fairtrading.html
The chapter focuses on ensuring that the BBC’s Commercial Activities (as carried out by the BBC’s commercial subsidiaries) do not receive an unfair advantage from the BBC’s Public Service Groups and in doing so sets out requirements for:

► Financial and operational separation between the BBC’s Public Service Activities and its commercial subsidiaries.

► Fair transfer pricing between the BBC’s Public Service Groups and its commercial subsidiaries.

The guidelines also state that these conditions equally apply to the relationship between BBC’s Public Service Groups and third party organisations.

For both of these conditions, the guidelines go into further detail about what is necessary to ensure compliance, in particular:

► **Section 3.7:** “For the BBC’s Commercial Services, it is necessary that:
  
  - transactions with the BBC Public Service Groups must be conducted on the basis of formal (documented) agreements for all goods and services supplied.”

► **Section 3.10:** “For the BBC’s Commercial Trading Activities, operational measures must be taken to simulate the disciplines of a Commercial Subsidiary. These will include:
  
  - Maintaining separate trading accounts – including records of information such as volumes, prices, revenues and costs; and
  
  - Binding agreements between the BBC and its trading partner(s).”

► **Section 3.13:** “The BBC aims to maximise the value of licence fee payer’s assets. The key principle of ‘fair transfer pricing’ is that charges for goods and services supplied by the BBC’s Public Service Groups, whether sold to the BBC’s Commercial Subsidiaries or to third parties, should be set in line with prevailing market practice.”

► **Section 3.14:** “In exceptional circumstances, and then only where it can be demonstrated that the approach conforms to prevailing market practice, it may be acceptable to set prices with reference to incremental costs (the term ‘incremental costs’ is akin to the costs that would be avoided if the particular good, service or increment of output was no longer supplied). This approach is conditional on prior approval by the Fair Trading department.”

► **Section 3.15:** “Under no circumstances should prices be set below the BBC’s incremental costs of providing a good or service.”

► **Section 3.16:** “in the absence of any verifiable or comparable information/data on prevailing market practice, prices charged should seek to cover;
  
  - all relevant direct costs involved in providing the good(s) or service(s); and
  
  - an appropriate contribution to the relevant overheads and/or capital costs incurred by the business area; and
  
  - an appropriate contribution for reinvestment in the BBC’s Public Service Activities.”

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29 EY notes the word “margin” is often used by the BBC as a short hand for this phrase. In terms of what the appropriate level of “margin” should be, there is currently no guidance provided in the FTGs as to the level any margin should be. In terms of internal guidance, the Abacus guidance (discussed in section 3.5.1 below) states the following, “the appropriate contribution for reinvestment can be set in line with market benchmarks or with reference to other suitable benchmarks, but should not be excessive”.

EY | 26
Section 3.17: “If the proposed price fails to satisfy the guidance outlined above, reference should be made in advance to the Fair Trading department. The Fair Trading department may require the prices to be revised if it concludes that there is no objective justification for the proposed approach.”

Sections 3.13-3.17 show that there is a clear hierarchy of how assets and services sold to the BBC’s commercial subsidiaries should be priced. The application of these procedures is discussed in detail in the remainder of this report, and outlined in Figure 2.

Figure 2: Transfer pricing hierarchy methodology

In terms of the governance of adherence to the FTGs, this rests ultimately with the BBC Executive who appoints the Executive Fair Trading Committee (“EFTC”) to take responsibility for implementing and following the guidelines and an Annual Fair Trading report is produced. The EFTC requires the Fair Trading and Competition Law team and – through this team – the heads of the BBC PS divisions, to ensure adherence. A number of internal procedures have also been designed to help govern the application of the guidelines. These include the appointment of FT Reps for each division, the quarterly returns process, a mandatory training programme, an external Fair Trading Audit (which reports directly to the EFTC), an ISO audit of Fair Trading procedures and an internal compliance function delivering system assurance. Each of these is discussed in further depth below, with an overview of the process shown in Figure 3.

30 As set out in footnote 28 “margin” in this context refers to the need to make an “appropriate contribution for reinvestment.”

31 Within the Fair Trading and Competition Law team, the front line FT advice and divisional contact rests with the FT adviser, but the team’s competition lawyers also contribute to ensuring the FTGs are met. This is due to the fact that compliance with State aid and competition law is a fundamental requirement.
If any breaches of internal procedures occur, for example targets for training not being met, these would be recognised by the annual Fair Trading Audit, conducted by Deloitte (see Section 3.8) which is subsequently reviewed by the EFTC and the BBC Trust, who will decide what action is then required to be taken.

A breach of the FTGs on transfer pricing may result in a breach of State aid law, and would illicit more severe repercussions for both the individual and the BBC – for example the implementation of fines.

### 3.2 What are the current agreements between Public Service divisions and commercial services?

There is a variety of different agreements between the BBC PS and its commercial subsidiaries, reflecting the type of services each of the subsidiaries provides. These agreements cover areas including:

- The use of BBC PS assets by the subsidiaries – for example the BBC’s brand, studios and technology.
- The use of BBC PS personnel, either through spare capacity or via joint sharing arrangements.
- Joint production agreements.
- Joint sharing of services, such as finance and HR.

Various BBC facilities and personnel are shared between the BBC PS divisions and commercial subsidiaries – with examples including:

- GNL’s use of BBC News assets in producing programmes for GNL’s international news services.
► Use by the commercial subsidiaries of a number of BBC shared systems (for example the Steria finance system).

► The provision of services by BBC Digital to the commercial subsidiaries on an arms-length basis – for example the Technology & Operations agreement between BBC Digital and GNL.

There is therefore a wide range of transfer pricing relationships relevant to this Review.

3.3 What are the current practices to train and promote transfer pricing knowledge inside the BBC?

As discussed in Sections 2 and 3.1, the Trust reviews the Fair Trading Policy every three years, and this review includes the transfer pricing arrangements. As a result of this process, the Trust confirms the Fair Trading Policy and requires the BBC Executive to create a set of FTGs consistent with the policy. These FTGs are used to ensure that the Fair Trading Policy is adhered to by all BBC personnel. In addition to the FTGs, the BBC FTT has created a set of internal procedural guidance – which EY has reviewed – and the FTT provides associated Fair Trading training to relevant BBC personnel.

The FTT and FT Reps in the divisions hold the responsibility for ensuring that all BBC PS staff have appropriate awareness of the transfer pricing regime and the respective roles in ensuring adherence. The role of the FT Reps is laid out in detail in the Public Service Fair Trading Procedure document. The FT Rep oversees adherence to the FTGs in the Group or Division concerned. The responsibilities of the FT Reps include:

► Confirming the accuracy of the biannual return prior to referral to the relevant Director for approval.

► Providing a focus in the business for compliance and management of commercial trading activity.

► Ensuring that the relevant FT Adviser is kept up-to-date of the Group or Division’s strategy, business and developments and that the necessary issues are referred to the FT team.

► Ensuring that the list of employees who require FT training is updated on a periodic basis.

The FTT ensures that all relevant staff are up to date with compulsory Fair Trading practices through a defined training process. The training is designed to ensure that BBC PS staff understand the relevant procedures that need to be followed.

The FTT along with the FT Rep ensures that all staff are trained to the relevant level required by their role by dividing training into a three tier system – as shown in the table below.

<table>
<thead>
<tr>
<th>Tier</th>
<th>Training delivery method</th>
<th>Frequency</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tier 1</td>
<td>Seminar delivered as part of BBC induction</td>
<td>Once, upon joining the BBC</td>
</tr>
<tr>
<td>Tier 2</td>
<td>Online training module</td>
<td>Every 3 years</td>
</tr>
<tr>
<td>Tier 3</td>
<td>Advanced Workshop run by the Fair Trading team</td>
<td>Every 3 years</td>
</tr>
</tbody>
</table>

Table 3: Requirements of Fair Trading training

---

32 Public Service Fair Trading Procedure – Section 2: Roles – p4
Staff are assigned to each tier based on seniority or how often they are likely to come across transfer pricing issues:

► All BBC personnel receive a basic overview of Fair Trading through “Tier 1” training as part of their BBC PS staff induction process.

► Tier 2 training is, according to the Public Service procedure, for staff between grades 8-11. Managers in divisions have to consider whether their staff require the training or not in consultation with their Fair Trading Representative and/or Fair Trading Adviser (with the assistance of the Fair Trading Champion(s) where appropriate) and, if required, they should be added to the group/divisional training list. Training is administered by the BBC Groups/Divisions directly, with the FTT administering this training to staff as GNL and S&PP.

► For the more intensive Tier 3 training, the decision as to whether staff are required to undertake the training is taken by the relevant divisional FT Rep. For example, BBC PS staff in Legal and Finance are most likely to require Tier 3 training, as they are often involved in sign-off of relevant BBC projects. Training for GNL and S&PP staff is provided by the FTT, whereas WW administers its own training.

The higher tiers of training cover the topic of transfer pricing in more depth than Tier 1, and also include case studies to provide examples of what can and cannot be done within the FTGs. Staff must repeat the training every three years to ensure they are up to date with the current procedures. The training for Tiers 2 and 3 cover approximately 3,000 staff. Staff trained in Tier 3 are encouraged to also complete the Tier 2 training.

To ensure compliance with training requirements, records of completion by staff are kept by the FTT (with the exception of Tier 2 training for Public Service staff, which is an online module and available to all groups) and are reviewed every quarter by the FTT and each of the division’s FT Reps. It is the responsibility of each division’s FT Reps to ensure that training targets are met. If these are breached then this is noted on the quarterly return and would be seen by the EFTC and the FT audit team.

The FTT has strict training targets. For example, in Public Service Groups or Divisions, 90% or more of staff in roles identified as Tier 2 must have completed their training by each quarter-end. Meanwhile, the three commercial subsidiaries are required to ensure that 100% of identified staff have completed Tier 2 training. For those staff in Tier 3 roles, regardless of which division or commercial subsidiary they are in, there must be a 100% completion record by the quarter-end. Any new staff who join the BBC, are new to the department/role or returning from a significant period of absence (for example maternity leave) must complete the relevant training within three months of starting the role / the identification of requirement for training.

The FTT produces quarterly KPIs on training completion, in the form of the quarterly returns, which are reviewed by FT Reps, CEOs of the commercial subsidiaries, and the Directors of the PS Divisions. The quarterly returns also include the relevant fair trading issues associated with the group or division, such as staff queries or changes to procedures. For the commercial subsidiaries, these quarterly returns must be signed and returned to the FTT by the Chief Executive of the relevant subsidiary. For the Public Service divisions, the returns must be signed and returned by the group directors on a twice yearly basis. Section 3.7 discusses these quarterly returns in more depth.

Staff can also contact the relevant FT Rep, who can advise them on FT matters or – if necessary – refer the query on to the relevant person in the FTT. Each member of the FTT is assigned responsibility to particular divisions or commercial subsidiaries. A list of the relevant FT Advisers and their assigned responsibilities is set out in the Annex of the Public Service Fair Trading Procedure document.

In addition, the external Fair Trading Audit is conducted annually. Amongst other matters, this audit reviews whether the Fair Trading training targets have been met.
As part of this review EY has assessed 12 case studies to determine whether the process and procedures that are in place are being adhered to appropriately. The results of these case studies are set out in Section 4.

3.4 When is the transfer pricing process triggered?

Although transfer pricing processes occur on a continual basis between the BBC Public Service and its commercial subsidiaries, certain thresholds, activities or procedures automatically trigger the involvement of the FTT.

BBC’s Public Service Groups or Divisions which undertake Commercial Trading Activities (“CTAs”) are responsible for providing local approval. It is the responsibility of the approver to ensure that all CTAs are considered from a Fair Trading perspective and that documentation supporting the approval is signed off. It is a requirement that approvers involved in sign-off have completed Tier 3 training (see Section 3.3). All transfer pricing transactions that relate to commercial income are recorded by the Finance Team, as well as being signed off by the relevant approver. In the case of significant transactions, the approver will be the division head.

