

PRIME MINISTER

MEETING OF MISC 128

You saw most of the papers for tomorrow's meeting over the weekend, as summarised in my earlier minute below.

The two new papers are briefs by Brian Griffiths on items 1 and 2 of the Agenda, which you will want to look at. I have flagged these up in yellow in dividers 1 and 2.

PRG.

Paul Gray

5 June 1989

PRIME MINISTER

MEETING OF MISC 128: 6 JUNE

You may like over the weekend to look at the main papers for next Tuesday's meeting of Misc 128.

You will recall that at the last meeting George Russell gave a presentation of the JTC's proposals. The main purpose of Tuesday's meeting is to reach at least provisional conclusions on the two most important outstanding issues - the arrangements for competitive tendering and the future of Channel 4. If time permits, the group may also want to consider the paper (carried over from the last meeting) on "the map and the clock" for Channels 3 and 5.

The enclosed papers are:

Flag A Steering brief from the Cabinet Office (immediately below this note)

IN DIVIDER 1

Flag B Douglas Hurd's paper on competitive tendering

Flag C Cabinet Office brief on competitive tendering

IN DIVIDER 2

Flag D Douglas Hurd's paper on Channel 4

Flag E Cabinet Office brief on Channel 4

IN DIVIDER 3

Flag F Douglas Hurd's earlier paper on "the map and the clock"

Flag G Cabinet Office brief on "the map and the clock"

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- 2 -

Flag H Brian Griffiths' earlier brief on this issue.

I have also enclosed at the back of the folder a copy of the White Paper (Flag I).

Brian Griffiths has not yet had the chance to consider the latest papers. I will let you have his briefs on competitive tendering and Channel 4 on Monday evening.

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2 June, 1989.

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PRIME MINISTER

cc: Mr Woolley

MINISTERIAL GROUP ON BROADCASTING SERVICES (MISC 128)
MEETING ON 6 JUNE 1989

At its last meeting the Group was given a presentation by Mr George Russell, chairman-designate of the Independent Television Commission (ITC), on his proposals, particularly as regards competitive tender. In the wake of that presentation and of the preliminary discussion which followed it, the Home Secretary brings to the Group three papers with proposals on:

1. the arrangements for competitive tendering for franchises on Channels 3 and 5 (MISC 128(89)8);
2. the future structure and financing of Channel 4 (MISC 128(89)7);
3. Channels 3 and 5: the map and the clock (MISC 128(89)5).

The last of these papers was held over from the Group's previous meeting.

2. The discussion on 6 June will be a crucial one. The competitive tender arrangements and the future organisation of Channel 4 have been at the centre of comment on the Government's White Paper. These issues embody what many critics have claimed to be a tension within the White Paper proposals between the introduction of market disciplines and the search for quality in programming. The Home Secretary regards it as essential in order to secure the passage of the Broadcasting Bill that he be able to demonstrate that the Government's deregulatory approach, of which

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competitive tendering is a key feature, will not mean the end of quality programming. He therefore sees the two papers as intimately interrelated. The more he can be satisfied that the arrangements agreed on by the Group for the future organisation of Channel 4 will preserve its distinctive remit, the less anxious he is likely to be about the competitive tender arrangements. On the other hand, the Chancellor of the Exchequer will be concerned to ensure that market disciplines can operate successfully and that maximum return to the Exchequer is obtained. The discussion will therefore be about balances and trade-offs between, for example, the transparency of the competitive tendering process and the extent of discretion left with the ITC, and between the extent to which Channel 4 is exposed to market forces or its existing remit preserved.

3. It is essential that the Group reaches at least provisional conclusions on as many of the issues as possible. There remain a number of important matters to be considered by the Group—notably proposals on privatising the transmission arrangements—and as many of the issues interrelate, the Group may not want to reach final decisions on any of them until they can see the balance of the package as a whole. But the Bill which will embody the Group's conclusions will be long and complex, and it is important that final decisions should not slip much beyond the beginning of July so that instructions to Parliamentary Counsel can be prepared before the Summer Recess. Your aim, I suggest, should therefore be to reach conclusions if at all possible at least on the papers on competitive tendering and Channel 4. The paper on the map and the clock could at a pinch be held over until the Group's next meeting, which is arranged for 21 June, and be taken then with papers on transmission and BBC night hours. There are provisional arrangements for a further meeting of the Group on 4 July should this prove necessary.

4. Apart from the specific issues for discussion, you may wish to take advantage of the meeting to enquire of the Home Secretary

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what he proposes by way of announcement of the Group's eventual decisions. The Home Secretary took advantage of a recent debate on a Private Member's Motion to announce the Group's decisions on ownership and we understand that he may have in mind a series of announcements through Ministerial speeches etc as the Group's decisions are reached. Given the interrelationship of the issues, however, there might be something to be said for a comprehensive statement of the Government's conclusions, for example by means of an arranged Written Answer before the Summer Recess. It would be useful if the Group could establish towards what it is working in this respect.

5. On handling, you have agreed that in addition to the Group's normal membership, the Foreign Secretary and the Secretary of State for Education and Science may be present in view of their interest in the implications of the issues to be discussed for quality in programming and for educational programmes. You may wish to take the papers in the order:

- i. Channels 3 and 5: competitive tendering
(MISC 128(89)8);
- ii. Channel 4:
(MISC 128(89)7);
- iii. Channels 3 and 5: the map and the clock
(MISC 128(89)5).

The Home Secretary could be invited briefly to introduce each one. Time is limited to one and a half hours so discussion will need to be brisk. Fuller advice on handling is given in the separate briefs on each of the agenda items, which I attach.



