

PRIME MINISTER

MINISTERIAL GROUP ON BROADCASTING SERVICES
PRIVATISATION OF THE TRANSMISSION SYSTEM (MISC 128(89)9 AND 10)

DECISIONS

1. The documents before this meeting address the major issue which remains to be settled before work on the Broadcasting Bill can proceed: whether and on what terms the Broadcasting transmission system should be privatised. The report by the Chairman of the Official Group (MISC 128(89)9) sets out the arguments for and against privatisation and the options for pursuing it. The paper by the Home Secretary (MISC 128(89)10) invites the Group to:

a. agree that the aim, set out in the Broadcasting White Paper, of privatising the transmission system set out in the Broadcasting White Paper should be confirmed. Key issues: does the Group accept that the market disciplines and opportunities for which privatisation would pave the way are worth the additional cost of transmission to programme companies, bearing in mind the limited nature of the competition which could be introduced and the difficulties of privatising the BBC transmission operation in advance of the expiry of the Charter in 1996?

b. agree that the BBC and IBA transmission systems should be privatised in roughly their present form. Key issue: does the Group accept that this option is preferable, on grounds of cost and enhanced competitive benefit, to either the regional model floated in the Broadcasting White Paper or the option favoured by Price Waterhouse of two national companies providing a patchwork quilt of local monopolies?

c. agree that the new arrangements should be subject to regulation, on quality as well as economic and technical

grounds. OPTTEL should be the regulatory authority. Key issue: does the Group accept that because of the limitations on competition even after privatisation, regulation is necessary and OPTTEL is the right body to undertake it?

d. note that there are no obstacles in the way of privatising the IBA transmission system.

e. agree that while the object should be to privatise the BBC system no later than 1996, the BBC should not be forced to accept privatisation against their will or persuaded to accept it by the offer of incentives. Key issue: does the Group agree that the BBC's Charter is a real obstacle to privatisation of their transmission assets against their will, and that there should not be any attempt to induce the BBC to accept privatisation?

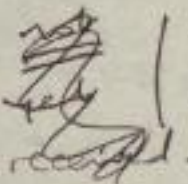
f. agree that the BBC's transmission operation should instead be established as an arm's length subsidiary of the Corporation. Key issues: does the Group accept that requiring the BBC to contract out the operation and maintenance of its transmission assets would not be a satisfactory alternative and that the aim should be to set up the BBC's transmission operation as a subsidiary of the Corporation but with safeguards to ensure that it is not cross-subsidised by the Corporation?

g. confirm the White Paper proposal that the BBC should be allowed to compete for new broadcasting transmission business. Key issue: is the Group satisfied that the subsidiary could be established on terms which did not offer unfair competition to a privatised ex-IBA operation?

h. agree that there should be a cautious, but not negative response to the BBC's proposal that they should enter into joint ventures with the private sector to compete for

telecommunications business. Key issue: involvement of the BBC in the telecommunications sector (subject to the outcome of the review of the telecommunications duopoly policy) would be a major step. Does the Group accept that the possible contribution which such a step might make to ending the BBC's dependence on the licence fee would make it worth contemplating and that there are adequate safeguards to prevent the BBC acquiring too dominant a role in the telecommunications market?

i. agree that the transmission charges for Channel 3 should be based on a national tariff related to the proportion of TV households in any given franchise area. Key issue: does the Group agree that, although such a step would prevent individual Channel 3 companies from making their own transmission arrangements, it is necessary in order to ensure the viability of the smaller regional companies?

 In his minute of 16 June to the Prime Minister, the Foreign Secretary seeks the Group's agreement that:

j. The transmission assets of the World Service should remain in the public sector but the BBC should be asked to propose options for the cost effective operation of the World Service system in the new environment which would be created by the Home Secretary's proposals on domestic transmission.

Finally, the Home Secretary's paper envisages that the conclusions reached by the Group on these various issues should be:

k. The subject of an early announcement by means of an arranged written Answer.

BACKGROUND

2. Paragraph 9.1 of the White Paper on broadcasting said that the Government intended to move the UHF broadcasting transmission networks run by the BBC and IBA progressively into the private sector, separating transmission (ie service delivery) from service provision, while ensuring that high technical standards were maintained. The White Paper suggested that the best arrangement in due course would be a regionally based, privatised transmission system, designed to promote competition, while containing certain common carrier obligations. The BBC would continue to have responsibility for transmitting its television and radio services, but would gradually test the possibilities of involving commercial contractors in the running of its transmission system. The Independent Television Commission (ITC) would not acquire the IBA's transmission system except as a short term arrangement pending its privatisation. It would, however, have a supervisory role in ensuring that the arrangements made for the transmission of all national or quasi-national independent broadcasting services made proper use of the frequencies available.