This is a key step, as the FTT does not review every CTA or transfer pricing transaction. Rather, the FTT becomes involved when any one of the following criteria is met33:

► **If the transaction is deemed to be “significant, novel or contentious”**. Examples that may fall under this category include use of non-standard contractual terms; if the transaction has the potential to have a significant market impact; or where the length of the contract is not in line with normal market practice.34

   EY notes that, in contrast to the objective criteria noted below, a definition for what precisely constitutes “significant, novel or contentious” is not currently contained within the BBC’s procedures, and therefore the BBC has discretion in how it applies and interprets the FTGs.

► **If the transaction relates to spare capacity and is above a £50,000 threshold**. Examples of spare capacity transactions may include the loan-out of staff to an independent production, loan-out of assets or equipment or the re-versioning of content for a third party.

► **All transactions which generate sponsorship revenue** for BBC off-air events if they are connected in any way to BBC on-air output.

► **If the activity or CTA uses incremental pricing to set prices**. This approach is conditional on prior approval by the Fair Trading & Competition Law Department.

► **Any joint ventures** require referral in advance to the FTT.

► **Any network TV rights above £5m and any national radio rights above £0.5m relating to the acquisition of sports rights**.

Further, one of the FTT’s procedures is to ensure that transfer pricing queries are recorded in the Fair Trading Enquiries Log35. If any part of the BBC has asked for Fair Trading Advice and/or approval by the FTT, then the relevant Adviser dealing with the enquiry must log this in the Enquiries Log. The Enquiries Log is then checked at least quarterly by the Advisers and the Fair Trading compliance team to ensure that it is up to date, as far as they have been advised by the Groups and Divisions. The quarterly FT returns for each division include the relevant entries from the Enquiries Log for that quarter. The Enquires Log is also audited as part of the Fair Trading Audit (discussed in further detail in Section 3.8).

33 These are contained in the Public Service Fair Trading Procedure document – Section 1 – pages 2-4
34 It is also useful to note that this criterion is relevant to several of the case studies considered in Section 4.
35 The Fair Trading Enquiries Log contains every enquiry that has been made to the FTT and the data from this is used in the quarterly return.
3.5 What are the transfer pricing practices used by the BBC?

The BBC uses a variety of different transfer pricing methods to ensure that all transactions are fair and, if applicable, undertaken at market rates. These practices are based on Sections 3.13-3.17 of the FTGs (as referred to in Section 3.1 of this report), and are used in conjunction with training and advice from the FTT to ensure the correct method is adopted.

3.5.1 Transfer pricing practices used by Public Service

For the BBC PS all transfer pricing must be conducted in accordance with the FTGs. EY understands from its interview with the FTT, that the majority of transactions are based on prevailing market practice and so market benchmarks are required to demonstrate that the transfer price is based on market rates. The BBC PS uses a variety of ways to benchmark depending on the asset or service in question:

► Industry rate cards are used to benchmark against, where the market rate is easy to establish (for example for hiring a studio).

► Competitive tendering as a way of obtaining and identifying market rates.

► Internal rates to benchmark against. For example, for crew rates the BBC PS can look to other productions to understand the rates used, and compare these against rates used in negotiations.

► Benchmarking analysis commissioned from external third parties, particularly in cases where the transaction is significant, novel or contentious (for example content rights).

We consider the approaches used for benchmarking analysis throughout the case studies in Section 4.

With regard to content rights, one of the ways in which the BBC PS seeks to ensure that the transfer price paid by BBC Worldwide is in line with prevailing market practice is to use the Open Offer Process ("OOP"). The purpose of the OOP is to benchmark the value of the BBC’s rights by offering a randomly selected, representative sample of rights directly to the market, rather than directly to WW through the First Look Agreement. The OOP is a competitive tender where any third party is allowed to bid for the rights. The rights offered are intended to represent the full range of BBC programming, and are in addition to the offers that the BBC PS makes to third party distributors when the offer from WW is not taken up. The responsibility for managing the OOP resides with the central Commercial Development team. Under the OOP, approximately 15-20% of eligible titles are selected on a randomised basis and the process is conducted once a quarter, with the aim to offer five titles every quarter.

However as discussed in Section 3.1, if there is no prevailing market practice, the FTGs allow for a bottom-up cost approach to be used. In relation to overhead rates, a percentage is applied to direct costs, and these rates are set by the FTT in conjunction with BBC Finance. These rates are provided to the divisions to use and ensure that a fair recovery of overheads is made. This percentage is reviewed every three years under project Abacus. EY has seen the internal BBC guidance relating to the percentage allocation of the overheads.

36 WW has a “first look agreement” with PS for all investment and distribution of content, which gives WW four weeks to decide whether it wishes to invest in content before it is put out to the open market. However, according to the FTG, the investment agreement must be completed on an “arm’s length basis” to minimise market distortion.

37 All titles with a reasonable probability of being commissioned are eligible for selection except for those which contravene an existing Joint Venture or output deal; uses an existing BBC programme brand; talent reasons where there is a pre-existing strategic relationship; and Natural History programming.

38 An electronic randomiser is used to select a representative set of titles across a number of different categories including genre, investment value and rights type.

39 As described in Section 3.16 of the Fair Trade Guidelines (see Section 3.1 of this Review)

40 A project developed by the FTT and BBC Finance and Operations to support the application of the Fair Trading Guidelines.
3.5.2 Benchmarking used by the commercial subsidiaries

When negotiating with the BBC PS divisions, the commercial subsidiaries also conduct analysis to ensure they offer a price in line with market rates.

For example, S&PP informed EY that it uses a benchmarking process to help it price its rate cards. S&PP benchmarks these rate cards against its major competitors, and an annual S&PP review process seeks to ensure that these rate cards remain competitive. During the annual review process, a variety of external factors can influence rate card price changes. These include, but are not limited to, labour market conditions and wage increases, price reductions by competitors, competitors having lower margins or the technical offering being highly specialised.

S&PP’s rate cards are used in negotiations with Public Service and other potential third parties to assess the price charged by S&PP for the services being provided. The quote offered during negotiations may be discounted, and EY understands from interviews with third parties that this is common market practice.

WW also has its own processes in place to benchmark the offer it makes for content rights against market practice. Such processes include reviewing previous rights deals within the genre; rights deals with non-BBC producers; and WW business case analysis assessing the revenue that could be generated from the rights in other markets.

EY notes that, although this process acts as a useful cross-check, it is not a substitute for proper assessment of transfer pricing activity by the PS.

Section 4 assesses how the transfer of assets or services has been priced for each of the case studies under review.

3.6 What are the procedures in place to review how contracts are managed?

In addition to the above, the FTT’s internal procedures – as cited earlier in Sections 3.3 and 3.4 – state that:

“it is essential [emphasis added] to seek advice if you become aware of material change to the size, nature and/or scope of an activity that has been previously advised upon or relevant changes in the external market which might significantly increase, for example, the BBC’s market strength.”

As such, the onus is on the division (and therefore the division head) to review any contracts which fall into the above categories, or if such provisions are contained in any of the Agreements which are currently in place between BBC PS and its commercial subsidiaries. Failure to do so could result in a breach of internal procedures or even the FTGs, the consequences of which are discussed in Section 3.1.

The case studies discussed in Section 4 assess whether this obligation is applied in practice.

3.7 What additional controls are in place?

In addition to the FTGs (see Section 3.1), the BBC’s Fair Trading training process, discussed in Section 3.3 above, provides another level of control. The training is designed to ensure that all staff are aware of their responsibilities about Fair Trading and transfer pricing. In addition, the tiered system of training seeks to ensure that those who are responsible for signing off transactions or are heavily involved in transactions with third parties (where third parties are deemed to include the commercial subsidiaries) have a deeper knowledge of the process required.
The internal Fair Trading procedures also provide a further level of control and require, as discussed in Section 3.3, the reporting of compliance via the quarterly return process. These reports include:

- A summary of significant issues arising in a Group or Division.
- Updates on any significant actions arising from the previous biannual meetings.
- Data demonstrating the volume of FT queries raised.
- Training statistics.
- Information on trading income.

The Biannual Returns from the BBC PS divisions include a representation from the relevant Director that the Group or Division has complied with the FTGs and Procedure, throughout the previous six month period, and is approved by the Director of the division. For the commercial subsidiaries the returns are signed off each quarter by the relevant CEO.

In addition to the divisional returns, there are the annual reports regarding compliance with the 4 Commercial Criteria (“4CCs”), from each commercial subsidiary, which are signed off by senior management. These are submitted to the EFTC along with the Annual Report on Fair Trading. The application of the 4CCs is set out in Section 2 of the FTGs, which consider the effect of commercial activities undertaken by the BBC and its subsidiaries on the relevant markets where commercial activity is taking place.

There is also a further control undertaken by the Fair Trading and Competition Law department’s FTT Compliance Manager. The FTT Compliance Manager periodically tests various aspects of the BBC’s Fair Trading systems, including income arising from Commercial Trading Activities; post advisory compliance; and review of other specific Fair Trading risks.

The results of this testing are discussed with the appropriate Fair Trading Adviser and FT Rep, to inform a process of continual improvement. If a breach has occurred, then the Fair Trading & Competition Law Department will instruct the relevant business areas to take appropriate preventative or corrective action.

### 3.8 Are there any external assurance mechanisms?

To provide assurance that the Fair Trading procedures are being followed, the BBC uses a variety of external assurance mechanisms.

First, there is the annual Fair Trading Audit, currently conducted by Deloitte, which provides the EFTC and the BBC Trust with a formal opinion on whether the Fair Trading internal control systems in place have complied with the requirements of the Fair Trading Arrangements. This aims to assess whether the BBC has established and applied a system of internal controls that provide reasonable assurance that the BBC is complying with Fair Trading requirements. Included in this is a testing of the OOP and a testing of a selected sample of transactions from the Fair Trading log. The audit also reviews specific risks – for example those relating to BBC Store, MyBBC, and Transforming International News – and the FTT’s quarterly returns to ensure that all relevant people have completed the required FT training. The audit is presented to the EFTC and to the Trust to provide an independent review, but is not publicly available.

EY has reviewed the audit opinion for the years 2012/13; 2013/14; and 2014/15 and can confirm that no specific requests for changes or issues were reported in these years. As such, Deloitte’s opinion is that the “BBC has established and applied a system of internal controls
that provide reasonable assurance that it has complied with the requirements of the Fair Trading Arrangements.\textsuperscript{41}

Secondly, there is the compulsory annual financial audit, which includes an audit of the BBC Public Service and the three BBC commercial subsidiaries. It also includes sample testing of transfer pricing. This is conducted by EY and EY’s audit opinion is publicly available.

In addition to the two audits, the BBC works with the National Audit Office and other independent experts to provide publicly available\textsuperscript{42} reports which give an in-depth review of value for money. Examples of these include a review of distribution arrangements (radio, TV, online) which relate to S&PP, Financial Management at the BBC and a review of the BBC’s management of the costs of producing continuing drama.

Finally, the BBC’s Fair Trading compliance systems are also subject to a biannual independent assessment to maintain its ISO 9001:2008 accreditation, an internationally recognised standard for management systems.

3.9 How is the wider market made aware of the BBC practices?

As part of making the wider market aware of the BBC transfer pricing practices, the BBC makes certain documents available to the public, in an attempt to assure relevant stakeholders, and also in an attempt to improve levels of transparency. Relevant published documents include the FTGs, the Complaints Bulletin (published quarterly), the FT section of the Annual Report and Accounts and the Strategic Framework for the BBC’s commercial services\textsuperscript{43}. PwC also provides a review of transfer pricing in BBC News. Although this is not an annual check, it represents the output of the periodic validation of the approach to transfer pricing in this area carried out by the BBC Executive.

The BBC website also has a Freedom of Information (“FOI”) page\textsuperscript{44}. On this it states:

“As a publically funded organisation, the BBC is fully committed to meeting both the spirit and the letter of the [Freedom of Information] Act. All the information which we have made available is listed in the Publication Scheme.”

The BBC website section titled “Publication Scheme”\textsuperscript{45} is a centralised hub which includes all of the available publicised information to the public, disclosure logs of previous responses to FOI requests and a section outlining what is excluded from FOI requests and why.

