

K01782

PRIME MINISTER

REFORM OF THE ITV SYSTEM: MISC 128(87)12, 11, 9 AND 8

CONCLUSIONS

1. You will wish the Group to decide whether

(i) to agree the Home Secretary's proposal that ITN should be opened up to new outside investors, to be represented on its Board, while retaining ITV control;

(ii) to endorse the Official Group's recommendations about the details of auctioning ITV franchises and operating the levy (which the Group have already agreed in principle);

(iii) to prevent a single company from holding or investing in more than one ITV contract;

(iv) to reconstitute Channel 4 as a separate broadcasting authority, required to fulfil its existing remit, with its revenue fixed separately from the income of the advertising sold on its behalf.

2. The firmness of decisions on these matters can take account of the decisions taken under Item 1 on the timetable for legislation. The proposals on ITV franchises and the levy and on the maximum permissible concentration of ownership of ITV companies have been under consideration for some time and it should be possible to tie these off fairly readily. But the Group may wish to have more time to consider the future arrangements for ITN, where a range of possible options has been presented, and the constitution of Channel 4, where the Home Secretary has recently come forward with a new proposal which may need further testing.

BACKGROUND AND MAIN ISSUES

1. Constitution of ITN

3. You will recall that at the last meeting of MISC128 you were concerned about the possible impact on ITN of the proposed new arrangements for competitive tendering for ITV contracts and for the levy. You were worried, in particular, that ITV companies would be reluctant to fund ITN properly and that ITN would therefore not be able to maintain its present high standards. Before going on to consider the various options which have been identified for changing the constitution of ITN, you may first wish to check that the Group agree with the Official Group's assessment that none of the various models for introducing competitive tendering and a revenue levy for ITV companies would have a significantly different impact on ITN (see MISC 128(87)11, paragraphs 10-11).

4. In considering the future arrangements for ITN, the Group will wish to satisfy itself that ITN would be able to continue to provide a high quality news service both for domestic audiences and as a competitor in the international market. The Official Group, at paragraph 9 of their paper, identified five options for changing the constitution of ITN. These are:

- a. opening up ITN to new outside investors (to be represented on its Board) while retaining ITV control;
 - b. the separation of ITN into two companies. One would be concerned solely with the provision of news for ITV and would, as now, be a mutual company owned by the ITV companies. All other activities would be provided by a subsidiary company in which outside investors could have up to a 49% shareholding;
 - c. as a., but with no restriction on outside investment so that overall control might pass from the ITV companies;
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- d. a direct contract between the IBA and ITN (or some other company) for the provision of national and international news for the ITV system;
- e. allowing ITV contractors to opt out of ITN and to take their news from elsewhere (which may be a foreign company).

There is a further option f., which the ITN management itself has put forward, under which the company would be floated off but would continue to be guaranteed a certain share of ITV revenue. But the Official Group considered that this proposal was not defensible, since it would not be right for an ITN company which was independent of the ITV companies to be free from outside competition.

5. Of these options, the Home Secretary favours option a. It would dilute ITV contractors' ownership and control of ITN, although they would retain a controlling interest, and would involve ITN providing the new service on the basis of a commercial contract, with quality criteria and a profit margin. The contract would not be open to external competition. The Home Secretary believes that this would provide a means of injecting the risk capital which ITN have been seeking, while ensuring that the high quality service it provides for the domestic market does not come under threat.

6. The Home Secretary suggests, however, that if the Group do not consider this sufficiently radical, it could be combined with option e. - allowing ITV companies to opt out of the ITN service. There are obvious dangers here. First, viewers in some ITV regions might get a markedly inferior news service to that provided by ITN. Second, if several ITV contractors opted out, ITN might not be able to sustain the overheads necessary to provide a high quality service for domestic viewers and for expansion into the international market. While, therefore, option e. would be most in line with the Government's general philosophy of increasing consumer choice by stimulating competition, it carries substantial risks.

2. Auctioning ITV Franchises and Operating the Levy

7. Provided the Group share the Official Group's assessment that none of the options for introducing new competitive tendering and levy arrangements for ITV contracts would have any special impact on ITN, consideration can be given to the proposals on auctioning ITV franchises and operating the levy in the report by the Official Group (MISC128(87)8).

8. Peacock recommended that ITV franchise contracts should be auctioned, with an annual review of performance by the IBA. At the meeting of MISC128 on 20 July, however, there was general agreement that there should be a two-stage system of allocating ITV contracts, so that companies which satisfied a quality threshold would be selected on the basis of a competitive tendering procedure, and the Home Secretary was invited to arrange for officials to work up the details.

9. Paragraphs 2-6 of the Report by the Official Group (MISC(87)8) summarise the proposed arrangements which have been worked out in detail between departments, including the Treasury. Briefly, tenders for contracts would be invited on the basis that applicants would have to pass an initial quality threshold; the levy would be based on advertising revenue per television household in the contractor's area, at a progressive structure of rates. Peacock's suggestions of reserve prices for contracts and a lengthening of the contract period to 10 years are not recommended; but it is recommended that there should be an annual performance review on the lines that Peacock suggested.

