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Prime Minister

MISC 128 : CHANNELS 3, 4 AND 5

At the close of the meeting of MISC 128 on 6 June I promised to circulate proposals for announcing the decisions we took on that day.

... I attach a draft announcement of our conclusions on the three papers which we discussed concerning competitive tendering, Channel 4 and the map and the clock on Channels 3 and 5. All the major decisions that we took on 6 June are included in this draft. The only addition is the technical change in the arrangements for funding the Welsh Fourth Channel which I included in paragraphs 24 and 25 of MISC 128(89)3 which we discussed on 24 April. Under this proposal, the S4C subscription would cease to be a first charge on the Channel 3 companies but would be taken directly out of the proceeds of competitive tender. This is in line with our general policy of freeing up commercial television and not placing unnecessary burdens on the commercial companies.

... I also attach a draft letter which I would propose to send to the Chairman of the Home Affairs Committee since our decisions on Channel 4 constitute a formal response to the Committee's Report of last March.

/This will

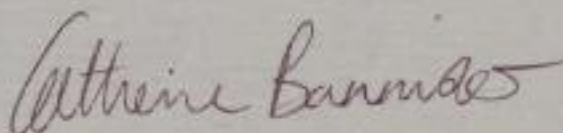
# CONFIDENTIAL

2.

This will be an important announcement both in terms of its wide scope and the significance of many of the decisions we have taken. It will be seen as the main Government statement on the future commercial television system following the White Paper and before the Broadcasting Bill. Although we have still to take decisions on transmission and BBC night hours, these are of less political significance to the broadcasting world and should not be allowed to hold up the present announcement.

If you and colleagues are content with the terms of the draft announcement, I would hope to make it by way of a Commons Oral Statement on 13 June; and write to John Wheeler the same day. Any comments on the draft will therefore need to reach me by mid-day on Monday 12 June.

I am copying this minute and enclosures to MISC 128 colleagues and to Sir Robin Butler.



Approved by the Home Secretary  
and signed in his absence.

9 June 1989

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## COMPETITIVE TENDER AND CHANNEL 4 : DRAFT ANNOUNCEMENT

With permission, Mr Speaker, I would like to make a statement on our proposals for the future of commercial television in the light of the comments we have received on the White Paper on Broadcasting.

2. The White Paper proposed a two-stage procedure for awarding licences for Channels 3 and 5 under which applicants would have first to pass a quality threshold, consisting of positive programme and consumer protection requirements, and would then go on to offer financial tenders. The Independent Television Commission would be required to select the highest bidder.

3. Many of those who commented on the White Paper expressed concern that these proposals might lead to a loss of quality in programming. I recognise that concern and believe that a case has been made out for strengthening the quality threshold. I do not consider it would be right to do so by adding more detailed requirements in the legislation to supply specific types of programme. I therefore propose to strengthen the quality threshold by broadening the third positive requirement in paragraph 6.11 of the White Paper 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."

It will be for applicants to interpret this combined quality and diversity test in drawing up their programme proposals. Those who fail to satisfy the ITC that they can meet this requirement will not have their financial bids considered.

/4. A number

4. A number of suggestions have been made to us about the form that the financial bid should take. The Chairman of the IBA proposed that it should comprise a sum fixed by the ITC and a bid by the applicant of a percentage of advertising revenue. I support this combination of elements but, in order to improve the transparency of the bidding process and to reduce the risk of over-bidding, propose that they should be reversed.

Accordingly, the ITC, with assistance from a merchant bank, will fix a percentage of net advertising or subscription revenue for each licence to form the minimum sale price. Applicants will then be required to bid a lump sum in addition. For successful applicants, both sums will be paid annually over the period of the licence to avoid the imposition of debt burdens on licensees.