3. Following publication of the White Paper, consultants-Price Waterhouse - were appointed by the Home Office and the Department of Trade and Industry to examine the options for privatisation. The executive summary of their report is at Annex A to MISC 128(89)9. Briefly, they found that the present system was not structured financially to provide an efficient allocation of capital or correct financial pressures on costs. There were, however, constraints on the degree of competition which privatisation could induce because of the existing pattern of ownership of transmission assets and service arrangements. Privatisation would need to be accompanied by price regulation and control over the standards of service provided. And because of the requirement to earn a return on capital, it would add some 15-30% to the transmission costs of the programme companies.

4. Price Waterhouse concluded that the White Paper proposal of privatising the present transmission networks on a regional basis would not be sensible: it would be technically feasible but it would be unlikely to produce significant benefits and there would probably be some loss, albeit modest, of economies of scale. They identified instead two options for privatising the systems on a national basis:

i. Two similarly sized organisations, each responsible for approximately half of the transmitting sites in the United Kingdom equally distributed throughout the country. Each company could be described as a patchwork quilt of local monopolies.

ii. Privatising the BBC and IBA operations separately in essentially their present form.

5. The first option was favoured by Price Waterhouse, although they recognised that, if changes to the BBC's Royal Charter were impracticable, the transmission systems could be privatised along the lines of the existing arrangements, given the need to find a solution for the IBA in the short term.

6. Officials have reviewed the options identified by Price Waterhouse and have also consulted the BBC, IBA and OFTEL. The key outcomes of these discussions are:

i. The BBC is opposed to the privatisation of its transmission system because of the likely increase in transmission costs and because it would prevent the Corporation from exploiting its transmission assets as a way of generating additional income. The Corporation has, however, proposed the establishment of its transmission operation as a wholly owned subsidiary company operating at arm's length from the Corporation.

ii. The IBA would enthusiastically embrace privatisation, although because of contractual relationships between the

IBA and the existing programme contractors, it would probably not be possible to privatise the IBA's transmission system before the expiry of the existing ITV franchises at the end of 1992.

iii. OFTEL would be prepared to regulate standards and charging in the new transmission system, provided that the necessary additional resources were made available to it.

7. In the light of these and other considerations, the Home Secretary endorses the Official Group's recommendation that privatisation should proceed, but on the basis of the two existing operations rather than Price Waterhouse's favoured option. This approach would avoid the costs and delays which would arise from any attempt to reallocate the existing systems, would hold out better competitive prospects in the long run and would enable the privatisation of the IBA operation to proceed even if that of the BBC could not do so ahead of revision of the Charter in 1996.

MAIN ISSUES

Whether or not to proceed with privatisation

8. You may wish first to establish whether the Group agrees that the object should continue to be to privatise both the BBC and the IBA transmission systems. The arguments against privatisation are that it would lead to only limited competition; that because of the requirement to earn a return on capital, it would put up the costs of transmission to the programme producers; and that it seems unlikely that the IBA's transmission operation could be privatised before 1993 or the BBC's before 1996. On the other hand, eventual privatisation would bring market disciplines to bear on the provision of services, encourage the more cost-effective use of transmission assets and potentially assist in opening up the telecommunications market, if private transmission operators were

permitted to enter that market after the telecommunication duopoly review due to begin at the end of 1991. For these reasons, you may wish to invite the Group to confirm that privatisation remains the aim.

What form should privatisation take?

9. You may then wish to establish whether the Group accepts the Price Waterhouse recommendation that the White Paper proposal of privatisation on a regional basis is not a runner. Assuming that the Group does so, the choice appears to lie between the Price Waterhouse-favoured option of two equally endowed national companies (which its report describes as "a patchwork quilt of local monopolies") or the recommendation of the Official Group, endorsed by the Home Secretary, that the system should be privatised in basically its present form (ie as two companies, based on the existing BBC and IBA operation). Does the Group agree that the additional cost and potential for delay inherent in the option favoured by Price Waterhouse point conclusively in the direction of privatising the two transmission operations in basically their present form?

10. Paragraphs 9-10 of the note by the Chairman of the Official Group (MISC 128(89)9) suggest that in order to make the two proposed transmission companies attractive to investors, it would probably be necessary for a limited period of, say, 5 years, to give each of the two companies guaranteed contracts for the transmission of two of the four main terrestrial television channels. This point is not picked up in the Home Secretary's paper and you may wish to invite him to comment on it, particularly as such an arrangement would give the newly privatised companies a substantial initial dowry.