10. These proposals are broadly in line with what the Group envisaged at their meeting of 20 July, and it will probably not be necessary to go through them in detail. The only substantial change is that the Official Group have turned away from the simplest arrangement - a single ITV levy - in favour of rather more complicated proposals, described above. They believe that their scheme would be better able to deal with variations in performance between

areas over an 8 year contract period. The chairman of the Official Group will be ready to speak to this if you wish, but the Treasury are absolutely content at official level.

11. If it is eventually decided to proceed with MMDS or a fifth UHF channel, it may be necessary to review decisions taken now on future arrangements for ITV contracts, in particular to ensure that the proposed contract period of 8 years is not too long. On the face of it, however, even if the broadcasting environment were to become markedly more uncertain with the introduction of new services, it seems unlikely that contract periods of anything much less than 8 years would be viable.

3. Limiting multiple ownership of franchises etc

12. At the last meeting, you and other members of the Group expressed doubts about the Home Secretary's proposal that a single individual or company should be allowed to own two, but no more than two, of the ITV companies. You felt that single ownership of even two of the larger companies would lead to too great a concentration of power; and the Lord President expressed concern that a single company could be swallowed up by a larger one if both were allowed to be held in the same pair of hands. The Home Secretary has reviewed the matter in the light of the concerns expressed at that meeting and now proposes that a single company should not hold or invest in more than one ITV contract, that an ITV contractor should not invest in another company holding a contract, and that an investor in a company holding a contract should not be allowed to hold more than 10% of the shareholdings in any company holding other ITV contracts. This should meet your concerns.

4. Future Constitution of Channel 4

13. At the last meeting of the Group, it was strongly felt that Channel 4 should retain its existing remit. However, before decisions were taken on whether Channel 4 should be reconstituted as a separate broadcasting authority or whether it should be privatised, the Home

Secretary was invited to give further consideration to the scope for providing effective safeguards against the risk of a privatised Channel 4 going down market. The Group also feared that a fully commercialised Channel 4, seeking advertising nationally, could distort the TV advertising market.

14. The Home Secretary now concludes that there is a substantial risk that a privatised Channel 4 would depart from its remit in order to maximise its advertising revenue. (The Trade and Industry Secretary also pressed this view at the last meeting.) While some of the existing advertisers undoubtedly placed value on the segmented audiences achieved by certain Channel 4 programmes, overall revenue could be increased by putting on popular programmes attracting larger audiences. The Home Secretary believes that the duty of a fully privatised profit-seeking company to its shareholders would inevitably put at risk its distinctive and minority remit.

15. The Home Secretary remains concerned, however, that Channel 4 should be allowed to sell its own advertising, in order to break up the monopoly currently enjoyed by the ITV companies. He also continues to believe that Channel 4 should be reconstituted as a separate broadcasting authority in order to reduce the dominant role of the IBA which stands to be further enhanced by DBS. His proposal for satisfying these various objectives is that Channel 4 advertising should be sold through a separate service contract and that a ceiling should be placed on Channel 4's maximum income.

16. The Home Secretary suggests (MISC 128(87)9 paragraph 4(iii)) that Channel 4 might be given a fixed proportion (say 17%) of the combined Net Advertising Revenue (NAR) of ITV and Channel 4. This means that, while there would be no incentive for Channel 4 to capture higher audiences at the expense of ITV, there would be an incentive for Channel 4 to increase its audience at the expense of the BBC or elsewhere - albeit that it would retain only 17% of any additional NAR thus generated. You will wish to ensure that the Group is satisfied that this, very diluted, effect would not produce undue

risk of Channel 4 going down market in order to increase its audience.

17. The Home Secretary proposes that, if this scheme is agreed, S4C should be funded first from its own NAR, second from any surplus in Channel 4's NAR over and above its ceiling, and that finally any remaining deficiency should be met from the proceeds of the levy on ITV companies.

18. If the proposed new scheme is not acceptable to the Group, the Home Secretary favours reverting to his original proposal - that Channel 4 should sell its own advertising as a non-profit seeking broadcasting authority - or that the status quo should be retained. Either of these options would, in his view, be preferable to reconstituting Channel 4 as a profit-maximising company.

HANDLING

19. You may wish to ask the HOME SECRETARY to take the Group through his overview paper MISC(87)12, referring to the other papers on the agenda as necessary. So far as possible, it may be best to discuss ITN, ITV and Channel 4 issues separately (as they appear in this brief) because they raise quite different issues. Before discussing the ITN proposals in detail, however, you will wish to ensure that the Group are broadly satisfied that the proposals for the award of ITV contracts and for the levy do not have unacceptable consequences for ITN.

20. THE TRADE AND INDUSTRY SECRETARY and THE CHANCELLOR OF THE EXCHEQUER will have comments on each of the proposals. THE LORD PRESIDENT may wish to comment on the proposals for reconstituting Channel 4. THE MINISTER OF STATE, WELSH OFFICE will wish to comment on the proposals for funding S4C.

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A J LANGDON

27 October 1987