*lump sum will be paid in equal instalments over the period of the licence.*

5. Applicants will also be required to post a cash bond with their tender application. It will be returned to unsuccessful candidates, but retained by the ITC in the case of the successful bidder who will be required to add to it a further amount to form a substantial performance bond. This requirement will strengthen the enforcement powers of the ITC. Those who fail to meet their programme promises given at the quality threshold stage will stand to lose a proportion of the bond.

6. I have considered carefully the arguments about the criteria on which the tenders should be decided. I do not believe that at the tender stage, before it is clear to whom the licences will be awarded and before the nature of any network arrangement is known, it will be possible for the ITC to make fine distinctions between the quality of programme service offered by different applicants, all of whom will have passed the strengthened quality hurdle I have announced today. We must avoid a return to the opaque and sometimes arbitrary selection procedures that have operated in the past. But some flexibility needs to be written into the procedure. We propose therefore that the ITC should be required in the normal course to accept the highest bid, but that

/it should

*This is not a "lump sum" clean surely*

*Size?*

*Surely not a further sum in cash?*



BG ✓  
correct

it should have a power in exceptional circumstances to select a lower bid. This power would operate only in exceptional circumstances and [on grounds determined by] the ITC [which] would be required to give its full reasons. Exercise of the power would, of course, be subject to judicial review.

7. The White Paper proposed that in addition to the sum bid at tender applicants would have to make a levy payment to the Exchequer. The proposals I have just announced for the fixing of a proportion of advertising or subscription revenue as part of the tender price overtake our original proposals for a levy. Successful candidates will have only to pay the two-part tender price I have outlined, and will not be required to pay levy in addition.

8. Under the ownership proposals I announced on 19 May, an individual licensee will be able to own two Channel 3 licences as long as they are not both large or contiguous. Applicants for Channel 3 licences will be permitted to apply for any number of licences provided they make clear their order of preference. Those who are successful in the bidding for more than the two licences to which they are entitled will be awarded the relevant licence or licences on the basis of their declared preference.

ITC?

9. Following the submission of comments on the White Paper, there has been some speculation as to whether the Government would impose a moratorium on takeovers at the beginning of 1993 and whether it would insist on compulsory networking for Channel 3. The Government's view on both issues has not changed since the publication of the White Paper. I understand that it is the intention of the Chairman of the IBA to permit takeovers in the period up to 1993, subject to the normal anti-monopoly rules and bearing in mind our proposals for the regime after 1992. It would not in the circumstances be either sensible or necessary to impose a moratorium thereafter. Networking will be a matter for

/the Channel 3

the Channel 3 companies themselves to decide without Government compulsion. Basic fair trading laws should ensure that no companies are excluded unfairly from any networking arrangements. We shall consider whether any further provisions are needed in the legislation to regulate the operation of any new network system in the interests of free access and fair competition.

10. We have received a number of representations on behalf of the four million viewers who are deaf or hard of hearing. I see considerable force in the argument that particular provision should be made for them. We have therefore decided that Channel 3 and Channel 5 licensees should be required to provide teletext sub-titling for some of the programmes in their schedules.

11. The White Paper proposed that Channel 5 should be shared between at least two licensees. In the light of the start-up costs of the new Channel and the competition it will face from the established terrestrial channels, we have given further thought to this proposal. We have now decided that Channel 5 should form a single licence, and will as a result   particularly in the early days, be better equipped to compete with the existing terrestrial channels.

12. Similarly, the White Paper proposed that there should be a separate night hours licence for Channel 3. Many of those who responded to the White Paper expressed doubts about the financial viability of a separate night hours licence and we have accordingly looked at the matter again. We wanted to ensure so far as possible that the night hours were fully used. I accept the argument that they may be better exploited commercially if they are linked with services provided at a more commercially attractive part of the broadcasting day. We have therefore decided not to disturb the present situation under which the night hours may remain connected with the peak viewing period. This position will be reviewed after five years of the new

/licences if



licences if the night hours are not being fully exploited. Under our proposals, the ITC will be free to allocate licences for other times of the day, such as a breakfast time service.

