



cc/nc

W0396

MR ADDISON - NO 10

14 May 1985

INFORMATION TECHNOLOGY ADVISORY PANEL - REPORT ON CABLE SYSTEMS.

I had expected to see a copy of the Secretary of State for Trade and Industry's reactions to the ITAP report which, as you mentioned in your minute of 30 April, has now been completed. However, this has not yet been made available to me and I therefore have difficulty in commenting on your minute. Perhaps you could forward me a copy of the document received in No.10 so that I can advise on the handling.

PP SIR ROBIN NICHOLSON
Chief Scientific Adviser

Tane Lane

CF
Please Sir RN a copy of
the DTI minute, + attachment.

MSA 15/5

CF
PL ✓ or 28/5.

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to

10 DOWNING STREET

From the Private Secretary

Sir Robin Nicholson

Information Technology Advisory Panel
Report on Cable Systems

Further to my note of 30 April, we have now received the attached minute from the Home Secretary.

I note the Home Secretary talks of making an announcement about the future licensing of MATV systems in a fortnight. We ought to have a word about how this would affect the overall timetable for responding to the panel's report.

Robin Nicholson MA

13 May, 1985.

- (1) Popping of IT/S to go ahead. with announcement - MATV. No need for action on part.
- (ii) RN will let us have a draft letter for the PM to send ITAP chairman, to wait in the DTI/HO response.

MEAT 21/5



Prime Minister

INFORMATION TECHNOLOGY ADVISORY PANEL (ITAP) REPORT ON CABLE SYSTEMS:
A RE-ASSESSMENT

I have now seen Norman Tebbit's minute to you of 26 April setting out his Department's response to the recommendations of the ITAP Report on cable systems.

As Norman says, most of the recommendations fall to his Department and I am entirely in agreement with the general lines of his response. My Department has a part to play in relation to the first recommendation which concerns a public restatement of the Government's commitment to the cable industry. In his speech to the Financial Times Conference on Satellite and Cable on 19 March, Giles Shaw made it clear that the Government's support and confidence in cable remained as strong as ever; and we shall continue to take the opportunity of future Ministerial speeches to complement the public statements by Ministers from the Department of Trade and Industry. Both our Departments have been working closely in recent months towards a statement on the future licensing of MATV systems (Recommendation 4) and, with Geoffrey Pattie, I have recently discussed with the shadow Satellite Broadcasting Board the implications of a relaxation in these rules for the proposed service of direct broadcasting by satellite. It now appears that we should be in a position to make an announcement on these matters in about a fortnight's time.

/I agree with

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I agree with Norman that the Report does not offer any radical proposals which will resolve the current problems of the cable industry over night. Nevertheless, the Panel's recent statement of their own support for cable, and the Government's response, should serve to make some contribution to the slight improvement in confidence in the industry that we have noted this year.

Copies of this minute go to Norman Tebbit, Nigel Lawson and David Young.

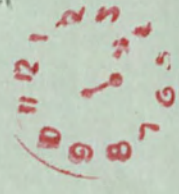
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13 May 1985

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10 DOWNING STREET

From the Private Secretary

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SIR ROBIN NICHOLSON

CABINET OFFICE

INFORMATION TECHNOLOGY ADVISORY PANEL (ITAP)

REPORT ON CABLE SYSTEMS: A RE-ASSESSMENT

The Secretary of State for Trade and Industry has now reported with his considered reactions to the ITAP Report. No doubt we can expect others to chip in. His reply is I think more luke-warm than your earlier reaction to the Report.

I should be grateful for a word next week on how we should take this forward.

WBA

30 April 1985

SMH



CC NO
~~CC Sir~~
Nicholson

PRIME MINISTER

INFORMATION TECHNOLOGY ADVISORY PANEL (ITAP) REPORT ON CABLE SYSTEMS : A RE-ASSESSMENT

I have now had an opportunity to consider the report by ITAP on Cable Systems which was circulated under cover of your Private Secretary's letter of 13 March. Most of the report's recommendations fall to this Department to respond to and I am enclosing with this minute a note setting out some detailed comments on each of the Recommendations.

2 At the more general level, the report is welcome in that the Panel have reaffirmed the view expressed in their first report in 1982 that the cabling of Britain should bring with it significant opportunities for increased economic activity, employment and improved communications. The development of the Government's cable policy over the last three years was to a large extent inspired by ITAP's first report and it is reassuring that despite the industry's recent set-backs, the Panel still have faith in cable's ability to deliver these benefits.