Who should regulate the new system?

11. Given the inherent limitations on competition even in a privatised system, it seems clear that some form of regulatory authority to ensure quality as well as to cover technical and

economic issues is necessary. If this is accepted by the Group, you may wish to invite them to confirm that OFTTEL should be the regulatory authority for the new system.

Position of the IBA and BBC

12. The IBA is positive about privatisation and as the Home Secretary's paper notes, the only outstanding issue there is whether the privatisation of the IBA system would be possible during the currency of the present ITV contracts. You may wish to invite the Home Secretary to pursue this issue with the IBA and to report back to the Group in correspondence.

13. The Home Secretary's paper suggests that, if an attempt were made to amend the Charter to force the BBC to accept privatisation against their will, the result would be a quasi-constitutional argument into which The Queen could be dragged. You may wish to establish that the other members of the Group agree with the Home Secretary that this effectively rules out privatisation of the BBC's assets in advance of the expiry of the Charter in 1996.

14. An alternative course would be to seek to persuade the BBC to accept privatisation by offering them incentives such as a share in the proceeds of privatisation. However, officials believe that any such offer would be ineffective and it is in any event questionable whether it would be right to seek to negotiate a return to the BBC on assets which they only hold thanks to the licence fee. For these reasons, you may wish to invite the Group to confirm that there should be no such negotiation with the Corporation.

15. The Home Secretary suggests that nonetheless the aim should be to privatise the BBC's transmission operation as soon as possible after the Charter expires (or earlier if possible). One option would be to require the Corporation to contract out the operation and maintenance of its system, but this was not recommended by Price Waterhouse as separating off ownership and

operation could jeopardise the maintenance of the necessary pool of skilled staff. A more obvious preliminary to privatisation, which the Home Secretary recommends, would be to espouse the BBC's proposal that they set up their transmission operation as an arms length subsidiary of the Corporation. If this option were to be contemplated, it would be essential to ensure that the subsidiary operated on commercial lines and in particular that there was no cross-subsidisation of the Company by the Corporation. The subsidiary might be encouraged to develop on commercial lines if private equity was involved in it. Provided that the subsidiary was established on a basis which did not represent unfair competition to the IBA's successor company, the Home Secretary proposes that the White Paper suggestion that the BBC should be permitted to compete for new broadcasting transmission business while it retains a transmission role, should be endorsed.

16. The Home Secretary notes that establishing the BBC transmission operation as a subsidiary company of the Corporation might generate substantial additional revenue for the BBC, especially if, as the BBC has proposed, it entered into joint ventures with the private sector to use its transmission assets for telecommunications purposes. Such a step would depend on the outcome of the telecommunications duopoly review, but it could establish the BBC as a major player in the telecommunications industry and provide a substantial alternative source of income to the licence fee. The Home Secretary argues that the terms of Charter itself, his own power to determine the basis on which the subsidiary was established, and the telecommunications licensing regime, would together provide adequate safeguards. On the other hand, it could be argued that the establishment of a transmission subsidiary on the lines envisaged would be of a wholly different order of magnitude from any income generation proposal previously contemplated. You may wish to invite the Group to consider carefully whether the safeguards referred to by the Home Secretary are sufficient to justify the cautious but not negative response which he favours. The Chancellor of the

Exchequer and the Secretary of State for Trade and Industry may have particular views on this proposal.

Regional cost variations: Channel 3

17. The Price Waterhouse report found very significant regional variations in the cost of transmission: for example in the independent television system, the cost per household in the Grampian area is about 20 times higher than that in London. If the smaller companies had to bear the full cost of transmission, it could put them into deficit and might well deter others from bidding for the franchise. The Group has already decided that Channel 3 should continue to be a universally available channel and that while it is not immutable, there should be a presumption that the present regional map of Channel 3 will continue at least initially. There was also a general feeling among members of the Group following the presentation by Mr Russell at the meeting on 11 May that the negative tender concept was not an acceptable way round the transmission cost problem. Accordingly, the Home Secretary proposes that the costs of transmission should be apportioned between all Channel 3 companies on the basis of a national tariff which would link the charge to the proportion of United Kingdom television households in the franchise area. Such an arrangement would mean that programme companies could not negotiate individually with privatised transmission operators. If, in the longer term, there are changes in the present regional arrangements, for example linking some of the larger with some of the smaller franchise areas, it would be possible to contemplate moving away from this arrangement. You may wish to invite the Home Secretary to confirm that there would be flexibility to alter his proposed system in future if a more competitive arrangement becomes feasible because of changes in the regional structure. The Secretary of State for Scotland and the Secretary of State for Wales will, of course, have a particular interest in the outcome of this part of the discussion.