13. The White Paper proposed that the ITC would be responsible for the geographical division of Channel 3 into regions. This has been generally welcomed. The Government has noted with understanding the statement of the Chairman-designate of the ITC, Mr George Russell, that he would see advantage in retaining the existing regions, if possible.

14. I turn to Channel 4. The White Paper made clear the Government's intention to maintain the remit of Channel 4 while at the same time providing for the selling of its advertising separately from that on Channel 3. The White Paper proposed three options ranging from a fully independent commercial service licensed by the ITC, through an option linking Channel 4 with the new Channel 5, to an arrangement whereby Channel 4 would continue as a subsidiary of the ITC with a possible minimum guaranteed income.

15. We have considered the comments we have received on these options following the publication of the White Paper, and in particular the helpful Report by the Home Affairs Select Committee which carried out a thorough review of this specific issue. I have written today to the Chairman of the Committee expressing the Government's gratitude for its work on Channel 4 and setting out the Government's decisions. A copy of that letter has been placed in the Library of the House.

16. In considering the various options, the Government has decided that it would not be feasible at the present time for Channel 4 to become an independent commercial company competing with the other broadcasters. The financial outlook for Channel 4 remains uncertain with the prospect of new competition and

/rising costs.

rising costs. I believe that the requirement in addition to provide a return for shareholders in a private company would put too much pressure upon Channel 4 finances and place its remit in serious jeopardy. But I see some difficulty in Channel 4 continuing to be owned by the authority who would be responsible for regulating its output; and I believe that any financial underpinning given to the Channel should be carefully circumscribed to provide clear incentives for cost-efficiency.

17. We have therefore decided that after 1993 Channel 4 should assume the status of a public trust, which would take over the shares of the present company and would be licensed by the ITC. Members of the trust would be appointed by the Government and would have as their sole objective the efficient running of the service and the maintenance of the remit. Channel 4 would sell its own advertising, and would be subject to a baseline budget of 14% per annum of terrestrial net advertising revenue. The baseline could be amended in secondary legislation. If the Channel's revenue fell below the baseline, the difference would be funded by the ITC to a maximum of 2% of terrestrial net advertising revenue levied on the Channel 3 companies. Any surplus revenues above the baseline would be shared equally between Channel 3 and Channel 4. The Trust would be required to hold their share of any surplus revenues to be used as a first call in the event of deficits in later years. To reduce the need for a call on the guarantee, the ITC would be empowered to require cross-announcement of programmes between Channel 3 and Channel 4. Complementary scheduling would be possible, but would not be a requirement. The Channel 4 licence would run for ten years, but these arrangements would be reviewed after seven. I believe this is a satisfactory way of securing the future of Channel 4 with its present remit.

18. The White Paper concluded that the arrangements for the Welsh Fourth Channel should remain unchanged. Some have argued

/that it



that it would not be consistent with the new and more free approach to regulation for the Channel to be funded by a direct subscription on the commercial companies. The situation is particularly marked in Scotland where the smaller companies are required to finance Welsh programmes as a first call on their resources before even they make provision for their own Gaelic speakers. The Government is sympathetic to these concerns, and has decided to make a small change to the funding arrangements for S4C. As proposed in the White Paper, the ITC, in consultation with the Welsh Fourth Channel Authority, will fix the level of S4C revenues, but these will be paid not as a first call on the commercial companies but directly out of the proceeds of the tender.

19. My statement today covers most of the major decisions on the future commercial television system following the publication of the White Paper. They will be incorporated in new broadcasting legislation which the Government hopes to bring forward in due course

John Wheeler Esq MP  
Chairman  
Home Affairs Committee  
House of Commons  
LONDON, SW1

for signature by: HOME SECRETARY

HOME AFFAIRS COMMITTEE REPORT  
THE FINANCING OF CHANNEL 4

I am writing to you to let you know the Government's response to your report of 15 March on the financing of Channel 4. I plan to make an announcement in the House of Commons on [13] June about our proposals for Channel 4 and other matters relating to Channels 3 and 5, but before doing so I wanted to provide you and your committee with a formal response to your report.