The BBC also responds directly to FOI Requests, and asks all relevant parties within the BBC to help respond to these requests. For example, the FTT has assisted in answering queries relating to transfer pricing. However, as outlined in the Excluded section of the Publication Scheme, any response will exclude commercially sensitive information.

3.10 Summary and conclusions

Overall, in relation to process and governance, we note the following:

- The Fair Trading Policy and Guidelines govern the BBC’s approach to transfer pricing, and there exist internal procedures designed to ensure the policy and guidelines are met: Under the Fair Trading Policy set by the BBC Trust, the BBC Executive is obliged to produce, publish and adhere to its FTGs. The key points in the FTGs relating to transfer pricing include requirements for the BBC PS and commercial services to have formal documented agreements in place for transactions; for transfer pricing.

\textsuperscript{41} From the Fair Trading Annual Audit report to the EFTC
\textsuperscript{42} Available at http://www.bbc.co.uk/bbctrust/our_work/value_for_money/
\textsuperscript{43} Available at http://www.bbc.co.uk/bbctrust/governance/tools_we_use/commercial_services.html
\textsuperscript{44} http://www.bbc.co.uk/foi/
\textsuperscript{45} http://www.bbc.co.uk/foi/publication-scheme
\textsuperscript{46} http://www.bbc.co.uk/foi/publication-scheme/excluded
pricing to be conducted at prices comparable to those in the market; or for cost-based pricing to be used only where market pricing is not available. In addition to the FTGs, the BBC has established a FTT, which has developed a set of internal procedural guidance.

► **The BBC’s Fair Trading Team (alongside the BBC PS Divisions) also administers Fair Trading training, designed to ensure that all BBC PS staff understand the relevant procedures that need to be followed.** There is a tiered approach to training, ensuring that all BBC PS staff receive a basic level of training, whilst those in more senior and more relevant positions receive more thorough training. For example, all personnel receive core Fair Trading training as part of their BBC PS staff induction process; and more intensive training is repeated by the necessary personnel (for instance, those in more senior positions and those who are involved in sign-off of relevant BBC projects) every three years.

► **Systems are in place to ensure transfer pricing processes are triggered for relevant transactions:** For instance, referral to the Fair Trading Team is required for “significant, novel or contentious” transactions (for instance where there are non-standard contractual terms, for high-value transactions (deemed to be those above a value of £50,000), and for any transactions where incremental cost pricing is being used. However, EY notes that a definition for what precisely constitute “significant” and/or “contentious” transactions is not currently contained within the BBC’s procedures, and therefore the BBC has discretion in how it applies and interprets the FTGs where a degree of ambiguity exists. This creates some potential risk, to which we return in our recommendations below.

► **Fair Trading quarterly returns are obligatory for BBC PS divisions and the commercial subsidiaries:** These returns report issues including significant transfer pricing activity, the relevant fair trading issues associated with the group or division, data demonstrating the volume of Fair Trading queries raised, and training statistics. The returns have to be formally signed-off by the Directors of the relevant divisions and Chief Executives of the commercial subsidiaries.

► **A range of relevant external controls are in place:** For instance, there is an annual Fair Trading Audit, and the Fair Trading compliance systems undergo independent assessment to maintain ISO 9001:2008 accreditation.

► **Any breaches of internal procedures are recognised by the annual Fair Trading Audit:** They are subsequently reviewed by the EFTC and the BBC Trust. A breach of the FTGs in relation to transfer pricing may constitute a breach of State aid law, and would illicit more severe repercussions for both the individual and the BBC.

EY considers that it is not realistic for every transaction which involves transfer pricing to be reviewed by the FT team given the volume of transactions and size of the team. As such, the use of triggers is therefore appropriate. That said, EY notes that a definition for what is deemed “significant” and “contentious” would provide further clarity on which transactions should be referred, particularly given that it is the responsibility of the division heads to flag such transactions. A more objective definition of “significant” could include a quantitative element similar to those already in place for the criteria applied to spare capacity or sports rights (as discussed in Section 3.4).

In addition, EY notes that providing the triggers are properly communicated and clear to division heads and the consequences understood, via the training process, then this should help to mitigate concerns that the responsibility for compliance lies, in part, with the divisions. Further, EY notes that the use of “dipstick” tests by the FT team to check for compliance would add an additional level of rigour to the process.

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47 ISO 9001 is a globally-recognised quality management system accreditation.
Given the above, although EY is of the opinion that there are detailed procedures in place designed to govern the transfer pricing process, there are likely to be areas where improvement could be made. For example, we note that the BBC Trust's Review of Fair Trading Policy stated its intention to “…ask the Executive to commission a more thorough fair trading audit this year, with a greater focus on whether the outcomes of individual cases are compliant, as well as whether processes have been followed correctly. We will also be more transparent and publish more information about the results of the audit in the Annual Report.” As part of the FT Audit, the auditors perform testing in line with their risk-based approach, where they follow the trajectory of projects from inception to approval. We consider that the annual FT audit is likely to be seen as even more effective and transparent if it followed the trajectory of projects through to the point of payment. As discussed above, the procedures could also be enhanced to provide further clarity, particularly around the triggers that are used.

In Section 4, we draw on our analysis of case studies to consider in more detail whether the BBC adheres to the above systems in practice; if the most appropriate transfer pricing method is being utilised for transactions; whether this follows best practice; and how benchmarking is used to facilitate this process.

4. **Overview of case studies**

4.1 **Selecting the case studies**

As part of the review of the BBC’s transfer pricing regime, EY has conducted an in-depth assessment of 12 case studies, focusing particularly on the adherence to the current procedures, and the final method adopted for the transfer price of the assets and services in question.

Although every care was taken when selecting the case studies, it was not practical to look at every transaction that fell under the transfer pricing regime. An ideal methodology would have been to start from a list of all relevant transfer pricing relationships, and then to select the largest transactions for each commercial subsidiary and a random sample of smaller transactions. However, information on transfer pricing is not tracked in this way by the Fair Trading Team, and as such we are not able to confirm the percentage of overall transfer pricing agreements that are covered by the Review.

We therefore sought to ensure that the methodology chosen to select the case studies, as listed below, provided both the breadth and depth of the case studies to make the selection representative and appropriate to enable robust conclusions to be drawn. In order to do this, we adopted the following criteria:

- To ensure the **breadth** of transfer pricing agreements were covered, case studies were selected that cover a similar transfer pricing agreement across each of the three commercial subsidiaries – for example case studies relating to each subsidiary’s use of the BBC brand. In assessing similar transactions across subsidiaries, we do not necessarily expect an identical approach to be taken for all cases. Rather, we have considered whether the actual approach adopted is appropriate and reflects the circumstances of the specific deal. Similarly, for the S&PP case studies (7 and 8), although these are comparable in terms of the services being purchased, the approaches adopted for each of them are different but have been assessed according to the requirements of each deal. In these cases EY considers that there is an onus on the BBC PS to demonstrate that the BBC has reviewed all the options, taking advice where necessary, to reach the appropriate decision.

- To ensure the **depth** of transfer pricing agreements were covered, case studies unique to each commercial subsidiary were selected, enabling EY to carry out detailed analysis of a specific transfer pricing agreement.

- To ensure that the case studies chosen were representative, the number of case studies assessed for each individual subsidiary considered the size of the subsidiary. As such, more case studies were chosen that related to activities conducted by BBC Worldwide given it is a significantly larger entity than GNL or S&PP, as demonstrated by the headline sales figures in Table 4 below.

<table>
<thead>
<tr>
<th>Commercial subsidiary</th>
<th>Headline sales 2014/15 (£m)</th>
<th>Number of case studies</th>
</tr>
</thead>
<tbody>
<tr>
<td>BBC Worldwide</td>
<td>1,002</td>
<td>5</td>
</tr>
<tr>
<td>BBC Global News Ltd</td>
<td>93</td>
<td>3</td>
</tr>
<tr>
<td>BBC S&amp;PP</td>
<td>29</td>
<td>4</td>
</tr>
</tbody>
</table>

Source: BBC Annual Report

- To address concerns previously raised by third parties during interviews with EY, primarily:
  - The belief that the BBC commercial subsidiaries are benefitting from subsidies from the licence fee in one form or another that commercial businesses would not...
receive, including a perception of collusion via the aligning of objectives between the BBC PS and its commercial subsidiaries.

- The ability to access BBC content on fair and reasonable terms.
- The apparent lack of transparency over how transfer pricing arrangements operate.
- The belief that the BBC does not communicate appropriately with external stakeholders.

- To ensure that the Review addresses the relevant industry concerns, the financial value of the transfer pricing arrangement was considered – based on the assumption that the greater the value of the arrangement, the greater the possibility of market distortion if the transfer price is set too low.

Based on the above criteria, EY worked with the BBC Trust and the BBC Executive to identify a list of potential case studies, as shown in Table 5. From this list, EY then independently selected the relevant case studies to remove potential bias in selection.

Of the 12 case studies selected, the majority do not relate to the specific criteria (e.g. relating to sports rights or sponsorship) set out in Section 3.4, but fall under the “significant, novel and contentious” category. As such the relevance of this category is important, but as discussed in Section 3.10, there remains ambiguity in what constitutes “significant” and “contentious”.
<table>
<thead>
<tr>
<th>Table 5: EY’s Case Study selection criteria check list</th>
<th>Breadth of transfer pricing captured</th>
<th>Depth of transfer pricing captured</th>
<th>Relates to 3rd party concerns</th>
<th>Financial value</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Shared services; Steria Contract with Worldwide</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>2. Shared services; Steria Contract with GNL</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>3. Shared services; Steria Contract with S&amp;PP</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>4. Brand agreements with Worldwide</td>
<td>✓</td>
<td>✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. Brand agreements with GNL</td>
<td>✓</td>
<td>✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td>6. Brand agreements with S&amp;PP</td>
<td>✓</td>
<td>✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td>7. S&amp;PP – EastEnders contract with BBC drama</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>8. S&amp;PP/BBC Production – S&amp;PP and Holby City</td>
<td>✓</td>
<td>✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td>9. GNL – Review of programme transactions between GNL and BBC PS (The Travel Show; Our World &amp; Click)</td>
<td>✓</td>
<td>✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td>10. Worldwide – A large external and a large Public Service content rights contract</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>11. Worldwide – A returning external and a returning Public Service content rights contract</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>12. Worldwide – Factual genre external and Public Service content rights contract</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
</tbody>
</table>

4.2 Assessing the case studies

For each case study, EY has undertaken a bottom-up approach to its analysis. This starts from a specific single transaction and uses this to analyse the transfer pricing procedure and outcome. The analysis specifically assesses two distinct areas:

(i) the transfer pricing procedures; and

(ii) the transfer pricing mechanism. On the basis of this analysis, EY has considered whether the appropriate outcome has been reached. When viewed across the case
studies, this has enabled us to gain a sense of the overall transfer pricing regime that is as representative as possible within the limits of the Review.

Based on the analysis for each case study, EY has considered whether the appropriate outcome has been reached i.e. that the transaction has been undertaken in line with the procedures identified in Section 3, and that the price paid is considered to be a fair transfer price based either on market rates or on a bottom-up basis.

To assess whether each transaction was appropriate, EY applied a series of questions to each case study as follows:

1. Was there a sufficiently documented agreement between the PS and the commercial subsidiary, as required by Section 3.10 of the FTGs?
2. What was the transfer price?
3. How was the transfer price determined?
4. Was the choice of transfer pricing methodology rational?
5. Was the methodology applied with a satisfactory degree of accuracy and rigour?

On this basis, below we set out our overall assessment as to whether the transfer pricing transactions reviewed were in line with the FTGs; whether they were conducted on an arm’s length basis; and whether a fair market price was paid. For each case study, EY has also highlighted any areas which EY considers may require further consideration by the BBC.

A summary of the process, analysis and assessment of each case study is found in Section 1.3, but not reproduced here. The Review’s overall conclusions and recommendations are set out in Section 5.
## 4.3 EY’s key findings

### 4.3.1 Case Studies 1-3: Steria Contracts with Commercial Subsidiaries

Case Studies 1-3 review the transfer pricing arrangements between the BBC’s three commercial subsidiaries and the BBC PS for use of Steria, an outsourced finance and accounting company that centralises those related business functions.