P J C MAWER

2 June 1989

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PRIME MINISTER

MINISTERIAL GROUP ON BROADCASTING SERVICES

CHANNEL 4 (MISC 128(89) 7)

DECISIONS

The broadcasting White Paper made clear the Government's intention of maintaining Channel 4's special remit while providing that advertising on that channel should be sold separately from advertising from Channel 3 or other channels. At the Group's meeting on 24 April (MISC 128(89) 1st Meeting; Minute 3), you said that it would be wrong in principle to place Channel 4 under the direct supervision of the ITC, which will be a regulatory agency. The Group also agreed at that meeting that the Home Secretary's proposal that any shortfall in Channel 4's income should be met in full provided insufficient incentives to efficiency. The Home Secretary was invited to bring forward further proposals, taking account of those points.

2. The Home Secretary's Memorandum sets out four possible models for the future structure and financing of Channel 4.

(i) Privatisation: the Home Secretary has never favoured this, and he now suggests that it would be difficult to carry it through Parliament.

(ii) An independent Channel 4 trust would be formed to own the Channel 4 company. The channel would be subject to a baseline budget of 14% of terrestrial net advertising revenue (NAR) (though with provision for the baseline to be amended by secondary legislation) and if Channel 4's revenue

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fell below this baseline the difference would be funded by the ITC up to a maximum of 2% of terrestrial NAR. This is the Home Secretary's preferred option.

(iii) As a variant of (ii), the ITC would pay to Channel 4 a proportion (say 50%) of any deficit below 14% of terrestrial NAR and Channel 4 would keep a proportion of any profits.

(iv) The ownership of Channel 4 would be divided equally between a Channel 4 trust and the Channel 3 companies. There would be no budget baseline, but any excess of expenditure over revenue would be met by the Channel 3 companies.

3. If the Group were able to reach a decision of principle in favour of one of these options, the Home Secretary would need to return with detailed proposals for its implementation: none of the options have been worked up in any detail and a good deal of work will be needed to flesh out whichever scheme the Group prefers. The Home Secretary will also need to bring forward proposals on various second-order issues, including whether Channel 3 companies should be permitted to sell Channel 4's regional advertising, and the arrangements for funding the Welsh fourth channel. It may be possible to settle these matters in correspondence but otherwise they could be taken at the meeting which has been provisionally arranged for 4 July.

BACKGROUND

4. Channel 4 is at present a wholly-owned subsidiary of the IBA, financed by subscriptions levied on the ITV companies, who sell the advertising on Channel 4 and retain the revenue thus

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raised. Channel 4 has a special remit to cater for interests that would not otherwise be met by the independent sector.

5. One of the Group's main concerns during the discussions in the run up to the White Paper was the high cost of television advertising, and one of the Group's basic tenets was that Channel 4 should sell its own advertising in order to introduce more competition. At the same time, the Group fully accepted that maintaining the Channel 4 remit would be a very important component of the quality guarantees that needed to be built into the White Paper prospectus. On one side of the argument, the Chancellor of the Exchequer felt that full privatisation was the only means of exposing Channel 4 to the drive for efficiency that underlay the whole of this policy review, and that the maintenance of the Channel's distinctive remit could be achieved through rigorous policing by the ITC. On the other side of the argument, the Home Secretary and the Trade and Industry Secretary felt that profit-seeking under a full privatisation model would inevitably drive the Channel down-market in pursuit of a mass audience, and that the ITC would not in practice be able to prevent this.

6. It was not possible to resolve the evenly balanced views in the Group on this issue, and the White Paper accordingly committed the Government to maintain the Channel 4 remit and to provide for the Channel's sale of its own advertising but canvassed three possible options for the Channel's new financial structure. These were:

- (i) full privatisation;

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(ii) Channel 4 to become a wholly-owned subsidiary of the ITC, with some form of guaranteed minimum income;

(iii) a link to be established between Channel 4 and Channel 5 to establish a third force standing against both the BBC and Channel 3.

7. The consultation on the White Paper revealed no support for option (iii). The responses to the White Paper were heavily weighted in favour of option (ii); and this was the model which was recommended by the Home Affairs Committee who suggested that Channel 4's guaranteed income should be set at 14% of the total NAR of terrestrial channels.

8. The Home Secretary sought agreement at the Group's meeting on 24 April to a model based on the Home Affairs Committee's recommendations. However, in summing up the discussion you said that the Group believed that these proposals were too generous to Channel 4 and failed to incorporate sufficient incentives to efficiency. You also made clear that there were profound objections of principle to placing the Channel under the direct supervision of the ITC since it would be wrong to give a regulatory authority direct responsibility for the provision of services.

MAIN ISSUES

9. The Home Secretary has now come forward with four options for the future financial structure of Channel 4.

(i) Privatisation

10. The Home Secretary believes that the Group's decision on the future financial status of Channel 4 will hold the key to the

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overall reception of next Session's Broadcasting Bill. He and Lord Young both consider that a privatised service would inevitably go down-market and that, in practice, the ITC would not be able to prevent this since the remit is not capable of being drafted in such a way as to guarantee high quality programming. More importantly, perhaps, in the light of the responses to the White Paper and of the Home Affairs Committee's report, the Home Secretary does not believe that it would be politically sustainable for the Government to propose the privatisation of Channel 4.

11. There are two main points here which you may wish to probe.

(a) You will wish to seek the views of the Chancellor of the Exchequer and the Trade and Industry Secretary on the prospects of a privatised Channel 4 maintaining its remit.

(b) You will wish to probe with the Chief Whip the likely Parliamentary reaction to a proposal to privatise Channel 4, and in particular to test with him the Home Secretary's view that it would be difficult to carry such a proposal through Parliament.