World Service

18. In his minute to you of 16 June, the Foreign Secretary proposed that the World Service transmission system should remain in the public sector and that the BBC should be asked to propose options for the cost effective operation of the World Service system in the new domestic transmission environment. This is in line with the conclusions of the Price Waterhouse report which found that any sale of the World Service transmission facilities would be unattractive because the Foreign Office could not guarantee funding of the World Service for more than 3 years at any one time. As the Official Group noted (paragraph 28 of MISC 128(89)9), the arguments advanced by Price Waterhouse do not rule out privatisation in principle. They do, however, present significant practical obstacles to privatisation. If privatisation of the transmission assets themselves is discarded, it would nevertheless be possible to contract out their management, operation and maintenance to one of the new transmission companies or to another private sector operator. Another possibility would be the establishment of a BBC World Service in-house short wave transmission group. The Foreign Secretary recommends that these options should be explored further with the BBC.

19. After inviting the Foreign Secretary to introduce this aspect of the discussion, you may wish to determine whether the Group agrees with the Foreign Secretary's conclusion that the World Service transmission assets should not be privatised but that the BBC should be invited to propose options for the cost-effective operation of the system in the context of the new domestic transmission arrangements previously agreed by the Group. Are there any conditions which the Group would wish to impose on this exercise (for example, should the BBC in-house option be ruled out)? And is the Group prepared to accept that if the BBC's domestic transmission system is privatised, this may result in increased costs to the World Service which would have to be found through the annual FCO grant-in-aid? The Chancellor

of the Exchequer may wish to comment particularly on this point.

Announcement of the Group's decisions

20. Paragraph 12 of the Home Secretary's paper (MISC 128(89)10) proposed that there should be an early announcement of the Group's decisions on future transmission arrangements. This seems sensible, given in particular the uncertainty among staff of the BBC and IBA. You will wish to establish that the Group is content for an announcement to be made by way of an arranged written Answer and in particular that the Foreign Secretary agrees that this should cover the position of the World Service. You may wish to invite the Home Secretary to circulate a draft of the proposed announcement to other members of the Group.

HANDLING

21. In addition to the usual membership of the Group, the FOREIGN SECRETARY will be present for the discussion of the World Service transmission arrangements. You may wish to begin the meeting by inviting the HOME SECRETARY to introduce his paper, and then follow the order of the conclusions set out in paragraph 9 of that paper (which corresponds with those in this brief). The CHANCELLOR OF THE EXCHEQUER will be concerned to ensure that the proposals put forward by the Home Secretary and the Foreign Secretary achieve, within the constraints of the practical, the maximum opening up of the transmission system to competitive disciplines and the optimum return on the transmission assets to the Treasury. The SECRETARY OF STATE FOR TRADE AND INDUSTRY will have a particular interest in the read-across from the present proposals to the telecommunications duopoly review. And the SECRETARIES OF STATE FOR WALES AND SCOTLAND will be concerned that any decisions taken do not damage the financial viability of the smaller regional production companies operating in high cost transmission areas.

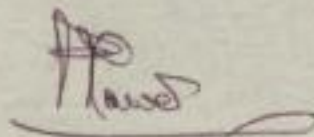
BBC NIGHT HOURS

22. In his minute to you of 14 June the Home Secretary proposed the reversal of the Group's earlier decision that one set of night hours should be removed from the BBC and assigned to the ITC for allocation by competitive tender for the provision of new services. The Home Secretary argued that it would not make sense to deprive the BBC of a set of night hours at the same time as encouraging them to expand their subscription services, and that the Group's decision that there should not be a separate night hours licence for Channel 3 also points towards reversing the Group's earlier position. If both sets of night hours were left with the BBC it would be made clear to the Corporation that the review of the licence fee in 1991 would assume that the retention of both sets would enable them to earn significant amounts of subscription income.

23. The Home Secretary suggested that if colleagues saw any difficulty with his proposal, the matter could be discussed at the Group's meeting on 21 June. I understand that the Secretary of State for Trade and Industry may favour discussion of the issue, on the grounds that the case made by the Home Secretary is unconvincing and that awarding both sets of night hours to the BBC would be detrimental to competition.

FUTURE MEETINGS

24. A further meeting of the Group has been provisionally arranged for 4 July. Provided that decisions on future transmission arrangements can be made at the meeting on 21 June, it is unlikely that this further meeting will be required. There are a number of other relatively minor issues still to be decided, but these should be capable of resolution through correspondence. If so, this may prove to be the last meeting of the Group.



P J C MAWER

16 June 1989