<table>
<thead>
<tr>
<th>Question</th>
<th>Findings</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Was there a sufficiently documented agreement between the public sector and the commercial subsidiary?</strong></td>
<td>A signed Service Level Agreement (“SLA”), as required by Section 3.10 of the FTGs (and discussed in Section 3.1 of this Review), has been in place since 2010 between BBC PS and both BBC Worldwide (“WW”) (updated in 2015) and BBC Studios &amp; Post Production (“S&amp;PP”). GNL sub-contracts Steria services through WW. As such there is no agreement between PS and GNL. This has been confirmed in the interviews with BBC PS staff and by GNL’s Head of Finance.</td>
</tr>
<tr>
<td><strong>What was the transfer price?</strong></td>
<td>A “recharge” calculated by BBC PS consisting of a fixed cost element and a volume generated variable cost element.</td>
</tr>
<tr>
<td><strong>Under the SLA the commercial subsidiary makes a payment based on an annual forecast. At the end of the financial year a reconciliation cost is applied to ensure the correct amount is paid.</strong></td>
<td></td>
</tr>
<tr>
<td><strong>How was the transfer price determined?</strong></td>
<td>As set out in the SLA, a “pass through costing” approach was used to determine the correct amount that should be paid by the commercial subsidiaries for the use of Steria’s financial and accounting services.</td>
</tr>
<tr>
<td><strong>The commercial subsidiaries pay for all variable costs that are attributed to their activities and staff. They then pay a proportion of the fixed costs, which is calculated from their proportion of the total variable costs.</strong></td>
<td></td>
</tr>
<tr>
<td><strong>WW is charged the full amount for services provided to both WW and GNL. WW then has a separate agreement with GNL for how it pays its share. As such, there is no transfer pricing arrangement between BBC PS &amp; GNL.</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Was the choice of pricing methodology rational?</strong></td>
<td>Yes. Costs are allocated between BBC PS and the subsidiaries based on usage, i.e. costs are paid in proportion to relative consumption.</td>
</tr>
<tr>
<td><strong>It is common market practice to have centralised and outsourced back office service provision, with each subsidiary paying part of the overall cost.</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Was it applied with a satisfactory degree of accuracy and rigour?</strong></td>
<td>Yes. The contracts between the BBC PS and WW, and BBC PS and S&amp;PP for accounting and finance services provided by Steria all followed prevailing market practice in line with the FTGs.</td>
</tr>
</tbody>
</table>

### Summary of Analysis

The cost data provided to EY demonstrates that the costs are allocated between BBC PS and the subsidiaries based on usage, i.e. that costs are passed through. It is therefore EY’s assessment, based on the data and documents received and interviews with relevant members of the BBC PS staff, that the agreement between the BBC PS and the three commercial
subsidiaries for the use of shared services was conducted according to the FTGs and met the BBC’s internal procedures. The deal appears to have been conducted on an arm’s length basis, with the BBC PS negotiating a fair market price with Steria.

EY notes that the SLA for S&PP has not been updated as recently as the WW SLA, however, the terms included in both SLAs are not materially different. For best practice and for consistency EY would expect all contracts to be updated simultaneously, given that costs are allocated based on usage, and a substantial change in usage by one commercial subsidiary would need to be reflected in the costs allocated to all other subsidiaries.

**EY Assessment**

_The contracts between the BBC PS and WW, and BBC PS and S&PP for accounting and finance services provided by Steria were all conducted on an arm’s length basis and BBC PS negotiated a fair market price. GNL contracts for these services directly with WW and therefore there is no transfer pricing arrangement between BBC PS and GNL. However EY would expect all contracts to be updated simultaneously for best practice._
### 4.3.2 Case Study 4: Brand Agreements with WW

Case Study 4 reviews the transfer pricing arrangements by which WW pays for the use of the BBC Brands as set out in the Brand Agreement between WW and BBC PS.

<table>
<thead>
<tr>
<th>Question</th>
<th>Findings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Was there a sufficiently documented agreement between the public sector and the commercial subsidiary?</td>
<td>- A Brand Licence Agreement (updated and signed in 2015) grants WW the use of the BBC Brand for commercial use. It covers how the brand can be used by WW and by BBC WW's international subsidiaries.</td>
</tr>
<tr>
<td></td>
<td>- Under the Brand Agreement, WW pays to PS a set percentage of its pre-tax revenue, depending on its source:</td>
</tr>
<tr>
<td></td>
<td>* &gt;5% of the pre-tax revenue raised by WW from all commercial activity generated from using the Master Brand⁴⁹.</td>
</tr>
<tr>
<td></td>
<td>- &gt;5% of all other pre-tax revenue raised by WW (excluding dividends from the 50% ownership of UKTV, income from BBC Advertising and “Any other revenue agreed as excluded in writing between the BBC and Worldwide from time to time”.</td>
</tr>
<tr>
<td></td>
<td>- WW pays this to the BBC separate to the corporate dividend.</td>
</tr>
<tr>
<td>What was the transfer price?</td>
<td>* A “market rate” approach was used to determine the correct ‘Brand Licence Royalty’ (BLR) that should be paid by WW for the various uses of the BBC brand by WW and its commercial subsidiaries.</td>
</tr>
<tr>
<td></td>
<td>* The benchmarking review was conducted by PwC in 2011⁵⁰. A range for the royalty payment of between 0.25%-2% was recommended. EY’s review suggests that the examples used by PwC are, in the main, still valid when the Agreement was signed in 2015.</td>
</tr>
<tr>
<td>How was the transfer price determined?</td>
<td>* Although the Brand Licence Royalty was supported by the PwC market research and case studies, EY has seen no formal documentation explaining why &gt;5% was considered appropriate by the BBC PS other than to state it was the intention to use the PwC recommendation in negotiations between BBC PS and WW.</td>
</tr>
<tr>
<td>Was the choice of pricing methodology rational?</td>
<td>* Yes. The transfer pricing process and mechanism for this specific transaction were conducted according to the FTGs and that the use of the PwC report was appropriate.</td>
</tr>
<tr>
<td>Was it applied with a satisfactory degree of accuracy and rigour?</td>
<td></td>
</tr>
</tbody>
</table>

⁴⁹ Master Brand means the name and mark “BBC” and any logo form of the work and mark “BBC” as notified by the BBC to Worldwide from time to time and the current form of which is set out in Schedule A of the Brand Licence Agreement.

⁵⁰ “What is an appropriate royalty for the use of the BBC brand by BBC Worldwide? Observations based on market practice”, PwC, 2011
Summary of Analysis

PwC recommended in both its 2010 and 2011 reports that it is not normal market practice to make implicit brand payments via the dividend as this lacks transparency, making it more difficult to assess whether the price paid by WW is a fair transfer price.

Regarding the payment for use of the Master Brand, as set out in the Brand Licence Agreement, the approach taken under the current agreement appears to be in line with PwC’s option 3, set out in Section 8 of the 2011 report – which recommends that an above the line royalty, for example a percentage of WW revenue, is determined, which helps to provide some transparency around what WW pays for the use of the brand and so helps to address third party concerns. However, we are unable to verify exactly how the payment is made separately to the dividend, as the agreement has only recently been put in place and the first payment is yet to be made. As such EY is not yet able to confirm that the procedures have been correctly followed on an end-to-end basis. Additionally, EY notes that there is no formal documentation explaining the reasoning behind why the rate was considered to be the correct percentage to apply from the PwC range. EY notes that the % is in range, however EY considers it good practice for the BBC to have documentation explaining the reason for choosing a particular percentage figure from the range.

As such EY recommends that a review of the 2015/16 WW financial statements and dividend payment is completed once the payment has been made, to ensure that the payment is consistent with the Fair Trading guidance. EY notes that WW has estimated the brand fee as £ in the recent budget process for the 2015/16 period, however this is an expected amount and may change.

Finally, EY recommends that regular reviews should be carried out in order to assess the comparability of the brand licensing agreement with market practice. This is to ensure that no market distortions are taking place due to changing commercial practice.

EY Assessment

Based on the data and documents received, interviews with relevant members of the BBC PS staff and EY’s review of PwC’s case studies (particularly regarding length of the agreements), EY’s assessment is that the transfer pricing process and mechanism for this specific transaction were conducted according to the FTGs and that the use of the PwC report was appropriate. The transaction was conducted on an arm’s length basis and BBC PS negotiated a fair market price. As noted above, the agreement has only recently been put in place and the first payment is yet to be made. EY is therefore not yet able to confirm that the procedures have been correctly followed on an end-to-end basis.

51 “Review of the licensing of the BBC brands by the BBC’s commercial subsidiaries”, PwC, April 2010
### 4.3.3 Case Study 5: Brand Agreements with GNL

Case Study 5 reviews the transfer pricing arrangements by which GNL pays for the use of the BBC Brand.

<table>
<thead>
<tr>
<th>Question</th>
<th>Findings</th>
</tr>
</thead>
</table>
| **Was there a sufficiently documented agreement between the public sector and the commercial subsidiary?** | • A Brand Licence Agreement is in place that covers the transfer of the BBC Brand and all relevant logos, icons and marks for use in GNL programmes – primarily used on the BBC News channel and related communications.  
• The Brand Licence Agreement was first signed in 2003 and last updated in 2011. However, it has not been updated to include bbc.com following the restructuring of commercial subsidiaries. |
| **What was the transfer price?**                                         | • Interbrand was hired by BBC PS in 2002 to calculate the correct payment that GNL should pay for use of the BBC brand.  
• Interbrand assessed relevant market benchmarks and determined the value of the BBC brand for GNL is worth ≈% of its intangible earnings\(^\text{52}\).  
• However, no further benchmarking analysis was conducted for the 2011 amendment. |
| **How was the transfer price determined?**                              | • A “market rate” approach was used to determine the amount that should be paid by GNL for the use of the BBC brand.  
• The royalty rate used in the brand agreement is based on benchmarking analysis from 2002, and is paid once GNL is profitable.  
• In addition this agreement was reviewed by PwC in 2010 although no further benchmarking was undertaken. |
| **Was the choice of pricing methodology rational?**                      | • Yes. Based on the accepted working assumption that GNL would become profitable, it was rational at the time to base the royalty rate on a percentage of GNL’s profits. |
| **Was it applied with a satisfactory degree of accuracy and rigour?**    | • The transfer pricing process and outcome for this specific transaction was conducted according to the FTGs at the time of the original agreement in 2003.  
• However, EY notes that 13 years have passed since then, with major re-structuring and changes in funding of international news having been undertaken, which appears at odds under current market conditions.  
• Additionally, under normal commercial agreements it would be unusual for the owner of a piece of intellectual property to allow continued exploitation by a third party in return for no payment over a prolonged period. |

\(^\text{52}\) Profit before interest, tax and any other payments, less a charge for tangible assets
Summary of Analysis

It is EY’s assessment based on the data and documents received, as well as interviews with relevant members of the BBC PS staff, that the transfer pricing process and outcome for this specific transaction was conducted according to the FTGs at the time of the original agreement in 2003.

However, EY notes that there is scope to improve the current arrangements, based on the following concerns relating to GNL’s use of the BBC brand:

► The structure of the brand payment means that GNL only pays BBC PS for the use of brand when it becomes profitable. As GNL has not made a profit since its inception, it has not paid for the use of the brand, yet has been exploiting the brand on its TV channels and related communications. EY understands this is not normal market practice.

► The current level of payment for the brand is \( \times \% \) of profit. This was calculated in 2002, and hence may no longer be the correct payment value for the use of the brand and no further benchmarking analysis has been undertaken since then. EY also observes that it is more common market practice to set royalty rates based on revenue than profits in cases where the entity in question goes through a prolonged period of non-profitability.

► As GNL has never made a profit, the payment has never been initiated. As such, there is a concern that a lack of brand payment may have become accepted practice within the BBC, and that the process for making a brand payment is not widely known within the BBC.