3 Turning to the report's Recommendations, I am bound to say that the Panel have not in my view come up with any proposals which would dramatically change the fortunes of the industry overnight. In some cases the Panel's recommendations propose action that is already in hand. For example, Geoffrey Pattie and John Butcher have recently been emphasising, in line with the Panel's first recommendation, the Government's commitment to the cable industry and, in the coming months, we will continue to press home this message.

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Similarly I wrote on 25 March to Leon Brittan, in the context of Recommendation 4, proposing a relaxation of the rules governing Master Antenna Television (MATV) on the grounds that an expansion of smaller systems of this kind will open up new opportunities for programme providers, cable operators and equipment manufacturers. I hope therefore that it will be possible to respond favourably to the Panel's proposals in this area.

4 The remaining recommendations of the report are much more difficult to accept. One of the Panel's main conclusions is that the cable industry will not be able to realise its potential unless some financial assistance is made available by Government to help cable operators sustain the high level of start-up costs. The Government's policy has always been that the cable industry should be privately financed and the White Paper on Cable Systems and Services of April 1983 deliberately rejected the view that the costs of cabling Britain should be covered in whole or in part by increased public expenditure. I have considerable difficulty, therefore, in accepting the proposals, contained in paragraphs 31-33, for providing cable operators with increased levels of Government funding. While it is claimed in paragraph 33 that the objective is to bring the costs of cabling within "existing arrangements from DTI and other Departments", the proposed changes to the BES, for example, would in fact amount to the creation of a new scheme for the cable industry with all that this would entail in terms of increased public expenditure and the creation of a new form of fiscal distortion. Of the schemes put forward by the Panel for improving the financial climate for cable, I therefore greatly prefer that contained in Recommendation 6 where it is suggested that Government should fund a limited number of demonstrator projects. This proposal could be

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followed up under the revised arrangements for Support for Innovation which, as you know, will place increased emphasis on projects that benefit industry as a whole. However, while my Department will be looking to provide such support, particularly for the development of interactive services, it is doubtful whether the Department's budget for SFI will be sufficiently large to enable us to make available the level of funding which the Panel are envisaging.

5 The final proposal in the report on which I would like to comment separately is Recommendation 2 which relates to the making available of BT (and Mercury) ducts and poles for the installation of cables. The idea has considerable attractions in that it would undoubtedly give immediate encouragement to independent cable providers and would also help to reassure those who are concerned about the effect of the major street works that are a necessary part of installing a system from scratch. But there are significant obstacles to achieving what ITAP propose and I think we must be wary of assuming, as the report appears to do, that access to the existing infrastructure owned by BT would be a panacea - Mercury's is insignificant for the purposes of cable.

6 The ability to install more overhead cable would certainly reduce costs in some areas where BT's existing distribution is by means of poles. We must recognise, however, that the commercial arrangements BT have made with the pilot franchise holders with which it is involved reflect its position as an investor in the particular cable systems concerned. This investment takes the form of paying for the installation of the system, the use of which is then leased to the company operating the cable system, a company in which BT's own cable subsidiary has a minority interest. This "banking" role is one we could not expect BT to take on in

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relation to all cable systems. Nor, for the reasons given in the report, would we want to encourage BT to become in effect the common carrier for cable. Thus the "reasonable and equitable terms" for permitting access to ducts etc would have to reflect the fact that a pathway was being provided for a potential competitor to BT in the provision of the whole range of telecommunication services and that their normal network renewal and development programmes were being distorted in response to the requirements of cable operators. Given these uncertainties I do not think it is possible accurately to quantify the cost reductions that would occur if ITAP's recommendations were put into practice.

7 I am bound to emphasise these constraints because the ITAP proposals would come as most unwelcome news to the Board of British Telecom. They would rightly respond that the prospectus, on the basis of which the flotation took place, made no reference to any possible development of this kind. They would also be bound to draw attention to the fact that the company's network of ducts and poles is arguably its most important asset. In my view, our freedom of action in this area is severely circumscribed by the assumptions underlying the statements made in relation to the flotation.

8 We must also recognise that legal powers are by no means as wide as paragraph 23 of the report suggests. I suspect that the Panel have failed to recognise that the structure of both the Telecommunications Act and the Competition Act severely limits the ability of Ministers themselves to take action. There are no provisions in the BT and Mercury licences for their main public telecommunication system which would give the Director General of Telecommunications (OFTEL)

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a lever with which to insist that cable providers were allowed access to ducts etc. He could propose a modification of the conditions of those licences which, subject to further consideration, might help to achieve that result, but on the assumption that BT resisted his proposal, the matter would have to be referred to the Monopolies and Mergers Commission. And as far as the Director General is concerned, it is worth remarking that I have no powers to set this train of events in motion. The Director is an independent creature of statute and all I could do would be to draw the issue to his attention.