The Government greatly appreciates the work which you and your committee have devoted to the question of Channel 4. Your report was presented at a crucial point in the debate and has strongly influenced our thinking. We have carefully considered all the recommendations which you have made.

As you know, the White Paper set out three options for the funding of Channel 4. Your report recommended (paragraph 19)



that option 2 of the White Paper (Channel 4 as a subsidiary of the ITC) provided the best way forward. We too concluded that option 1 (full privatisation) and option 3 (linking Channel 4 to Channel 5) would not fulfil the Government's policy intentions. We felt, however, that it was important, if Channel 4 were to maintain its remit, that it should not be both owned and regulated by the same body. For this reason, we are proposing that Channel 4 should be wholly owned by a Trust, which will replace the present Channel 4 Board. Members of the Trust will be appointed by the Government and, apart from a salary, will have no financial interest in the profits or losses of Channel 4.

You recommended (paragraph 32) that Channel 4 should be funded to the level of 14% of terrestrial national advertising revenue, and in the event of Channel 4 achieving a surplus, it should retain that money as a reserve against future deficits. We agree that the baseline budget should be 14% of terrestrial NAR. If Channel 4's revenue fell below this baseline, we propose that the difference should be funded by the ITC, but never to an extent of more than 2% of terrestrial NAR. The ITC would impose a special levy on all Channel 3 companies to raise the required subsidy. Thus if advertising revenue fell to not less than 12% of terrestrial NAR, the amount would be made up to the full 14%. But if it fell below 12%, then only an additional 2% of terrestrial NAR would be added per annum. This arrangement will create a strong incentive to efficiency since Channel 4 can never be certain of a subsidy of more than 2%. Any surplus revenues above the baseline value would be shared equally between

Channel 3 and Channel 4. The Trust would be required to hold any profits to be used as a first call in the event of deficits in later years. The ITC will be empowered to require Channel 3 to cross-announce programmes on Channel 4. Complementary scheduling will be enabled but will not be a requirement.

You recommended (paragraph 23) that subject to amendments to take account of the change in structure of the Channel, the remit of Channel 4 should be fully restated in the Broadcasting Bill. I can confirm that the Government does intend that Channel 4 should continue with its present remit, and that the remit suitably modified to take account of the change in structure that we have proposed, will be fully restated in the Broadcasting Bill.

You recommended (paragraph 30) that the legislation should ensure that the ITC would be able to meet from its resources all its financial obligations in any one year. We shall certainly ensure that the ITC is able to discharge its financial obligations. As far as the funding of Channel 4 is concerned, you will see from the proposals set out above that any underpinning required for Channel 4 will be obtained by a special levy on Channel 3 licensees.

You recommended (paragraph 43) that a contractual arrangement between Channel 4 and the ITC should be enabled in the forthcoming legislation. This recommendation was put forward on the basis that Channel 4 would be a subsidiary of the ITC. In fact, as I have said, we are proposing that Channel 4 should be



wholly owned by a Trust which would be licensed by the ITC. The nature of the relationship between the ITC and the Channel 4 Trust will be fully specified in that licence. The duties of the Channel 4 Trust will be fully specified in the forthcoming Bill.

We have taken note of the comments of your Committee in paragraph 42 of the report about the relationship between the S4C subscription and the future viability of some of the Channel 3 companies. We have decided accordingly that S4C funding should not after 1993 be a first charge on the commercial companies but should be taken directly from the proceeds of competitive tender.

I would like to take this opportunity to thank you and the members of your committee for the very helpful report which you have prepared. You will see from what I have said in this letter that it has had an important influence on the formulation of our proposals for the future of Channel 4.

I am placing a copy of this letter in the Library of the House of Commons.

A:wheeler.