► The latest amendment to the Brand Licence Agreement was signed in 2011 with the precursor to GNL, BBC World News Limited. Since then there has been significant restructuring at the BBC, including bbc.com now coming under the remit of GNL. The current brand agreement is not signed with GNL and does not include bbc.com’s use of the BBC brand. The Brand Licence Agreement is open-ended and does not have a regular review period included in it.

EY agrees with the 2010 PwC report which states that the BBC brand has additional costs and restrictions due to the additional governance, monitoring and publically funded nature of the BBC brand, and that these should be taken into account when completing the market review to determine the brand payment. However, this should not apply in a way which results in no payment being made for use of the brand.

EY Assessment

It is EY’s assessment based on the data and documents received, as well as interviews with relevant members of the BBC PS staff, that the transfer pricing process and outcome for this specific transaction was conducted according to the FTGs at the time of the original agreement in 2003. However, the fact that no payment has been made in the thirteen years since this time does not align with market practice.

EY notes concerns regarding the Brand Licence Agreement between GNL and the BBC PS, such as the structure of the Agreement and the significant restructuring of GNL that has occurred since the Brand Licence Agreement was last amended.

Meeting with \( \times \) and \( \times \) on 25 November 2015
## 4.3.4 Case Study 6: Brand Agreements with S&PP

Case Study 6 reviews the transfer pricing arrangements by which S&PP pays for the use of the BBC Brand.

<table>
<thead>
<tr>
<th>Question</th>
<th>Findings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Was there a sufficiently documented agreement between the public sector and the commercial subsidiary?</td>
<td>• Although the BBC informed EY that there is a Brand Licence Agreement in place, neither S&amp;PP nor BBC PS has been able to provide EY with a copy of the Agreement.</td>
</tr>
<tr>
<td>What was the transfer price?</td>
<td>• According to the BBC, S&amp;PP pay the BBC a nominal royalty rate of ( \geq % ) of the company’s net profit on non BBC business.</td>
</tr>
<tr>
<td>How was the transfer price determined?</td>
<td>• EY asked whether S&amp;PP had made payments for use of the brand, in lieu of being able to see the Agreement. There was a payment made in the financial year 2008/09, however no further payments has been made in the last five years as, despite generating non-BBC revenues, S&amp;PP has continued to make a net loss.</td>
</tr>
<tr>
<td>How was the transfer price determined?</td>
<td>• The PwC report states that the royalty fee was calculated by Interbrand in 1998 and that the royalty fee takes into account the fact that the brand is only exploited by the BBC on non-BBC revenue.</td>
</tr>
<tr>
<td>Was the choice of pricing methodology rational?</td>
<td>• S&amp;PP only pays for use of the brand on non-BBC revenues, as transactions between BBC PS and S&amp;PP are not exploiting the use of the BBC brand by S&amp;PP.</td>
</tr>
<tr>
<td></td>
<td>• Under normal market conditions it is common for the licensee to pay a royalty to the owner of the brand, most commonly a proportion of revenue or – if appropriate – profits, in return for being able to exploit the intellectual property.</td>
</tr>
<tr>
<td></td>
<td>• The BBC PS has stated that it believes that S&amp;PP is technically not exploiting BBC IP, as being owned by the BBC does not attract a price premium for the services it provides(^{54}).</td>
</tr>
<tr>
<td></td>
<td>• However, EY considers that the reputational benefit of use of the BBC brand is sufficient to require a brand agreement to be put in place between the two entities.</td>
</tr>
<tr>
<td>Was it applied with a satisfactory degree of accuracy and rigour?</td>
<td>• EY cannot fully comment on the application of the transfer pricing process for this specific transaction because:</td>
</tr>
<tr>
<td></td>
<td>• EY has not seen the Brand Licence Agreement.</td>
</tr>
<tr>
<td></td>
<td>• EY has not seen any of the underlying data as to what method was used by Interbrand to calculate the royalty fee.</td>
</tr>
</tbody>
</table>

\(^{54}\) Meeting with Charlie Villar and the FT team on 1 December 2015
Summary of Analysis

EY cannot fully comment on whether the transfer pricing process and outcome for this specific transaction was conducted according to the FTGs. This is because:

► EY has not seen the Brand Licence Agreement.
► EY has not seen any of the underlying data as to what method was used by Interbrand to calculate the royalty fee.

EY does note that, according to the PwC report, S&PP does not contribute to the International Trademark Fund (ITMF)\(^\text{55}\) or pay a royalty on BBC revenues. However as S&PP does not have relationships with any international clients, nor does it exploit the use of the BBC brand in its dealings with BBC PS, these conditions appear reasonable and in line with market practice. However EY considers that the reputational benefit of use of the BBC brand is sufficient to require a brand agreement to be put in place between the two entities.

On the basis of our review, EY recommends that:

► A new review process should be completed to calculate the correct royalty fee for the use of BBC brand by S&PP.
► A new Brand Licence Agreement is drawn up, and involves the Fair Trading Team in discussions. This new agreement should set out the new royalty fee from the above review process, and we consider that it should also include a regular review period.

EY Assessment

*In the case of the brand agreement between S&PP and BBC PS, EY has not seen the Brand Licence Agreement, nor the underlying data behind the royalty fee calculations, so cannot fully comment on the adherence to the FTGs. It is a concern that the Brand Licence Agreement does not appear to be available.*

*Given that the agreement has not been found, and that the royalty fee appears to be based on a report dated from 1998, EY recommends that a new brand agreement is drawn up.*

\(^{55}\) A BBC fund to aid protection of its brand outside of the UK.
### 4.3.5 Case Study 7: S&PP and EastEnders

Case Study 7 reviews the contract agreement that is in place between S&PP and BBC EastEnders (“Public Service”) for the production of the drama soap opera EastEnders.

<table>
<thead>
<tr>
<th>Question</th>
<th>Findings</th>
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</table>
| **Was there a sufficiently documented agreement between the public sector and the commercial subsidiary?** | • There is a contract between BBC EastEnders and S&PP for the provision of studios, shooting and production, and associated post production services for EastEnders.  
  • The Agreement was signed in April 2015 and lasts for five years. It went through a number of internal boards for approval including the Executive Board. The contract does not have a review provision regarding costs and pricing; however there are a number of KPIs which need to be met. |
| **What was the transfer price?**                                          | • Under this Agreement BBC EastEnders pays £<p> pa for a minimum of 208 episodes of 30 minutes each year for the duration of the contract.  |
| **How was the transfer price determined?**                               | • For this Agreement a number of options were considered by BBC PS, and procurement and legal advice sought, before opening negotiations with the incumbent.  
  • Although no competitive tender occurred, a negotiation took place between the parties to determine a market based price for the contract. |
| **Was the choice of pricing methodology rational?**                      | • Yes. It is normal market practice to negotiate contracts of this nature and to introduce as much competitive tension as possible to achieve best price and value for money for the Licence Fee Payer.  
  • A review of external rates was performed where applicable. Here the BBC team reviewed comparable rates, (for example, crew rates used on other BBC shows) and in-house knowledge to test rates offered (for example the Dock 10 agreement with BBC North). |
| **Was it applied with a satisfactory degree of accuracy and rigour?**    | • Yes. Based on the data and documents received, the transfer pricing process and outcome for this specific transaction was conducted according to the FTGs, as well as BBC PS achieving a “fair market price” for the services involved in this transaction. |

**Summary of Analysis**

As discussed above, the BBC Drama team introduced competitive tension into the negotiations by using comparative evidence, for example crew rates on other BBC shows and in-house knowledge of the prices of the services being offered, to ensure market rates were paid. The BBC team noted that as part of the 2010 contract negotiation some benchmarking was carried out to challenge S&PP’s pricing, however it was found that it was difficult to comprehensively benchmark services for a number of reasons including:

- Few comparable production contracts.
- That suppliers were motivated to under-quote because they knew that it was a benchmarking exercise and that the quotes issued assumed that the new suppliers would inherit some of the existing S&PP assets rather than being required to purchase them.
On a like-for-like comparison, although some of the smaller elements were cheaper, the total cost and level of risk to the BBC of using a competitor to S&PP was higher.

Given the problems involved in seeking reliable external benchmarks, the team sought to make internal comparisons. An exercise was carried out to compare the main variable cost in the contract – the crew rates – to the BBC arrangements in place at Salford. The rate cards for the old and new S&PP contracts were compared to the rate card used by BBC North for the Dock 10 studio. The comparison confirmed that the total crew cost was cheaper under the new S&PP rate card by \(<%\) compared to the old S&PP rates, and rising to \(<%\) by end of the contract, in part due to the static nature of pricing of this contract.

EY notes that the evidence set out in the Executive Board paper supports the view that the contract is in line with market practice, with market rates being used within the negotiation and the price paid for S&PP’s service represents a “fair transfer price” as well as being assessed as being value for money for the Licence Fee Payer.

The contract between BBC PS and S&PP does not have any form of price review process built into it. However, after discussions with relevant BBC PS staff, EY understands that there were internal reasons for taking this approach, justifying the length of contract without review, which has advantages and disadvantages for both parties. It provides incentives for S&PP to reduce its cost base in order to benefit from static prices which given the low margin of the agreement may help to mitigate this. Equally it protects the BBC from inflationary increases and enables the BBC to manage its cost base effectively given the static nature of the Licence Fee over the past years.

**EY Assessment**

*It is EY’s assessment based on the data and documents received, as well as interviews with relevant members of the BBC PS staff, that the agreement between BBC EastEnders and S&PP for the EastEnders contract was conducted according to the FTGs and met the BBC’s internal procedures for ensuring the deal was conducted on an arm’s length basis, with a fair transfer price paid. Although there was no competitive tender, we note that the BBC PS received relevant procurement and legal advice, and benchmarked S&PP’s pricing against market practice.*
4.3.6 Case Study 8: S&PP and Holby City

Case Study 8 assesses the transaction between BBC PS and S&PP for the post production services for the TV show Holby City.

<table>
<thead>
<tr>
<th>Question</th>
<th>Findings</th>
</tr>
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</table>
| Was there a sufficiently documented agreement between the public sector and the commercial subsidiary? | • A contract, as required by Section 3.10 of the FTGs, has been in place since 2013.  
  • S&PP won these contracts in an open market tender.  
  • The contract started on 1 January 2013 and lasts for a minimum of two years. The contract can be extended by up to 24 months, 12 months at a time. After this period a new contract will be signed. |
| What was the transfer price?                                              | • Although the amount paid to S&PP is commercially sensitive, by hosting an open tender process for the provision of services, BBC PS ensured that the decision to award the contract to S&PP was in line with prevailing market practice and the use of market rates.  
  • The open tender process ensured that the price offered by S&PP was benchmarked against relevant market competitors. |
| How was the transfer price determined?                                   | • As noted above, the contract was awarded via an open tender process.  
  • By the close of the process there had been offers from eight separate companies across all three Lots, with S&PP the only company to bid on multiple Lots – bidding on all three (and winning two). |
| Was the choice of pricing methodology rational?                          | • Yes. An open tender process is a common market practice, and the transaction was completed under normal market conditions, with S&PP effectively acting the same as its competitors. |
| Was it applied with a satisfactory degree of accuracy and rigour?        | • Yes. Due care was taken by the BBC to ensure that there was no unfair or external influencing factors that resulted in S&PP’s selection. |

Summary of Analysis

In September 2012, BBC PS issued a tender to the open market for the provision of post-production equipment and services for the weekly TV medical drama Holby City. The tender consisted of three separate and specific lots:

- **Lot 1**: Picture post equipment, maintenance, support and expertise.
- **Lot 2**: Audio post equipment, maintenance, support and expertise.
- **Lot 3**: Grading service.

The contract was for a minimum of two years starting 1 January 2013, with a potential 24 month extension extended, 12 months each time. Those who submitted offers as part of the tender process could bid on one, two or all of the Lots with the BBC reserving the right to award multiple Lots or all Lots to one provider.
At the close of the tender process, there had been a total of eight unique offers across all three of the Lots. S&PP was the only entrant to bid on multiple Lots, deciding to bid on all three. As part of its offer, S&PP included ☝. After careful review of all offers by BBC PS, Lots 1 and 2 were awarded to S&PP.