9 A similar difficulty arises in relation to the Competition Act where an investigation into restrictions on BT's use of its ducts would rely on the Director and his counterpart, the Director General of Fair Trading (who have joint jurisdiction in relation to that legislation as it affects telecommunications) deciding that such an investigation should be mounted. I would add a further qualification in this context because the anti-competitive effects which are referred to in paragraph 23 of the report are not clear cut. The Cable Authority has said that it does not envisage awarding more than one franchise for the provision of cable programme services over a broadband system in any one area for the foreseeable future. Whilst there may be more than one applicant for a particular franchise, our criteria would not give preference to a BT-led proposal simply because it was less costly. It is not clear, therefore, whether such action by BT could fairly be described as squeezing out the competition in any one area and whether a refusal by BT to make its ducts etc available would constitute a "course of conduct" in relation to which action could be taken under the Competition Act.

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10 It seems to me, therefore, that the only realistic option is to consider whether we can use our ability to withhold new licences to persuade BT to co-operate. (As far as Mercury is concerned the threat of withholding cable licences would be of no concern since they do not currently conceive of their role in cable as that of cable provider). Even doing that would, as I have indicated, be to step into a minefield. The negotiations with BT over the terms of the telecommunications licence that is to apply in relation to the pilot projects with which the company is involved (the terms of which are designed to safeguard the competitive environment) revealed that BT were quite prepared to walk away from cable altogether if our terms were unacceptable. However meritorious ITAP's proposal I am sure that in the light of the present fragile state of confidence in cable a departure by BT would be more damaging than the status quo.

11 Despite these qualifications I do not think that we should ignore the recommendation and I have asked my officials to approach BT to find out what steps they might be prepared to take to respond positively to the report. For this reason I have not included in the attachment to this letter a formal response to the second recommendation. I have asked officials to report to me after they have ascertained the preliminary reactions of BT and I shall then consider how we should proceed.

12 Copies of this minute and attachment go to Nigel Lawson, Leon Brittan and David Young.

NT

26 April 1985

JH5AZA

Department of Trade and Industry

DRAFT

DEPARTMENT OF TRADE AND INDUSTRY RESPONSE TO THE ITAP
REPORT "CABLE SYSTEMS : A RE-ASSESSMENT"

General

1 The main conclusion of the ITAP report is that confidence in the financial viability of cable has now deteriorated to the point where Government must take corrective action to prevent the cable industry from failing to take advantage of the commercial and industrial opportunities which ITAP identified in their first report in 1982. ITAP take the view that this downturn in confidence has been caused by a variety of factors, notably the decision in 1984 to phase out capital allowances, the slow progress in reaching agreement on the licences for the pilot cable systems, a weakening of Government commitment to the industry and uncertainties about the level of demand for interactive services. ITAP's package of measures is designed to restore the confidence of potential investors in cable and so pave the way to the creation of a national network of advanced cable systems capable of offering a wide range of interactive services.

2 There is much in the report which the Department of Trade and Industry supports. In contrast to some sections of the cable industry, ITAP remain fully committed to the policy of using cable as a vehicle for introducing new forms of interactive service in both the domestic and business sectors. Their analysis in paragraphs 18 and 19 is a powerful case against those in the industry who argue that the present difficulties faced by cable operators will inevitably result in a

reduction in the quality of the technology. We also welcome ITAP's endorsement at paragraph 10 of the report of the Department's flexible approach towards the timetable for upgrading systems to full interactivity.

3 However, even allowing for the short timescale in which ITAP completed its work, it has to be said that much of the report is a considerable disappointment. There is a misguided but perhaps understandable tendency to blame all of cable's current difficulties on Government. One important contributory factor to the industry's problems which ITAP fails to mention are the problems experienced by the equipment manufacturers in producing the switches that will be required for the more advanced cable networks: the delays and increases in price have caused cable operators considerable difficulty. The report also ignores the significant steps that Government has taken to promote the development of cable. These include the decision earlier this year to include cable as a qualifying activity for regional development grants, the extension by three years of the length of the telecommunications licence out of recognition of the difficulties caused by the phasing out of capital allowances, and the significant levels of financial support that the Department has already provided equipment manufacturers under the Support for Innovation programme. However, the Department's main concern is that the recommendations which ITAP put forward are, with a few exceptions, unlikely to achieve their intended result. The following paragraphs provide a response to each of the seven recommendations contained in the report.