(ii) and (iii) Non-profit making status with a guaranteed income

12. The Home Secretary's preferred alternative to privatisation would involve the creation of an independent Channel 4 trust to own Channel 4 and to operate it under licence from the ITC. The Channel would be subject to a baseline budget of 14% of terrestrial NAR (but with provision for this to be adjusted by means of secondary legislation) and if Channel 4's revenue fell below this baseline the deficit would be funded by the ITC up to a maximum of 2% of terrestrial NAR. The shortfall would be met

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by a special levy on all Channel 3 companies.

13. Under this scheme, the only spur to efficiency is that Channel 4's income would not be made up to the full 14% if its own advertising revenue dropped below 12% of terrestrial NAR; provided that it reached the target of 12%, however, any remaining deficit would be fully funded by the Channel 3 companies. The Group may accordingly feel that this scheme fails to provide sufficient incentives to efficiency and, if so, they may prefer the Home Secretary's third option. Under this option, Channel 4 would receive only a proportion of any deficit below 14% and, conversely, would retain a similar proportion of any profit above this level.

14. There is no indication in the Home Secretary's paper as to who would appoint a Channel 4 trust, who would be its members, whether it would be in the public sector etc. You may wish to invite the Home Secretary to provide some indication of his thinking on these issues.

(iv) Joint ownership by a Channel 4 trust and the Channel 3 companies

15. Under the Home Secretary's final option, the ownership of Channel 4 would be divided equally between a Channel 4 trust and the Channel 3 companies. There would be no budget baseline or any guaranteed revenue: any profits would be divided equally between Channel 3 and the trust, who would hold their share against any future deficits; and any losses would be funded initially by any accumulated reserves and otherwise by the Channel 3 companies.

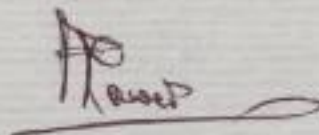
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16. The Home Secretary suggests that, under this model, Channel 3 would want Channel 4 to retain its remit. On the face of it, however, it seems likely that Channel 3 would instead prefer Channel 4 to switch to more popular programming since, under this model, the Channel 3 companies would retain 50% of any profits which Channel 4 accrued. The Group may also feel that an arrangement under which Channel 4 was partly owned by Channel 3 would mean that the two Channels would have a powerful incentive to act in tandem and that, taken together, they would provide an unfair challenge to Channel 5 and the DBS channels. Moreover, as the Home Secretary notes in his paper, such an arrangement might undermine the intended competition between Channels 3 and 4 for advertising revenue.

HANDLING

17. In inviting the HOME SECRETARY to introduce his Memorandum, you may wish to ask him to say a few words in turn about each of the four options set out in his paper. The CHANCELLOR OF THE EXCHEQUER and the TRADE AND INDUSTRY SECRETARY in particular will have comments about these options. You may wish to ask the CHIEF WHIP for an assessment of the likely Parliamentary reaction to a proposal to privatise Channel 4.



P J C MAWER

2 June 1989

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PRIME MINISTER

MINISTERIAL GROUP ON BROADCASTING SERVICES
CHANNELS 3 AND 5: THE MAP AND THE CLOCK
(MISC 128(89)5)

DECISIONS

The Home Secretary is seeking decisions in principle that:

(i) the Independent Television Commission (ITC) should be responsible for the division of Channel 3 into regions, but the Government should endorse the IBA's view that there would be advantage in keeping to the present ITV regional structure;

(ii) there would be a strong case for a national licence which embraced Channel 3's night and breakfast hours, rather than for Channel 3's night hours to be licensed separately as the White Paper had proposed; and

(iii) the IBA should be permitted to divide Channel 5 by day of the week as well as time of the day.

2. The Home Secretary accepts that the Group will need to review any decisions in principle which they take at this meeting once decisions have been taken on related matters, including the competitive tender and transmission arrangements. However, he hopes that the Group will be prepared to reach provisional decisions so that work can proceed on the preparation of Instructions to Counsel.

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BACKGROUND

3. Under the present law, the IBA are responsible for the division of the ITV system by regions and by time slots. The IBA made only minor adjustments to regional boundaries during the last franchise round in 1980, but prior to that they had sometimes made some quite substantial alterations.

4. The White Paper (paragraph 6.16) said that the ITC would be responsible for the geographical division of Channel 3 into regions. It proposed that there should be a separate night hours licence, or licences, for Channel 3, and that the ITC should determine the exact boundaries and should decide on possible additional licences covering other times of the day (eg for a breakfast time service). As to Channel 5, the White Paper said that the Government believed that this should be a national service which should be split into two or more different licences covering different parts of the day and night, with the ITC being responsible for deciding on the boundaries between the time-slots.

MAIN ISSUES

(i) Channel 3 regions

5. The IBA's response to the White Paper states (at paragraph 4.8) that

"we would see advantage to both viewers and advertisers in keeping the present well-established ITV areas post-1992".

But they qualify this in the following sentence:

"However, the regional map on Channel 3 in the 1990s would depend to a large extent on decisions taken about night-

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hours, networking, transmission arrangements, negative tenders and S4C".

So the IBA have certainly not given any firm assurances about the future of the existing ITV regions. At the Group's previous meeting, Mr George Russell (chairman of the IBA and chairman designate of the ITC) said that he envisaged that, while the existing 15 franchise areas would be retained, the number of regionally-based companies might well be much reduced as a result of the competitive tender procedure and subsequent takeovers.