Based on the data and documents received, it appears that the transfer pricing process and outcome for this specific transaction was conducted according to the FTGs, as well as BBC PS achieving a fair market price for the assets involved in this transaction.

EY notes that the Invitation to Tender (“ITT”) resulted in S&PP winning the Holby City contracts under normal market conditions. As part of the ITT a detailed section of the document outlined how BBC PS would evaluate the tenders, so that BBC PS was able to compare offers effectively and fairly. A document was produced which set out the evaluation criteria and how each individual bid scored. As part of its review, EY looked into whether there had been any unfair or external influencing factors in S&PP’s selection. EY’s review of the ITT document found:

► It provided to third parties a clear goal of the BBC to select “the most economically advantageous tender”. It describes this as an optimum combination of being able to meet the BBC’s operational requirements and the total cost to the BBC over the whole life of the contract.

► The operational requirements are set out in the document, and are the “BBC’s minimum requirements only” and invites applicants to describe additional factors that go beyond this requirement in their offer.

► The document describes a clear scoring system that was used to assess the operational requirements. The scoring system standardises tender responses so that comparisons can be made, as well as to provide transparency in selection.

► The scoring system sets a minimum score of 60% that an offer must achieve to be considered, and BBC PS discarded any tenders which failed to meet this score.

In addition to the ITT document, BBC PS provided EY with the financial offers received from all competitors as well as the internal meeting notes from the selection panel which outlined who the successful bidder was and why it was selected. From this, the S&PP bids were assessed. For example based on this EY was able to see that S&PP reduced its offer for continuing to provide audio post equipment, maintenance, support and expertise.

**EY Assessment**

*BBC PS adhered to the FTGs and achieved a fair market price when tendering the Holby City contracts that were won by S&PP.*
### 4.3.7 Case Study 9: GNL and BBC PS programme transactions

Case Study 9 assesses the transactions between GNL and BBC PS for various programmes that are broadcast on the BBC World News channel ("WNC")\(^{56}\).

<table>
<thead>
<tr>
<th>Question</th>
<th>Findings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Was there a sufficiently documented agreement between the public sector</td>
<td>• An SLA is in place between GNL and BBC News, amended and signed in June 2015 for the 15/16 financial year.</td>
</tr>
<tr>
<td>and the commercial subsidiary?</td>
<td>• The SLA only lasts for one financial year before it expires, requiring a new signed amendment each financial year.</td>
</tr>
<tr>
<td>What was the transfer price?</td>
<td>• The transfer prices for all three programmes are based on the cost of producing the programmes, rather than the use of market rates and benchmarks.</td>
</tr>
<tr>
<td>How was the transfer price determined?</td>
<td>• For GNL commissioned programmes, according to the PwC report(^{57}) there are no suitable market benchmarks, as such based on the FTGs Section 3.16, a cost plus approach has been used as a proxy for the production of Our World and the Travel Show. However, a discount has then been applied, using the decision flow tool discussed below, which results in a reduction to the cost for GNL, equivalent to the cost of the overheads and margin.</td>
</tr>
<tr>
<td>Was the choice of pricing methodology rational?</td>
<td>• For BBC News content, specifically Hard Talk, the GNL payment is set at incremental cost, based on the FTGs Section 3.14.</td>
</tr>
<tr>
<td>Was it applied with a satisfactory degree of accuracy and rigour?</td>
<td>• The rationale for the pricing method chosen is based on advice from FTT and BBC Legal, as well as external economic advice from PwC.</td>
</tr>
<tr>
<td></td>
<td>• For the transactions between GNL and BBC PS for Our World and the Travel Show, there are no suitable market benchmarks. As such, a cost-plus approach is in line with the FTGs and is a rational approach to take. That said, the payment of overheads and margin by BBC News for this content is not consistent with the payment method adopted by GNL for purchase of BBC News content.</td>
</tr>
<tr>
<td></td>
<td>• For the transaction between GNL and BBC PS for Hard Talk, based on a narrow interpretation of the market (as discussed by PwC) and based on a strict interpretation of the FTGs, this would imply that incremental cost pricing is not appropriate. However, EY notes that PwC also considered a wider interpretation of the market (with third parties who were not directly comparable) which suggested incremental cost pricing followed market practice. However, the PwC report did not use this interpretation in its final conclusions.</td>
</tr>
</tbody>
</table>

\(^{56}\) These programmes are Travel Show – a GNL Commission; Our World – a Co-commission and HardTalk – a BBC News commission.

\(^{57}\) “A Review of the transfer pricing methodology applied to the relationship between BBC Public Service and BBC Global News Ltd”, PwC, October 2015
Internal Procedures – Decision Flow Tool

As discussed above, in addition to the FTGs, there are further internal procedures relating to the transfer pricing arrangements between BBC News and GNL. Fair Trading has created a “decision flow” diagram which determines the pricing approach that should be adopted for the supply of BBC content to GNL or for GNL made programmes. This tool should be used for all content that is part of the SLA and a review conducted by Fair Trading at the end of 2014 concluded that the decision flow tool was being used.

The decision flow sets out three tests to help decide what the most appropriate pricing should be. These are:

► **Who retains editorial control of the content?** This is the main driver of the cost approach. It looks to determine who drives the need for the content being delivered. If this is driven by the needs of BBC News with GNL having no editorial control over content then an incremental cost approach is applied; if, however, GNL has editorial control of the content then a Fully Allocated Cost ("FAC") approach is applied with a margin added to transfers where the content could be supplied externally.

► **Who has primacy of transmission?** This refers to the channels on which the content is broadcast and usually sits with editorial control. For example, if GNL has first transmission then it indicates that it is primarily delivered to commercial outlets and therefore an FAC approach is applied.

► **Does the counterparty benefit from the content provided and to what extent?** Although editorial control and primary broadcaster may sit with GNL for certain programmes, BBC News may still benefit from its production. In this situation where BBC News derives a secondary benefit from the content, the flow chart looks to assess whether it is appropriate to apply a discount to the margin or overheads.

The first two tests are used to determine the correct pricing method to use. If the chosen pricing approach involves using the FAC approach, then the third test is undertaken to determine whether any discount to the use of margins and overheads should be applied. If BBC News can derive a benefit from the use of the content, then GNL may be able to apply a discount to the margin or overheads. EY can confirm that, for the three programmes chosen in this case study, the above decision flow diagrams were used to derive the price methodology used.

Summary of Analysis

As discussed in Section 1.2, EY has been asked by the BBC Trust to assess the transfer pricing processes that are currently in place based on the guidance set out in the FTGs. As such EY’s assessment is limited to this guidance alone, i.e., we have not considered any additional guidance that may have been considered separate to the FTGs.

The following areas are considered good practice:

► The annual SLA amendments ensure that a thorough review of the transfer pricing agreement between BBC News and GNL for programming occurs regularly.

► The SLA and underlying costs data have become more granular over the last few years, increasing transparency and the ability to be more certain that the correct costs have been

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58 As discussed in section 3.1, there is currently no guidance provided in the FTGs as to the level any margin should be. In terms of internal guidance, the Abacus guidance (section 3.5.1) the following is noted, “the appropriate contribution for reinvestment can be set in line with market benchmarks or with reference to other suitable benchmarks, but should not be excessive”. EY also notes that under the decision flow tool, no margin payment has ever been paid as a full discount has always been applied.
The use of the flow diagrams, as discussed above, has also helped in this regard.

► EY notes that the FTT recently conducted an internal review to ensure the relevant areas of the BBC are complying with the new transfer pricing procedures.

However, EY does note some concerns:

For example, there appears to be some inconsistency in the way that content is paid for between GNL commissioned content and BBC News commissioned content, as well as co-commissioned content, in line with the FTGs:

► For GNL commissioned content, BBC News makes a payment to GNL via a discount for overheads and margin based on the secondary value BBC News derives from it.

► On the other hand, for BBC News content the GNL payment is set at incremental cost, which can be as low as zero.

It is unclear why there are two different approaches taken for payment of news content by GNL and BBC News – this implies that BBC News effectively pays more for GNL commissioned content than GNL pays for BBC News commissioned content, which on a cost basis would appear inappropriate. EY considers that there should be consistency in the approach taken for payment of content i.e. that content should be priced using the same methodology unless there is evidence to justify different approaches.

► For the co-commissioned programme EY would expect that overheads along with the costs of production should be split equally between both parties. However, we note that for Our World it appears that BBC News pays all the overheads.

In addition to these concerns, although the transfer pricing process and price paid were conducted according to the procedures based on the current approach to pricing, EY notes that the use of incremental cost pricing, based on the narrow interpretation of the market, as discussed by PwC, means there is no market for “ready-made” news content and programmes, and therefore no “market practice” to base incremental cost pricing on. As such, based on a strict interpretation of the FTGs (specifically Section 3.14), this would imply that incremental cost pricing is not appropriate.

However, EY notes that PwC, in its report, also considered whether a wider interpretation of the market was appropriate. Here PwC reviewed the transfer pricing principles that news media organisations which provide similar, but not directly competing services to those provided by BBC PS to GNL, apply. Under this interpretation, PwC found evidence to suggest that incremental cost pricing was used by third parties i.e. it was market practice; however, EY notes that the PwC report did not use this interpretation in its final conclusions and as such EY has based its assessment on the narrow interpretation.

EY Assessment

The transfer pricing process and price paid for the transactions reviewed followed the internal procedures currently in place. However, as discussed above, EY notes that:

► There appear to be some differences in the way that content is paid for between GNL commissioned content and BBC News commissioned content as well as co-commissioned content. EY would expect to see consistency between these pricing approaches unless there is evidence to show a different approach is justified.

► There is, according to the PwC report, no prevailing market practice, based on a narrow interpretation of the market, on which to base incremental cost pricing. On this basis, the use of incremental cost pricing would appear to be inconsistent with the FTGs. However, EY notes that if a wider interpretation was used, there is evidence to suggest that
incremental cost pricing is used by third parties. However, no conclusion was reached by PwC as to which was the more appropriate interpretation to use.

► EY also notes that whilst this case study has focused on a set of particular programmes and how the transfer price has been set for these, the conclusions drawn above about Hard Talk are also applicable to all BBC News content priced at incremental cost.
Case Study 10 assesses the investment by WW for the content rights of a large production – the BBC-produced drama “Undercover”. For comparison EY has also considered WW’s investment in a similar-scale large external production, titled “SS-GB”.

### Question

**Was there a sufficiently documented agreement between the public sector and the commercial subsidiary?**

- Signed Joint Co-Production (“JCP”) Agreement between PS and WW outlining the production, signed in 2015.

**What was the transfer price?**

- The combined investment from BBC WW and BBC America/AMC totalled over £\text{x}.
- In addition, BBC PS invested £\text{y} in the programme.

**How was the transfer price determined?**

- BBC PS uses a variety of sources, for example offers on previous titles; offers from the Open Offer Process – discussed in Section 3; use of third party relationships; use of specialist genres teams; and returns on investment, in an attempt to ensure that its benchmark estimate of the value of the content is in line with the market.
- Once it has an estimate of what it believes the content to be worth, this forms the basis of negotiations with WW.
- Throughout the negotiation process, BBC PS was also able to leverage \text{z} to secure a better price.

**Was the choice of pricing methodology rational?**

- Yes. It is normal market practice to negotiate contracts of this nature and to introduce as much competitive tension as possible to obtain the best price possible for the rights on offer.
- BBC PS uses benchmarks to ensure the offer is appropriate to what the market would likely be.

**Was it applied with a satisfactory degree of accuracy and rigour?**

- Yes. The deal was conducted on an arm’s length basis and BBC PS negotiated a market price using a variety of benchmarks.

### Summary of Analysis

Based on the data and documents received, as well as interviews with relevant members of the BBC PS staff, it appears that the agreement between the BBC Drama content team and WW for the “Undercover” content rights was conducted according to the FTGs and met the BBC’s internal procedures. The deal was conducted on an arm’s length basis and BBC PS negotiated a market price using a variety of benchmarks.

