



PRIME MINISTER

TRANSMISSION AND NIGHT HOURS

mainly attended

At MISC 128 on 21 June I was asked to circulate draft announcements about our decisions on transmission and the BBC night hours.

2. I attach drafts of Arranged Questions on these two subjects. I would like to make these announcements on 4 July, and I should therefore be grateful for any comments by noon on 3 July.

3. The one issue which we left open was what arrangements should be made to mitigate the effects on the smaller Channel 3 companies of the wide regional variations in the cost of transmission. I attach a note prepared by officials which analyses the options.

4. The proposal put forward by the Financial Secretary is an ingenious one, and I see the attractions in allowing Channel 3 companies to procure transmission facilities individually rather than collectively. However, I also see two major difficulties with this approach:

- (a) it could lead to the smaller Channel 3 companies being cross-subsidised by Channel 4 (or S4C in Wales), and in some places by Channel 5. This would be a perverse result. If the weaker Channel 3 companies need support, then the stronger Channel 3 companies are the natural candidates to provide it, not Channels 4 and 5;

(b) it would not be clear whether the smaller companies would be viable until they had completed their negotiations with the transmission company. The continuing uncertainty (which would last until well into 1992), might well make it impossible to stick to the present map at all. We would be letting ourselves in for three more years of political difficulty on this subject.

5. I therefore think that we have a choice between a tariff based on NAR and one based on population share. The advantages and disadvantages of these two approaches are evenly balanced. Colleagues at MISC 128 appeared in general to favour the NAR option, and I am content with this. As the note by officials points out, the tariff would in fact have to be based on each company's share of the total relevant income of the Channel 3 companies, taking account of sponsorship and subscription income as well as advertising revenue.

6. Although we have decided that the BBC should not be permitted to compete for new broadcasting transmission business, some of the new broadcasting services will, as a matter of practical necessity, have to be transmitted from BBC masts. There may be other back-up technical facilities which can only be provided by the BBC. The draft announcement therefore does not exclude this.

7. If possible I should like to include our decision on engineering and R and D in the transmission announcement. If, however, it does not prove possible to settle this issue in time, I would propose to press ahead with the transmission announcement on 4 July, leaving the other matters to be dealt with separately.

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

Catherine Barnock

Approved by the Home Secretary
and signed in his absence.

29 June 1989

DRAFT ARRANGED PQ ON PRIVATISATION OF THE TRANSMISSION SYSTEM

To ask the Secretary of State for the Home Department if he will make a statement about the privatisation of the terrestrial broadcasting transmission system in the light of the Price Waterhouse report.

DRAFT REPLY

In the White Paper on Broadcasting we stated that our objective was to move the terrestrial transmission system progressively into the private sector. The Price Waterhouse report analysed the various ways in which this could be achieved. In the light of that report, we confirm that our intention is to privatise the transmission networks owned and operated by the BBC and the IBA as soon as we are in a position to do so. We believe that a move into the private sector will reinforce the pressures for efficiency, and will enable more intensive use to be made of the valuable transmission infrastructure.

We have considered carefully the different possible options for the structure of a privatised transmission industry. On balance we have decided that the best approach would be to set up two national transmission companies based on the present BBC and IBA transmission networks, rather than to restructure the system in the way proposed in the Price Waterhouse report.

The BBC's transmission responsibilities are rooted in their Royal Charter which lasts until the end of 1996. They have

indicated that they do not wish to have these responsibilities transferred to a private transmission operator. We have therefore decided that the BBC should retain their transmission responsibilities, including for the World Service, until the expiry of the Charter. The position will be reviewed at that point with a view to privatisation. In the meantime, the BBC will be confined to transmitting its own services, and will not be permitted to compete for the transmission of new broadcasting services. However the BBC will be allowed to provide essential, ancillary services to private transmission companies where necessary. We are concerned that the private transmission market should develop in a fair manner; and, while the BBC's transmission operation remains in the public sector, there would be insuperable difficulties in ensuring that the BBC entered this market in a way which would be perceived to be fair to its competitors.

The IBA have welcomed the proposal that their transmission operation should be privatised, and we will be including the necessary provisions in our legislative proposals on broadcasting. We shall be considering further the timescale for privatisation, bearing in mind the possible implications for the ITV contracts. We have taken note of the wide regional variations in the cost of transmission, and of the possible consequences of these variations for the smaller Channel 3 companies. We propose that there should be a uniform tariff for Channel 3 companies based on their share of the total Channel 3 income, taking account of any subscription and sponsorship revenue as well as net advertising revenue.