6. The Home Secretary suggests that the Government should itself make clear that it sees advantage in retaining the existing regional structure. Following Mr Russell's presentation at the Group's previous meeting, you asked whether the IBA were intending to preserve the existing regional pattern not because it was necessarily the most suitable arrangement but instead because existing ITV companies had lobbied very hard for the retention of the status quo. Mr Russell said that there had been some lobbying by the ITV companies but that much of the pressure had come from politicians. Viewers appear to have a good deal of attachment to their local regional service (a point which Mr Rifkind has previously emphasised in relation to the Scottish ITV services) and this is clearly a politically sensitive issue. Nevertheless, you may wish to probe with the Home Secretary whether it makes sense to preserve the existing regional structure.

7. The Chancellor of the Exchequer may argue that the Group should not take decisions on the future of the existing ITV regions until after they have reached decisions on transmission arrangements. The point here is that, at present, the regions

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with high population densities effectively subsidise the transmission costs of those with low population densities. Cross-subsidies between the regions may need to be abolished once the transmission system is privatised, and the Chancellor may suggest that one possible way of achieving this might be to amalgamate some of the smaller regions into larger regions. This is one of the most sensitive issues for Scotland, in particular.

8. Even if the Group are prepared to take a decision in principle at this meeting that there would be advantage in preserving the existing regions, they may have reservations about leaving decisions about the geographical division of Channel 3 entirely at the discretion of the ITC. If so, there are a number of possible options that the Home Secretary could be asked to explore. One possibility would be for the Act to spell out the criteria for regionalisation in a fair degree of detail. Another possibility might be to introduce an arrangement under which the Secretary of State would be required to seek advice from the ITC and then to put forward proposals for approval by Parliament (perhaps under the affirmative resolution procedure). This would guard against the risk of the ITC implementing unattractive arrangements. However, an important drawback would be that the Government, rather than the ITC, could be the focus of criticism from viewers aggrieved about the division of the Channel 3 map.

(ii) Channel 3 night hours

9. A number of independent analysts (as well as ITV interests) have criticised as commercially unrealistic the White Paper proposal that there should be a separate Channel 3 night hours licence. The Home Secretary is concerned that unless the night hours are packaged with some more lucrative part of the day, there may be no serious bids at all for the night hours licence

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and that these hours might accordingly remain fallow. He therefore suggests that the night hours should be linked with breakfast time and that these hours should be advertised as a single national licence.

10. The Scottish Secretary may suggest instead that Channel 3 companies should be allowed to retain their night hours so that these hours could be used for regional broadcasting rather than siphoned off into a national night hours channel. However, it seems doubtful whether there would be enough viewers during the night hours to make it viable for the Channel 3 companies to provide regional programmes at that time: the likelihood must be instead that each of the Channel 3 companies would provide essentially the same menu of films, repeats, overseas material, etc.

11. Before considering the Home Secretary's proposal, you may wish to seek the Trade and Industry Secretary's views on whether or not a separate national night hours licence would in fact be viable. If he believed that such a licence might be viable and the Group were therefore not convinced that the White Paper proposal for a separate night hours licence should be discarded, one possible compromise would be to advertise the night hours and breakfast hours as separate licences but enable a single company to hold both franchises if it were to put in the highest bid for each of them.

12. The division of the Channel 3 clock is a much less sensitive issue than the division of the map, and there is therefore a less strong case for suggesting Ministerial or Parliamentary approval. Nevertheless, the Group may feel that it might be prudent to include some such provision to guard against the risk of the ITC

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reaching perverse decisions. Again, however, this would suffer from the drawback that the Government rather than the ITC would become the focus for any complaints about the decisions reached.

(iii) Channel 5

13. No one has seriously questioned the White Paper proposal that Channel 5 (which is expected to be receivable by only around 65 per cent of the population, with most viewers requiring a new or additional aerial) should be licensed on a national basis. The White Paper suggested that there should be two or more licences for Channel 5, divided according to time of day. The Home Secretary is now proposing, as the ITC recommended in their response to the White Paper, that the ITC should also have the option of making a division by day of the week (eg a week-day/weekend split). This seems sensible.

14. Mr Russell suggested at the Group's previous meeting that it would be desirable for Channel 5 companies to be based outside London, with perhaps one being based in the North and the other in Scotland. You may wish to confirm with the Home Secretary, however, that the competitive tendering arrangements will simply take their course and that it will not be open to the ITC to arrange for the Channel 5 licensees to be based outside London.

15. If it were decided to impose Ministerial and Parliamentary approval on the ITC's proposals for the Channel 3 clock, then the same arrangements would probably need to apply to Channel 5.

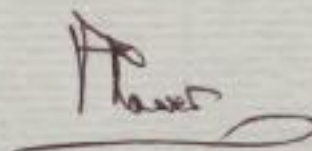
HANDLING

16. You will wish to invite the HOME SECRETARY to introduce his Memorandum. The CHANCELLOR OF THE EXCHEQUER will have comments, in particular on the arrangements for dividing Channel 3 into

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regions. The WELSH SECRETARY and the SCOTTISH SECRETARY will also have comments on this issue. The TRADE AND INDUSTRY SECRETARY will have general comments, and you may wish to ask in particular for his assessment of the viability of a separate night hours licence on Channel 3.

A handwritten signature in dark ink, appearing to read 'P J C Mawer', with a long horizontal flourish extending to the right.