On the BBC PS side, the negotiations with WW are tracked in the Negotiation Tracker system and EY has seen an extract of the negotiations that took place with WW for “Undercover”. As the investment from BBC PS was above £\text{xx}, it went to the Drama Programme Finance Committee, for approval of both the BBC PS proportion of the funding as well as the investment from WW.
However, EY notes it does appear that the benchmarking used by BBC PS relies heavily on genre knowledge and previous market experiences, as the First Look agreement precludes the need for a tender process unless no agreement between BBC PS and WW can be reached. Tendering has been noted in interviews with third party stakeholders as being a key means of ensuring a market price is paid and would be considered the first choice method to ensure a fair market price. That said there appears to be a competitive tension in the negotiating process between BBC PS and WW, with both sides aiming to secure the best value deal possible. We are not aware of evidence to suggest that the BBC PS has any incentive to favour WW in negotiations – if value is not secured from WW, then BBC PS has looked to third party distributors. Through interviews with BBC PS staff, examples were provided to EY of cases where this has occurred – for example, Living Dead; Jack and Harvey Williams and Crimson Field and Our Girl (with the Open Offer Process applied to the last of these titles).

**EY Assessment**

*When assessing the investment by WW for the content rights of a large production, the BBC drama “Undercover”, EY found that the transaction was conducted on an arm’s length basis and BBC PS negotiated a fair market price.*
4.3.9 Case Study 11: WW content rights – Returning Series

Case Study 11 assessed the investment by WW for the content rights of a returning series, the BBC-produced comedy programme “Wrong Mans”. For comparison EY has also considered WW's investment in a similar genre external production, titled “The Moaning of Life”.

<table>
<thead>
<tr>
<th>Question</th>
<th>Findings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Was there a sufficiently documented agreement between the public sector and the commercial subsidiary?</td>
<td>• A JCP Agreement between WW and BBC PS outlining the conditions upon which both parties have agreed to jointly produce “The Wrong Mans: Series 2”, signed in 2014.</td>
</tr>
<tr>
<td>What was the transfer price?</td>
<td>• The investment from BBC WW was £&lt;.</td>
</tr>
<tr>
<td></td>
<td>• In addition, BBC PS invested £&lt; in the programme.</td>
</tr>
<tr>
<td>How was the transfer price determined?</td>
<td>• EY received confirmation that PS benchmarked the value of the programme against a variety of sources, in line with benchmarks used by other genres, but also including previous series investment as a baseline, to ensure that the investment offer they received from WW is valued at market price.</td>
</tr>
<tr>
<td></td>
<td>• BBC staff have confirmed that the negotiation process that takes place is the same, regardless of whether they are dealing with WW or with a third party distributor.</td>
</tr>
<tr>
<td>Was the choice of pricing methodology rational?</td>
<td>• Yes. It is common market practice for content producers to negotiate with distributors to secure investment in return for content rights.</td>
</tr>
<tr>
<td>Was it applied with a satisfactory degree of accuracy and rigour?</td>
<td>• Yes. EY has not seen any evidence to suggest that the BBC PS has any incentive to favour WW in negotiations. The agreement between the BBC Comedy content team and WW for the “Wrong Mans: Series 2” content rights, was conducted according to the FTGs and met the BBC’s internal procedures. The deal was conducted on an arm's length basis and BBC PS negotiated a market price using a variety of benchmarks.</td>
</tr>
</tbody>
</table>

Summary of Analysis

It is EY’s assessment based on the data and documents received, as well as interviews with relevant members of BBC PS staff, that the agreement between the BBC Drama content team and WW for the “Wrong Mans: Series 2” content rights was conducted according to the FTGs and met the BBC’s internal procedures. It is apparent that a comprehensive process is in place regarding sign-off by appropriate BBC PS staff, and that the deal was conducted on an arm’s length basis and BBC PS negotiated a fair market price, as shown by the rejection of WW’s initial offer and continued negotiations thereafter.

However, EY notes, as discussed above in relation to the large commission, that it appears the benchmarking used by BBC PS relies heavily on genre knowledge and previous market experiences. However, as with the large commission, EY notes that there appears to be a competitive tension in the negotiating process between BBC PS and WW, with both sides aiming to secure the best value deal possible. We are not aware of evidence to suggest that the BBC PS has any incentive to favour WW in negotiations – if value is not secured from WW, then BBC PS has looked to third party distributors. Through interviews with BBC PS staff,
examples were provided to EY of cases where this has occurred – for example, Professor Branestawm is distributed by Universal Pictures.

EY Assessment

When assessing the investment by WW for the content rights of a returning series (the BBC comedy “Wrong Mans: Series 2”), EY found that the transaction was conducted on an arm’s length basis and BBC PS negotiated a fair market price.
4.3.10 Case Study 12: WW content rights – Factual Genre

Case Study 12 assesses the investment by WW for the content rights of a factual production, the BBC-produced programme “Special Forces: Ultimate Hell Week”. For comparison EY has also considered WW’s investment in a similar genre external production, titled “Stephen Fry in Central America”.

<table>
<thead>
<tr>
<th>Question</th>
<th>Findings</th>
</tr>
</thead>
</table>
| **Was there a sufficiently documented agreement between the public sector and the commercial subsidiary?** | • A JCP Agreement between WW and BBC PS outlining the conditions upon which both parties have agreed to jointly produce “Special Forces: Ultimate Hell Week”, signed in 2014.  
• EY was also provided with the three papers prepared for the WW Content Investment Group for “Special Forces: Ultimate Hell Week”, following the various rounds of negotiations, which is required if the investment is over £30m. |
| **What was the transfer price?** | • The total amount invested is confidential.  
• In accordance with WW’s new “Additional Commercial Hours” strategy, WW put in an offer for a selection of factual genre titles. As part of this offer, WW would fund a greater proportion of the budget for the package of titles, on the condition that it secured the content rights for these titles.  
• The eventual agreement was for £30m. |
| **How was the transfer price determined?** | • EY received confirmation that PS benchmarked the value of the programme against a variety of sources, in line with benchmarks used by other genres, but also for factual content a much larger proportion of this is put to the open market due to the nature of the content being fairly specialist. These sources of information were used to inform their negotiations with WW before entering into the agreement described above. |
| **Was the choice of pricing methodology rational?** | • Yes. It is common market practice for content producers to negotiate with distributors to secure investment in return for content rights. |
| **Was it applied with a satisfactory degree of accuracy and rigour?** | • Yes. The agreement between the BBC Factual content team and WW for the “Special Forces: Ultimate Hell Week” content rights was conducted according to the FTGs and met the BBC’s internal procedures. The deal was conducted on an arm’s length basis and BBC PS negotiated the price using a variety of benchmarks. As discussed above, WW was prepared to fund a greater proportion of the programme based on securing a package of titles.  
• However due to the “Additional Commercial Hours” strategy, WW’s investment in “Special Forces: Ultimate Hell Week” was more than would normally be expected for this type of content. BBC PS commented that investment in a factual programme can vary from very low, e.g. 5% of funding, to high (c.70% of funding) depending on whether the content has a wide enough appeal to be able to exploit in international markets. |
Summary of Analysis

Negotiations between BBC PS and WW for a selection of factual titles, which included “Special Forces: Ultimate Hell Week”, led to an agreement that WW would sign a contract for $>
.

The factual genre encompasses a vast array of different topics, and therefore it is hard to compare titles as they cover differing content with differing degrees of appeal to viewers. This is likely to occur across many of the factual genre investments, which includes much specialist content. Due to this nature investment decisions and forecasts vary. For example, the WW Content Investment Group paper highlighted a growing interest in “adventure and escapism programming” which leads to a better forecast for “Special Forces: Ultimate Hell Week”.

EY notes that there could be some concern about the “Additional Commercial Hours” strategy\(^{59}\) because WW was willing to fund a greater proportion of the budget for the bundle of titles than for each individual programme. Although we understand that bundling is the market norm, given the growing demand for this genre this strategy could potentially have knock on effects in the market (particularly if this strategy of bundling rights is regularly used). However, the outcome for the BBC PS, from a transfer pricing point of view, is positive as by grouping the titles together it secured greater investment.

EY Assessment

It is EY’s assessment based on the data and documents received, as well as interviews with relevant members of BBC PS staff, that the agreement between the BBC Factual content team and WW for the “Special Forces: Ultimate Hell Week” content rights was conducted according to the FTGs and met the BBC’s internal procedures. The deal was conducted on an arm’s length basis and BBC PS negotiated a price that reflected the demand for this content by WW at the time of negotiation, which may have been greater than the outcome of a tender process, but which reflected the value WW placed on it at the time.

However, we raise a potential concern that paying more for bundled rights, in order to secure access to content, could create negative competitive effects in the market for this content, possibly pushing prices above competitive levels, or restricting further access. This could become a particular issue if this type of strategy becomes more prevalent.

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59 WW’s new strategy is $>. 
5. Conclusions and options for change

This section sets out EY’s conclusions on the current transfer pricing arrangements, based on the procedures, interviews, outcome of the case studies and EY’s benchmarking review. We also set out options on how the transfer pricing regime could be improved, in particular to help address third party concerns. It is important to note in this context that any relevant decisions relating to the implementation or otherwise of EY’s suggested options for change to the current BBC processes will ultimately be made by the BBC Trust.

Our assessment, as set out in Sections 3 and 4, concludes that the majority of the case studies reviewed show that the transfer pricing processes and governance procedures in place are adequate, and that they have been applied correctly resulting in satisfactory outcomes in terms of a fair transfer price being paid. However there are exceptions to this, as we discuss in more detail below.

Before considering areas for improvement, we note that our review of the case studies and BBC procedures has identified a number of areas of good practice in relation to transfer pricing:

► There is a substantial set of policies and procedures in place at the BBC to govern the transfer pricing arrangements. This includes a tiered approach to training, ensuring that all BBC PS staff receive a basic level of training (Tier 1), whilst those in more senior and more relevant positions receive more thorough training via Tiers 2 and 3.

► EY’s assessment, based on our review of case studies, is that there are no fundamental inconsistencies between the outcomes of the transfer pricing relationships and the Fair Trading Guidelines. That said – and as discussed further below – there are a number of areas for possible improvement when considered against the case study questions set out previously.

► The majority of the case studies adhere to the procedures and processes currently in place: for example, relevant agreements are in place, sign-off procedures are followed, and relevant fair trading advice is sought where this is required. That said, EY notes that documentation is lacking in some cases.

► Appropriate methodologies have been adopted in the majority of the case studies, including all those involving BBC WW. Where there is relevant market practice available, market prices have been used, and benchmarking has been conducted. That said, in some cases – for example in the S&PP and GNL branding agreements – this benchmarking is of variable quantity and quality.

However, the case study analysis has identified a number of potential risks and areas for improvement which run through the subsidiaries. These fall into the following categories:

Procedural improvements

Our review of procedures and processes has identified a number of areas in which the BBC has discretion in how it applies and interprets the FTGs and transfer pricing processes. For instance:

► The BBC divisions decide which transactions are sufficiently “significant” to be referred to the Fair Trading team for further review. Although we have not identified examples of potentially significant transactions that have not been referred, there is sufficient ambiguity to suggest that there is a risk that cases could be inappropriately overlooked. EY notes that in this regard it would provide greater clarity if “significant” was defined in the internal

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60 The use of the decision flow tool in case study 9 – GNL and BBC PS programme transactions – is a useful tool in determining the payment required given the complexity of the process. As such EY would recommend that this (or a similar) tool could be used for other transactions which are complex in nature, in order to help ensure alignment with the FTGs.
procedures which set out the triggers for referral, particularly as no cross-checks are in place to ensure that the full range of relevant transactions are reviewed. In addition, we consider that the BBC Fair Trading team should conduct “dipstick” tests of randomly selected transactions (which otherwise have not been referred to the Fair Trading team) in order to assess whether appropriate procedures have been followed.

► Further, we note that, in selecting case studies, we were unable to assess the percentage of overall BBC transfer pricing agreements that are covered by the Review, as this information is not tracked by the Fair Trading team. Given that information on transfer pricing is collated by the BBC’s finance teams, we consider that there would be merit in transfer pricing activity being tracked more systematically by the Fair Trading team and the BBC Trust. This would enable the BBC to gain a better understanding of the full scale of transfer pricing activity, which could be used to help define further triggers, and would also aid any future reviews similar to this study.