The private transmission company which takes over the IBA's transmission operation will have a powerful market position. We therefore consider that economic as well as technical regulation will be necessary. We propose to amend the Telecommunications Act 1984 to enable this regulation to be carried out by the Director General of Telecommunications. This

regulatory framework will be designed to ensure that the transmission market operates fairly, and also that the coverage, quality and reliability of the system is maintained.

[IBA R & D]

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DRAFT ARRANGED PQ ON BBC NIGHT HOURS

To ask the Secretary of State for the Home Department if he will make a statement about the proposal in the broadcasting White Paper that the night hours of one BBC channel should be assigned to the ITC.

DRAFT REPLY

We have considered carefully the comments we have received on this proposal. We have decided on balance that it would be better to leave the BBC with both sets of night hours in order to enable a faster start to be made with the development of subscription services. The BBC will therefore be permitted to retain both sets, on condition that it makes the fullest possible use of them for raising subscription income, consistent with its public service obligations.

When we come to consider the level of the licence fee from April 1991 onwards we will review the use which the BBC is making of the night hours. The level at which the licence fee is set will take account of the BBC's capacity to generate subscription revenue from two sets of night hours.

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TRANSMISSION CHARGES FOR CHANNEL 3

Note by the Home Office

At MISC 128 on 21 June Ministers decided that a mechanism should be devised to mitigate the effects of the regional variations in the cost of transmission upon the smaller Channel 3 companies. Officials were asked to examine two options:

- a. a system in which the smaller Channel 3 companies would approach a national transmission operator in their areas, offering to pay a charge slightly exceeding the marginal cost of transmitting their service; and
- b. a national tariff based on shares of Net Advertising Revenue (NAR).

In examining option (b) this note compares it with a national tariff based on population shares.

Marginal cost system

2. Under this system individual Channel 3 licensees would procure their transmission facilities individually rather than collectively. The companies would approach a national transmission operator capable of providing a service in their areas and negotiate a price. In practice the transmission operator would want a price exceeding the marginal cost of transmitting their service.

3. As the BBC is not to be permitted to provide transmission facilities to other broadcasters, the Channel 3 licensees would initially have to be transmitted by the IBA's privatised successor. (In theory it would be possible, in some areas at

least, for a new entrant to offer an alternative service using BBC masts. But as it is hard to see how this operator could be transmitting any other services, the marginal cost of transmitting the Channel 3 licensee would be equal to the full cost). The IBA's privatised successor would also be transmitting Channel 4 and (in some areas) Channel 5. As the Channel 3 licensee would not be bearing his share of the transmission operator's fixed costs these would have to be recovered from Channel 4 and (in some areas) Channel 5. Channels 4 and 5 would therefore be subsidising the Channel 3 licensees. The extent of cross subsidy would depend on the prices which the transmission company could negotiate with C3 licensees. The assumption would be that it would seek the maximum contribution the market would bear from each C3 company towards its fixed costs. This might mean a higher price for the richer C3 companies and a lower (marginal) price to those of slender means but still one which provided some income and profit which would be foregone if their business was not there.

4. The transmission operator's charges will be subject to regulation by Oftel who would not normally allow fixed costs to be recovered disproportionately. Special provision would therefore need to be made for this in the transmission operator's licence. Oftel would also ensure that the transmission company did not exploit its position excessively with either rich or poor licensees.

5. Following the privatisation of the BBC's transmission operations after 1996, this arrangement would offer the greatest opportunity for market forces to operate, as individual Channel 3 licensees would be able to switch from one transmission company to the other.

NAR tariff

6. The main advantages of a NAR tariff is that it is transparent; is capable of being applied as a uniform national tariff; and, most importantly, it links the charges for local transmission to the earning power of the local network. But, as with national tariffs for utilities such as the postal service, it would have only a tenuous link with the actual costs of providing these local services. Between them the five small companies would pay £1.61m (on the basis of present NAR shares) against actual costs of £7.51m. Nevertheless, they would pay more than twice as much for transmission as they do at present, and their share of C3 transmission costs is projected to increase further over the years.

7. Under the Government's proposals Channel 3 companies (like all independent broadcasters) are to be permitted to raise revenue through subscription and sponsorship as well as advertising. The NAR tariff proposal should therefore presumably be widened to take account of these two other sources of revenue. The result would be a formula based on Channel 3 companies' share of the total Channel 3 revenue from advertising, subscription and sponsorship. This broader approach would be consistent with the decisions announced about competitive tender.