P J C MAWER

2 June 1989

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PRIME MINISTER

MINISTERIAL GROUP ON BROADCASTING SERVICES
CHANNELS 3 AND 5: COMPETITIVE TENDERING (MISC 128(89)8)

DECISIONS

1. Following the presentation by the Chairman-designate of the Independent Television Commission (ITC), Mr George Russell, at the Group's meeting on 11 May and the preliminary discussion of the issues which followed it, the Home Secretary is seeking decisions on the main shape of the arrangements for awarding licences on Channels 3 and 5. He proposes that licences should be awarded under a two-stage tender process, broadly on the lines of that set out in paragraph 6.17 of the Broadcasting White Paper (copy attached), but subject to a number of refinements:

i. the positive programme requirements set out in paragraph 6.11 of the White Paper should be strengthened.
Key issues: how specific should the enhanced requirements be? to what extent should they be embodied in legislation? how much discretion should rest with the ITC?

ii. Applicants for licences should bid a fixed sum to be paid in annual instalments. Successful applicants would also pay a proportion of net advertising revenue (NAR) or subscription revenue, to be predetermined by the ITC with advice from a merchant bank: this would replace the levy.
Key issue: is the Group satisfied that these proposals meet the requirement for a transparent bidding process, which reduces ITC discretion to an unavoidable minimum and secures the best return to the Exchequer?

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iii. Applicants should also be required to post a substantial performance bond with their tender application, which in the case of the successful bidder would be retained by the ITC as an important element in the system for enforcing programme promises. Key issue: would the requirement to post a substantial bond put off potential applicants? Presumably the ITC would fix the bond and decide on the circumstances in which it would be forfeit. Against what criteria would it make these decisions? The Home Secretary proposes to bring forward detailed proposals for a graduated enforcement system and you may wish to invite him to clear these in correspondence.

iv. The highest bid should win, but the ITC should have an exceptional discretion to select a lower bid for reasons which it would be required to make public. Key issues: how would this discretion be framed in legislation and limited in order to avoid giving too wide a discretion to the ITC? Would it be sensible, given the possibilities of judicial review, for the ITC to avoid publishing its reasons for deciding to select a lower bid?

v. There should be no levy system in addition to the proposed tender arrangements. Key issue: is the Chancellor of the Exchequer satisfied that the arrangements proposed would secure a reasonable return to the Exchequer?

vi. The details of the tender arrangements are best left to the ITC to work out, but an applicant would be able to apply for any number of Channel 3 licences. If he was successful in bidding for more than the two licences he is permitted to own, the ITC should decide which licences to award him on the basis of the combination of bids that gives the highest return for the franchises taken together. Key issue: is there a need to lay down in legislation at least the principles to be followed, for example in establishing

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the mechanism for judging tenders? Where an applicant successfully bids for more than two licences, is the Chancellor satisfied that the ITC will be sensibly placed to judge which combination of bids will give the highest return to the Exchequer?

vii. There should be a 1-year moratorium on takeovers immediately after franchises have been let. Key issue: is the Group content to reverse its previous view that there should be no such moratorium?

viii. Licences should run for 10 years with scope for the ITC to award a fresh licence at the end of the period at a new price which it would determine. Key issue: is the Group content to confirm this aspect of the White Paper proposals?

ix. The ITC should not be able to require networking on Channel 3. Key issue: is the Group content to confirm this aspect of the White Paper proposals?

x. There should be a power to require subtitling for the deaf on Channels 3 and 5. Key issue: does the Group accept that such a requirement would not make it harder to resist the arguments of other groups lobbying for particular programme types?

BACKGROUND

2. Paragraph 6.17 of the White Paper on the future of broadcasting proposed a two-stage procedure for awarding licences for Channels 3 and 5 (and for Channel 4, if it were decided to privatise that channel). First, applicants would be required to pass a fairly rudimentary quality threshold. This would comprise:

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i. Consumer protection requirements (eg that news should be impartial and accurate; and that nothing should be included in programmes which offended against taste and decency);

plus the following positive programming requirements:

ii. To show regional programming;

iii. To show high quality news and current affairs dealing with national and international matters, and to include news coverage (and possibly also current affairs) in main viewing periods;

iv. To provide a diverse programme service calculated to appeal to a variety of tastes and interests;

v. To provide a minimum of 25% of original programming from independent producers;

vi. To ensure that a proper proportion of programme material is of EC origin.

*Schools?
Educational
programmes?*

In addition the White Paper indicated that the ITC should be required to ensure that there was adequate provision of schools broadcasting by the independent sector as a whole.

3. The White Paper proposed that applicants which satisfied the quality threshold would put forward financial tenders, which would take the form of a lump sum payable at the outset, with the ITC being required to select the highest bidder. Each licence-holder would be required to pay an annual levy in the form of a percentage of advertising revenue at progressive rates. (This would replace the present levy, which until recently has been based on profits, and is now based on a mix of profits and revenue.)

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4. The Government's object in proposing these arrangements was to open up the independent broadcasting sector to competitive market disciplines and to get away from the present paternalistic franchise-awarding arrangements under which a great deal of discretion rests with the Independent Broadcasting Authority (IBA). Much of the debate on the White Paper has focused on this aspect of the Government's proposals. The principal concern voiced has been that a system based on awarding franchises to the highest bidder would put a squeeze on quality. In particular, the IBA argued in its response to the White Paper that the highest bidder might not have the capabilities and resources to provide a viable service and proposed that the ITC should accordingly have some discretion in choosing between the various applicants.

5. Mr Russell presented the IBA's counter-proposals at the Group's last meeting. These would involve the ITC, after consultation with City advisers, prescribing a cash bond which all applicants for a particular franchise would be required to pay in advance as a token of serious intent. It would be refundable to all except the successful applicant. Applicants would be required to submit bids expressed not as a lump sum but as a percentage of NAR. There would be no separate levy. The Group found these proposals unsatisfactory in a number of respects. It was concerned, for example, about the extent of discretion which would still be retained by the ITC, by the suggestion that the ITC should employ merchant banks in an attempt to second-guess tenderers, and by the proposal that the Commission should publish reasons for its decisions.