► We have noted concerns around documentation and record-keeping – in particular, it is of concern that the S&PP brand agreement has not been found.

► As discussed in Section 1.3, EY adopted a set of criteria in order to select the 12 case studies. The first criterion was designed to consider breadth of transfer pricing agreements, including similar transactions across subsidiaries (for example shared services and access to the BBC brand). EY notes that, whilst the majority of these similar transactions meet the FTGs, the approach taken to negotiate the outcomes were managed separately, for example in the S&PP contracts for EastEnders and Holby City (case studies 7 and 8). EY would recommend that the BBC considers adopting an overarching framework to similar transactions in future, to ensure that the approaches are either consistent or that differences in approach are appropriate to the circumstances of the particular deal.

► Our analysis has also highlighted areas where transfer pricing arrangements have departed from a strict interpretation of the FTGs. For example, we note in Case Study 9 (in relation to GNL programme transactions) that there is lack of evidence of market practice in using incremental cost – which implies that the use of incremental cost pricing for the supply of BBC News content to GNL is inappropriate. EY therefore considers, in such cases, that these pricing arrangements should be subject to further review by the Trust.

Benchmarking and contract review period

► In some cases – such as the brand agreement with GNL – the BBC PS and commercial subsidiaries engage in open-ended contracts with limited (if any) scope for review of pricing and other contractual arrangements. We consider that there should be regular review of contracts and relevant pricing benchmarks, so as to ensure the terms continue to be in line with market practice.

► EY also notes that the lack of contractual review in some cases creates the risk of entrenching behaviour that may not be consistent with market practice. For instance, we note that GNL has never made a royalty payment for use of the BBC brand, but the contractual arrangements have not been reviewed in order to enable the BBC PS to recover a payment for use of the brand (for instance, by revising the royalty terms to reflect a payment based on revenue). EY would expect that where there has been significant change in the market, for example with the creation and restructuring of GNL, such that review is subsequently required.

► More generally, we consider that, where there are transfer pricing arrangements in place, there is merit in reviewing benchmarking analysis more regularly, and ensuring that arrangements are reviewed whenever there is material change to underlying relationships (e.g. when there is restructuring of the commercial subsidiary in question). In addition to this, the FTGs state that, under the cost-based pricing approach, “an appropriate contribution for reinvestment in the BBC’s Public Service Activities” (often referred to within the BBC as a “margin”) is required. However, there is currently very little detailed
guidance as to what level this “margin” should be set at. As such EY would recommend that more detailed internal guidance is provided to BBC staff, in order to ensure a consistent approach regarding what is considered an appropriate contribution.

Transparency

► There are areas where details of the transactions suggest that improvements to transparency are also required. For instance, the reasoning behind some of the arrangements for WW’s brand payment is not clear, and some evidence of bundled rights deals by WW may inhibit the transparency associated with the pricing of individual programmes.

► As noted in Section 3, the BBC Trust is taking steps to improve the transparency of the BBC’s transfer pricing arrangements. In the BBC Trust’s Review of Fair Trading Policy, the BBC Trust states its intention to “…ask the Executive to commission a more thorough fair trading audit this year, with a greater focus on whether the outcomes of individual cases are compliant, as well as whether processes have been followed correctly. We will also be more transparent and publish more information about the results of the audit in the Annual Report.”

Potential actions for consideration

In light of the above assessment, we suggest a number of options for consideration by the BBC Trust when seeking to resolve these issues:

► Some stakeholders highlighted the need for greater regulatory scrutiny and enforcement in relation to the relationship between the BBC PS and its subsidiaries. For instance, it was argued that there should be more active regulatory review of these relationships – backed by formal information gathering powers, and the potential to enforce sanctions if the FTGs are breached. Stakeholders commented that such scrutiny and enforcement would help to hold the parties to account in relation to transfer pricing activity, and would provide greater comfort for external parties.

► Further, there is a lack of understanding in industry about the nature and extent of the governance framework that oversees the transfer pricing relationships, due to a lack of transparency regarding the procedures in place. EY considers that the BBC Trust should consider appropriate steps to pro-actively promote transparency – as this may help to allay some of the concerns expressed by external stakeholders. For instance, whilst it was acknowledged by external stakeholders that commercial confidentiality inevitably limits the amount of transfer pricing (and other related) information that can be made available externally, it was argued that the current approach to confidentiality leads to insufficient information being provided to market participants.

► One way to help increase regulatory scrutiny and transparency would be to publish an annual monitoring report on the arm’s length agreements between the BBC PS and its subsidiaries to review whether they are in line with the FTGs. The report should be within the boundaries of confidentiality, and it would be a matter for the BBC’s regulator to determine whether this was published by the regulator itself, or by the BBC under obligations enforced by the regulator. Further, the act of collecting the relevant data, whether or not it is eventually redacted from the published report, would be a transparency benefit in and of itself.

► This report could include the results of dipstick tests conducted by the FTT; and further clarity on the internal processes undertaken by the BBC Executive to ensure compliance,

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61 EY has found in the internal guidance published for the use of overhead contributions the following, “the appropriate contribution for reinvestment can be set in line with market benchmarks or with reference to other suitable benchmarks, but should not be excessive”.

for example the review of overhead allocation and how this is applied to cost plus transfer pricing arrangements. As discussed in the Fingleton Associates Fair Trading Policy Review report for the BBC Trust, changes to the Fair Trading Policy document and FTGs to simplify the guidance and signpost to additional documents would be helpful in creating better understanding outside the BBC. External stakeholders also noted that a workshop on Fair Trading Policy and the implementation of this would be welcome.

Application of the current transfer pricing arrangements to BBC Studios

The BBC Trust also asked EY to consider whether any of the issues or recommendations identified as part of the current transfer pricing arrangements could be relevant to the BBC Executive’s proposals for a new commercial BBC Studios proposition – i.e., the BBC Executive’s proposal to evolve its in-house TV production operation (currently a BBC PS operation which, in the main, produces content only for the BBC) into a new commercial operation that competes with other production companies in the markets for external commissioning.

There is currently uncertainty around any future evolution of the BBC’s content supply arrangements: the Trust recently issued its advice to the DCMS on future content supply, and DCMS will reach its own conclusions on the subject in the context of Charter Review. At the same time, the BBC Executive is developing its BBC Studios proposals further. Subject to the conclusions of DCMS and the BBC Executive’s further work, the Trust may be required to carry out a full review of the BBC Studios proposals in due course.

In the context of any such review, we recommend that the Trust ensures that appropriate transfer pricing arrangements are in place for any commercial BBC Studios proposition. At this stage, and in the absence of clarity from DCMS as to whether the BBC TV production operation will evolve in this way, EY has considered the potential implications of our case study analysis for the BBC Trust’s consideration of BBC Studios.

This has led to the following observations that are likely to be of relevance for the BBC Trust to consider when reviewing any transfer pricing arrangements that may occur between BBC PS and BBC Studios:

► From the outset, and given the significant external scrutiny a BBC Studios proposal is likely to receive, it will be important to clearly document, articulate and communicate transfer pricing procedures and outcomes to stakeholders, in order to ensure transparency and address industry concerns.

► As noted in the BBC Worldwide brand case study it is important to be able to demonstrate the reasoning behind particular individual decisions – for example why a specific value has been used in setting payments. This would be particularly relevant to BBC Studios, given the level of external scrutiny.

► The majority of the case studies used market rates to set transfer prices, which highlights the significance of benchmarking analysis to help validate the market rates being used and so there is a need to update this analysis regularly.

► The alternative, as in the Holby City case study is that a tendering process is used to ensure rates are competitive. Some external stakeholders noted in our interview programme that tendering would be the only way to ensure fair competition and transparency in relation to BBC Studios and BBC Worldwide. The BBC Trust and BBC

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64 EY notes that any pricing arrangements between the commercial subsidiaries e.g. BBC Worldwide and BBC Studios would not represent transfer pricing subject to State aid law, although these arrangements would need to comply with competition law.
Executive should therefore consider which option would secure best value and quality for the BBC and the licence fee payer.

► The case studies highlighted that trigger points or a formal review process should be in place to review long-term contracts. Further, payments for access to BBC assets – for example the BBC brand – should be made above the line to ensure greater transparency.
## Appendix A: Questions posed by the BBC Trust

<table>
<thead>
<tr>
<th>Key questions</th>
<th>Sub questions</th>
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</table>
| **1. Transfer Pricing Practice Process and Governance**                       | **What are the current agreements between public divisions and commercial services?**
|                                                                               | - What are the current agreements in place between BBC public service divisions and its commercial subsidiaries?  
|                                                                               | - What facilities and personnel does the BBC share between public service divisions and commercial services (BBC WW, GNL and S&PP)?                      |
| **What are the current practices to train and promote transfer pricing knowledge inside the BBC?** | - What type of training is provided?  
|                                                                               | - Who is trained?  
|                                                                               | - How are they trained?  
|                                                                               | - Is the training sufficient to guarantee the good functioning of the transfer pricing system?                                                                                                             |
| **When is the transfer pricing process triggered?**                           | - Describe the procedures and personnel that determine when a transfer pricing mechanism is required                                                                                                         |
| **What are the transfer pricing practices used by the BBC?**                  | - What type of pricing exercises does the BBC uses? (eg competitive tenders, benchmarking, others)  
|                                                                               | - How is the best pricing practice chosen?  
|                                                                               | - Are pricing practices appropriate?  
|                                                                               | - When deals split or transfer resources between public and private BBC entities, are the agreements competitive?                                                                                     |
| **What are the procedures in place for to review how contracts are managed?** | - Are long term agreements reviewed during their life?  
|                                                                               | - How often are long term agreements reviewed?  
|                                                                               | - What type of controls are in place when long term agreements are reviewed?                                                                                                                                 |
| **What are the controls in place?**                                          | - What are the procedural controls to guarantee ex post that transfer pricing agreements do not infringe state aid laws?                                                                                 |
| **Are there any external assurance mechanisms?**                             | - What are the external bodies and mechanisms in place to provide assurance to the market?  
|                                                                               | - Are they effective?  
|                                                                               | - Are they sufficient?                                                                                                                                                                                  |
| **2. Outcome**                                                              | **What are the practices and methodologies used to transfer tangible and intangible assets between public and commercial subsidiaries?**
|                                                                               | - What are the BBC’s current practices and methodologies to transfer assets?  
|                                                                               | - IF there is a market for the product, does the BBC use the market price?  
|                                                                               | - If there is no market, what are the practices of competitors and how does the BBC establish a price?  
|                                                                               | - Is BBC practice comparable to competitors?  
|                                                                               | - Is BBC practice in line with the market/law?                                                                                                                                                    |
| **Does the BBC transact at market rate?**                                    | - Are the rates consistent with State aid law?  
|                                                                               | - How do rates reflect brand and goodwill?                                                                                                                                                           |
| **How is the transfer pricing regime performing overall?**                   | - How can the transfer pricing regime be improved?  
|                                                                               | - Are the controls sufficient to guarantee a smooth functioning  
|                                                                               | - Are there areas for improvement?  
|                                                                               | - What are the pros and cons of the current structure?                                                                                      |
### Key questions

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<th>Sub questions</th>
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<tr>
<td>Does the BBC inform external stakeholders of its practice?</td>
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<td>Does the BBC respond to external requests of transparency?</td>
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<td>Is there enough information in the public domain about BBC transfer pricing practices to assure stakeholders?</td>
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<td>Does the BBC communicate appropriately with external stakeholders?</td>
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### Future challenges

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<th>How can the transfer pricing regime being improved?</th>
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<tr>
<td>Are the volume of controls and procedures about right?</td>
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<td>Is the process efficient?</td>
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<tr>
<td>What are the areas where improvements may occur?</td>
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<tr>
<th>In light of the BBC Studio proposal, what are the possible challenges for the future?</th>
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<tr>
<td>What are the specific legal challenges that BBC Studios may face?</td>
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<td>What are the risks associated with transfer pricing practice?</td>
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<td>Are risk mitigations strategies in place?</td>
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