8. Any tariff based on revenue shares would act as a disincentive to Channel 3 companies to increase their share of the Channel 3 market, although they would have a powerful general incentive to increase their overall revenue (and their share of overall NAR) and reduce costs in order to remain profitable.

9. The effect of a NAR tariff is likely to change over the next franchise period as illustrated in the table (which is based on

financial modelling by the IBA). The main reason for this change is that the penetration of Channel 5 will vary from region to region. Where a Channel 3 licensee is subject to competition his NAR will tend to be depressed, leading his share of the total Channel 3 NAR to fall. Conversely, a Channel 3 licensee who is subject to little competition will find his share of the Channel 3 NAR tending to rise, even if his NAR is not growing in itself. The small Channel 3 companies are likely to be subject to less competition than the others (mainly because of the limited geographical coverage of Channel 5), and so their aggregate share of the Channel 3 NAR is likely to rise over the next franchise period.

Population share tariff

10. An alternative approach would be a tariff based on population share. The main advantages of this approach are that it would be simple, predictable and (like the charging arrangements for other universally provided services, such as the postal service) would be based on the proposition that there should be a uniform charge for serving each individual person or household. The main disadvantage is that it would not take account of the differences in the earning power of different transmitters, attributable to the varying attractiveness to advertisers of the populations which they serve - though this is, of course, a point which would be reflected in the competitive tender mechanism.

Comparison of NAR and population share tariffs

11. On the basis of the 1989 NAR shares a NAR tariff would be more beneficial than a population share tariff to all of the five small companies, except Channel. However, according to the IBA projections, the population share tariff would be more beneficial than a NAR tariff to TSW as well as Channel by 2002.

While Grampian would still be better off with a NAR tariff the gap would have narrowed. By 2002 the aggregate transmission charges paid by the five small companies would be roughly the same under either tariff system.

12. Among the larger companies, Thames, LWT and TVS would all pay more under a NAR than a population share tariff. In the case of TVS this disparity would grow (because Channel 5 will not have UHF coverage over large parts of its franchise area). As to the medium sized companies, HTV and Tyne Tees would pay more under a population share tariff (though in the case of the former the difference would disappear by 2002). TV-AM would be significantly worse off with a population share tariff.

13. It would be necessary to make clear how long any arrangement based on cross-subsidy between Channel 3 companies would last. If it lasted for the whole of their licence period it would bind the companies to seeking transmission facilities collectively for ten years. This would restrict competition with the privatised BBC operator after 1996, or any potential new entrant to the transmission market.

Home Office
June 1989

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EFFECT OF DIFFERENT TRANSMISSION TARIFFS ON CHANNEL 3 COMPANIES

	<u>Actual</u> <u>Costs</u>	<u>Present</u> <u>Tariff</u>	<u>Population</u> <u>Share</u>	<u>NAR</u> <u>(1989)</u>	<u>NAR</u> <u>(1997)</u>	<u>NAR</u> <u>(2002)</u>
Thames	0.67	4.19	3.00	4.05	3.7	3.6
LWT	0.35	3.15	1.74	3.04	2.7	2.6
Central	2.41	3.97	3.88	3.84	3.7	3.6
Granada	1.23	2.93	2.84	2.84	2.4	2.2
Yorkshire	1.46	2.38	2.44	2.30	2.2	2.2
TWS	2.57	3.12	2.17	3.02	3.7	3.9
HTV	3.54	1.72	1.94	1.67	2.0	2.1
Scottish	1.93	1.48	1.44	1.43	1.3	1.3
Anglia	1.23	1.78	1.71	1.72	2.2	2.4
Tyne Tees	1.44	0.99	1.31	0.95	0.9	0.9
TSW	1.86	0.39	0.68	0.66	0.9	1.0
Ulster	1.14	0.14	0.63	0.40	0.4	0.4
Grampian	2.81	0.14	0.50	0.32	0.3	0.4
Border	1.35	0.03	0.27	0.19	0.2	0.2
Channel	0.35	0.01	0.05	0.08	0.1	0.1
TV-AM	3.75	1.67	3.51	1.61	1.4	1.4

Notes:

1. Figures based on a total charge for Channel 3 of £28.09m, which includes an assumed return on capital of 5%. Numbers do not necessarily amount to £28.09 due to rounding.

2. Actual cost and population share figures for Thames, LWT and TV-AM are time apportioned.

3. Figures for 1997 and 2002 assume 70% coverage of Channel 5; penetration of 65% within coverage areas; and viewing share of 21.5% within households equipped to receive it.