MAIN ISSUES

6. The proposals brought forward by the Home Secretary on the tender process and on Channel 4 seek to guard against the criticism that the White Paper jettisons quality, while avoiding the main deficiencies of the Russell proposals. The Home

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Secretary rejects Mr Russell's proposal that the ITC should be empowered to assess an applicant's quality of money and proposes instead that the ITC should (subject to certain exceptions - see paragraphs 11 and 12 below) be required to accept the highest bid. To meet the concerns expressed about quality, however, the Home Secretary proposes (paragraph 11 of his paper):

- a. that the quality threshold should be enhanced;
- b. that there should be an exceptional veto on the highest bid wins principle; and
- c. that the tenderer should be required to put up a performance bond.

Quality threshold

7. The establishment of a quality threshold is one of the key means by which the White Paper proposes to secure programme quality. The threshold must be sufficiently rigorous to represent a real hurdle, but not so demanding as to fetter individual enterprise. There is bound to be considerable pressure during the passage of the Bill to implement the Government's proposals to strengthen the threshold by including in it particular programme requirements. Recognising this, the Home Secretary proposes that the Government should set its face against adding more positive programme requirements in the legislation but that the third positive requirement set out in paragraph 6.11 of the White Paper should be amended to read:

"To provide a reasonable proportion of programmes (in addition to news and current affairs) of high quality, and to provide a diverse programme service calculated to appeal to a wide variety of tastes and interests."

The additions proposed by the Home Secretary are underlined. The additional requirement suggested by the Home Secretary is

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cast in fairly subjective terms and it may be difficult to frame satisfactorily in legislation. It runs the risk of being inadequate on the one hand to satisfy the Government's critics and yet so broadly framed as to leave considerable discretion in the hands of the ITC. As the Group recognised at its meeting on 11 May, there is a trade-off between the degree of specificity of programme requirements and the amount of discretion which is to be left to the ITC. You may wish to probe whether the Home Secretary's proposals get that balance right. In particular you may wish to establish:

i. whether the Group accepts the Home Secretary's proposal that the quality threshold should be strengthened;

ii. if so, whether it is content with the particular form of words he proposes and that there should not be any more specific programming requirement framed either in the legislation itself or in subordinate instruments under the Bill;

iii. whether the Group is content that the ITC should be required to re-formulate the quality threshold in specific programming terms as part of the franchise allocation procedure.

Form of bid

8. The White Paper proposed that the ITC should be required to select the highest bidder from among applicants for licences who had passed the quality threshold. The bid would be made in the form of a lump sum. In addition, each successful applicant would be required to pay levy in the form of a percentage of advertising revenue at progressive rates, the initial level of which would be prescribed when licences were advertised. This arrangement would replace the present levy. Under the IBA proposals, applicants' bids were to be expressed as a percentage

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of NAR. The Home Secretary proposes that bids should be a combination of a proportion of NAR or subscription revenue (representing the minimum franchise price) to be predetermined by the ITC with advice from a merchant bank, and a fixed sum offered by the applicant. Both would be paid annually, to avoid debt burdens on licensees. The Home Secretary argues that such a system would achieve a transparent bidding process, limiting risks to bidders while securing a reasonable return to the Exchequer. You will wish to invite the Chancellor of the Exchequer and the Secretary of State for Trade and Industry to comment in particular on this aspect of the proposals.

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Performance bond/Sanctions

9. At the Group's last meeting Mr Russell proposed that bidders should have to post a performance bond as a means of deterring frivolous applications. The Home Secretary proposes to build on this suggestion by making the bond an important element in the process of enforcing programme standards. It would presumably be for the ITC to set the level of the bond and to decide the circumstances in which part or whole of it should be forfeited. You may wish to explore with the Home Secretary the criteria against which the ITC would be expected to make these judgements. Should the Commission be given any guidance on the criteria to be followed and, if so, how should this be set out? You may also wish to establish that the Chancellor of the Exchequer is satisfied that the requirement to post a substantial bond will not put off some potential tender applicants. If this is thought to be a risk it would be possible for the initial bond to be small, with the successful applicant being required to lodge a more substantial bond later.

What level?

10. In paragraph 27 of his paper, the Home Secretary notes that the IBA has offered a number of proposals which would supplement those in the White Paper on sanctions. The Home Secretary suggests that he should give further thought to these proposals

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with a view to working up possible intermediate sanctions in addition to the yellow and red card system proposed in the White Paper. At its meeting on 11 May the Group recognised that sanction arrangements were a vital part of the quality assurance process, and that the development of a graduated enforcement system was desirable. An effective system will be important in securing acceptance of the Government's proposals as a whole. You may wish to invite the Home Secretary to submit his proposals on sanctions to the Group at a later date for clearance through correspondence.

Highest bid wins

11. The Home Secretary proposes that while the ITC should normally accept the highest bid, it should have discretion, as recommended by the Peacock Commission, to select a bid lower than the highest for exceptional reasons which the Commission would be required to make public. The Home Secretary envisages that this discretion would be used only on very rare occasions, eg where the finance underpinning the bid was unsound or came from a politically undesirable source, or where the programmes on offer by the lower bidder were so clearly superior to that of the leading bidder, that it would be perverse to ignore that fact. The proposal has obvious advantages in meeting the criticism that the highest bid wins formula is too inflexible. But the latter example given by the Home Secretary underlines in particular the width and subjective nature of the discretion which is proposed. It may be difficult to frame the discretion satisfactorily in legislation. You may wish to explore with the Home Secretary whether the proposal does not again involve giving too wide a discretion to the ITC.

12. The Home Secretary's proposal also envisages that the ITC would make public its reasons for exceptionally selecting a lower bid. At its last meeting, the Group expressed concern at the proposal that the ITC should give its reasons for accepting

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successful bids, on the basis that this would open the Commission's decisions to judicial review. Presumably, similar considerations would apply in the even more fraught circumstances of the ITC rejecting the highest bidder. You may wish to explore with the Home Secretary whether this aspect of his proposals is not in conflict with the inclination expressed by the Group at its previous meeting.

The levy

13. The White Paper envisaged that each licensee would be required, in addition to his financial tender, to pay levy in the form of a percentage of advertising revenue at progressive rates, the initial level of which would be prescribed when licences were advertised. The Home Secretary suggests that, since the tender which he now proposes would consist of a proportion of NAR or subscription income, there would be no need for a levy in addition. This seems right but you will wish to establish whether the Chancellor of the Exchequer is content.

Tendering process

14. The Home Secretary suggests that the details of the tendering process are best left to the ITC to decide. Some of these details will be of considerable importance, but it is probably inevitable that they be left to the ITC's discretion if the proposed Bill is not to become too detailed and unwieldy. You will wish to establish whether the Group is content, or whether it feels that there are any principles which it would wish to see enshrined in legislation.

15. One issue on which the Home Secretary proposes that guidance should be given to the ITC is the number of Channel 3 licences for which an individual company can apply. The IBA proposed that this should be restricted to one licence application per company, but the Home Secretary recommends that a company should be

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permitted to bid for any number of Channel 3 licences, and to state its preference for each franchise when doing so. At its meeting on 24 April the Group decided that a company should be allowed to own one large and one small franchise, or two small franchises, but not two large franchises; and that a company should be precluded from owning the franchises for two contiguous areas. The Home Secretary suggests that if an applicant was successful in bidding for more than two licences, the ITC should decide which licences to award him on the basis of the combination of bids that gives the highest return (to the Exchequer) for the franchises taken together. You may wish to establish that the Chancellor of the Exchequer is content that the ITC would be satisfactorily placed to form such a judgement.

Moratorium on takeovers

16. At its meeting on 24 April the Group agreed that there should be no moratorium on takeovers merely to allow the new commercial system to settle down. Mr Russell suggested at the meeting on 11 May, however, that there should be a moratorium of one year after the award of franchises in order to deter speculative tendering. The Home Secretary proposes to accept Mr Russell's approach. You will wish to ensure that the Group is content to reverse its earlier decision in this way.

Licence period and renewal

17. The White Paper suggested that the licence period should be for 10 years and that the ITC should have discretion to award a fresh licence without a further tendering process but at a new price which it would determine. The Home Secretary recognises that there is some logical inconsistency between this renewal process and the initial tender arrangements but recommends that, since the White Paper proposals on this score have been generally accepted, they should not be altered. You will want to establish

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whether the Group is content to confirm this aspect of the White Paper proposals.

Networking

18. The Home Secretary notes that commentators on the White Paper have suggested that, if the ITC had power to require networking arrangements on Channel 3, higher quality programmes would result. The certainty that licensees would have access to a networking arrangement might also enhance the value of franchises at the tender stage. The Home Secretary concludes, however, that, as envisaged in the White Paper, the development of networking arrangements should be left to emerge naturally from the new arrangements. This would be firmly in line with the Government's deregulatory approach.

Subtitling for the deaf

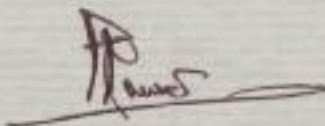
19. The Home Secretary takes the opportunity of his paper to seek the Group's agreement that there should be a power to require Channel 3 and Channel 5 licensees to continue to provide a teletext subtitling facility for the deaf. You will wish to establish that the Group is content for such a requirement to be included and that its inclusion will not make more difficult the task of resisting proposals for the inclusion in legislation of other particular programme requirements.

HANDLING

20. You may wish to invite the HOME SECRETARY briefly to introduce his paper and then to work through the proposals in the order set out in this brief. The CHANCELLOR OF THE EXCHEQUER and the SECRETARY OF STATE FOR TRADE AND INDUSTRY will have particular points to make on the Home Secretary's proposals on the form of bids and on the levy. Other Ministers, including the FOREIGN SECRETARY, will be particularly concerned about the

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balance which the Home Secretary seeks to strike between the achievement of quality and the opening up of the arrangements to market disciplines. The EDUCATION SECRETARY has indicated his interest in the implications of the proposals for the proposed requirement that Channel 3 companies continue to provide schools programmes. You may wish at the conclusion of the discussion to check that the CHIEF WHIP is content that the overall balance of the decisions which emerge will be acceptable to the Government's supporters in the House.

A handwritten signature in dark ink, appearing to read 'P J C Mawer', with a long horizontal flourish extending to the right.

P J C MAWER

1 June 1989

~~in exchange would have the opportunity to own shares in it. However, whereas at present all ITN shares are held by ITV contractors, under the new provision some shares would be held externally, by bodies without licences on any television channel. Eventually a majority of shares should be held by non-licensees. The detailed arrangements need further study and consultation, but one approach would be as follows. Initially the Channel 3 licensees might hold the majority, or all, of the shares in the news organisation or organisations. The supply of news to Channel 3 would be governed by a service contract which would, unlike the funding for ITN at present, include a profit element to establish the organisation's commercial value. The ITC would be under a duty, at the right time, to ensure that some, perhaps the majority, of shares were sold to non-licensees. No external investor should hold more than 5 per cent of the shares.~~

6.14 Although not having general control of scheduling, the ITC would have powers to ensure that the news service provided by one or more of the news organisations was shown by Channel 3 stations and, as already indicated, that this should include exposure during peak viewing times. As a necessary safeguard, the ITC would have power to withdraw, after adequate notice, its approval of a news organisation established under the arrangements discussed in the previous paragraph which failed to deliver an acceptable service.

Other responsibilities of licensees

6.15 The Government envisages that the Channel 3 programme service should be provided with the same universal coverage as at present, but by the companies rather than being provided, as now, by a broadcasting authority. It follows from this that, subject to what is said above about news coverage, the ITC would not have the IBA's responsibility for detailed approval of scheduling or prior clearance of particular programmes. It should be for the operators to decide what to show and when to show it, subject to the general law and the regulatory requirements described in paragraphs 6.10-6.11. It would also be their responsibility to decide on commercial grounds on any arrangements for networking or syndicating programmes among themselves. This means that much of the detailed supervisory work now done by the IBA would come to an end. The operators will also be free to decide their own mix between advertising and subscription.

Division of Channel 3 licences

6.16 In order to create more opportunities for entry to the broadcasting market and competition within it the Government proposes that there should be a separate night hours licence, or licences, for Channel 3. It will be for the ITC to determine the exact boundaries, and to decide on possible additional licences covering other times of day—eg for a breakfast time service. The ITC will also be responsible for the geographical division of Channel 3 into regions, whose particular interests licensees will need to cater for, as envisaged in paragraph 6.11 above. The Government envisages that the extent to which the regional and any schools programming obligations apply to any night time or breakfast time licensees would be determined by the ITC taking account of the basis on which ~~the Channel 3 licences were being divided up.~~

Allocation of licences

6.17 The present arrangements for awarding ITV contracts have been conscientiously applied, and in some respects reformed, by the IBA. But they have been widely criticised as arbitrary and opaque. The Home Affairs Committee saw advantage in introducing a more commercial element into the allocation of ITV franchises, and recommended that a suitably regulated tendering process should be introduced (paragraph 134). The Government agrees and proposes that the ITC should operate a two-stage procedure. In the first stage applicants for licences would have to pass a quality threshold. They would have to satisfy the ITC that they would meet the programming requirements set out in paragraphs 6.10 and 6.11 above—in other words that they were qualified to take on a Channel 3 licence. They would also have to meet whatever ownership tests are eventually imposed: this subject is discussed in paragraphs 6.48-6.53. All applicants passing this threshold would go on to the second stage in which they would

offer financial tenders for the licence. The ITC would be required to select the applicant for each licence who had submitted the highest tender. Both stages of the procedure will be open to public scrutiny. This two stage procedure will provide a more objective method of licence allocation which will be fairer to all applicants, and will at the same time secure a proper return for the taxpayer for the use of a public resource. In order to ensure that the tender procedure meets the latter objective and that there is a fair sharing of risks between Channel 3 operators the Government envisages that each licensee will also be required to pay levy in the form of a percentage of advertising revenue at progressive rates, the initial level of which will be prescribed when licences are advertised. This will replace the present ITV levy.

Takeovers 6.18 ~~The ITC will not have or need the IBA's present powers to block takeovers, which reflect the discretionary nature of the present contract allocation process. But those buying into companies will have to satisfy the proposed programming tests and the ownership rules discussed in paragraphs 6.48-6.53 below. Subject to these tests and rules, takeovers can be a useful way of bringing new ideas and talent into television and re-inforcing pressures for efficiency.~~

Performance reviews 6.19 The quality tests set out in paragraphs 6.10 and 6.11, which would be reflected in licence conditions, would not cease to apply when operators had been selected. They would continue throughout the licence period. The ITC would be responsible for monitoring performance and following up complaints by the public. The ITC would undertake formal reviews of the performance of licensees at intervals or as needed. As recommended by Peacock (paragraph 657), the ITC will have power, after a review, to issue a formal warning (a yellow card) and to remove a licensee (a red card) one year later if performance remains unsatisfactory—for example in failing to deliver a sufficiently diverse programme service. The Government is considering whether, as an additional sanction, the ITC should be able to impose financial penalties. This enforcement machinery will be designed for effective use if necessary.

Licence terms 6.20 The Government has carefully considered the arguments for and against fixed term or unlimited licences for UHF independent television services. It could be argued that the new flexibility as regards takeovers (paragraph 6.18 above) will ensure against the inefficiency or rigidity which an indefinite licence might otherwise produce, and that an indefinite licence would avoid the risk of failing interest or involvement towards the end of a fixed term. Against this, under an entirely open-ended system competitive tender would benefit the Exchequer only once. It might also be difficult for the ITC to secure agreement to any necessary future structural changes either in licence conditions or in the system more widely, such as changes to the geographical framework of Channel 3. Taking account of these considerations, the Government proposes that the licences for UHF independent television services should be for a fixed term of ten years (as recommended in paragraph 658 of the Peacock Report), but that it should be open to licensees, during the final years (perhaps the last four) of their licences, to apply for licence renewal for further 10 year terms. The licensee would have to satisfy the ITC that he was continuing to meet his programming obligations and otherwise sustaining a satisfactory performance, and the ITC would retain the ability to make structural changes in the system. The licensee would also have to pay a licence renewal fee to the ITC, which would be calculated on a formula based on the licensee's advertising, subscription and sponsorship revenue. Where the ITC was not satisfied that the licence should be renewed it would be open to it to proceed to competitive tender on the basis proposed in paragraph 6.17, or else to invite the licensee to re-apply for renewal after a further period during the currency of the existing licence.

(ii) *Channels 5 and 6* 6.21 The Government proposes that, subject to what is said below, the same regulatory regime (although without the regional programming obligations) and the same licence allocation and review arrangements should apply equally to Channel 5. ~~The Government proposes that Channel 5 should come on stream~~