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RECOMMENDATION 1 : The Government should firmly restate its support for cabling Britain and its confidence in the future of cable systems as part of the national infrastructure

4 Mr Pattie has already made some positive public statements about the future of cable following visits to Swindon and Bolton. Mr Butcher will be making a major speech on communication technologies at a Royal Television Society Conference on 16 April and this will provide a further opportunity to put across the message that the Government fully supports the cabling of Britain. However as the report acknowledges, little would be achieved if Ministers were to make a series of over-optimistic statements that were not supported by the facts. The approach, therefore, that we intend to adopt is to link such statements, wherever possible, with the positive developments on cable that are expected in the coming months.

RECOMMENDATION 2 : All necessary legal steps should be taken to ensure that BT and Mercury allow all cable providers access on reasonable and equitable terms to cable ducts, overhead wiring from poles, etc. If the powers available to the Director-General OFTEL under the BT and Mercury licences are not adequate to achieve this then other options ... should be explored

5 Further consideration is being given to this recommendation.

RECOMMENDATION 3 : Cable franchises should be allowed to develop gradually within constraints which avoid lucrative areas being cabled to the exclusion of the remainder of the community. This applies both within

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the typical cable franchise area and, where possible without conflict with consumer interests, beyond the boundary of such an area

6 The draft telecommunications licence which the Department has recently agreed with the Cable Television Association already permits the type of flexible construction programme which ITAP envisages in this recommendation. Condition 1 of the licence includes a timetable for the installation of the system couched in terms of the number of premises passed by particular dates. The approach that has been adopted gives the cable operator complete freedom to choose which parts of his franchise area to cable first. The Office of Telecommunications (OFTEL), who will be monitoring the installation, will need to be satisfied that adequate progress is being made towards the final objective of cabling the whole area by reference to the stated milestones. The Director General OFTEL will have the power to agree changes in the milestones (but not the final completion date) without the need to go through the formal process of modifying the licence condition itself under the procedures set out in the Telecommunications Act 1984.

7 What this means in practice is that the cable operator will have complete freedom to determine the order in which he constructs his cable system but will be under an obligation to ensure that the whole of the licence area is cabled by the end of the installation period. This latter obligation is to avoid the possibility, which ITAP rejects as being undesirable, of the lucrative parts of a licence area being cabled up to the exclusion of the other areas.

8 ITAP also recommends that the cable operator should be allowed some flexibility in extending the cable system beyond the original licence area. This is a matter for the Cable Authority who have already indicated that they are prepared to consider applications for extensions.

RECOMMENDATION 4 : Licences should be granted for the reception of cable programmes from satellites by MATV installations, both new and developed from existing systems, and the period and terms of these licences should encourage the extension of cable systems into full cable networks

9 DTI believes that a carefully controlled expansion of Master Antenna Television (MATV) will be beneficial to the cable industry by providing it with an early source of revenue, increasing the potential audience for programme services delivered from low-powered satellites and opening up new opportunities for equipment manufacturers. The policy which the Department has been developing envisages MATV systems being licensed in a way which does not prejudice the subsequent upgrading of those systems into full cable networks. The Department's approach is therefore consistent with that advocated by ITAP in paragraphs 28 and 29 of the report.

... 10 The Secretary of State for Trade and Industry has recently written to the Home Secretary (see Annex 1) proposing a relaxation in the rules governing both MATV and individual direct reception of programme services from low-powered satellites. Changes in both these areas could have implications for the prospects of Direct Broadcasting by Satellite and before any public announcement can be made, it will be necessary to consult with the Shadow Satellite Broadcasting Board.

RECOMMENDATION 5 : Government should bring cable ventures within the scope of the Business Expansion Scheme, under the supervision of the Cable Authority, and should consider whether other suitable forms of assistance can be made available

11 Contrary to the impression given in the report, cable is not currently excluded from the Business Expansion Scheme since individuals can qualify for relief on investments of up to £40,000 in cable ventures. The Panel's recommendation that companies investing in cable should also qualify for relief on investments of up to £500,000 is open to a number of objections. First, to extend the scheme in this way would have significant public expenditure implications. Companies wishing to invest in areas other than cable would press for similar treatment and these claims would be difficult to resist, particularly in relation to other forms of telecommunication system such as the BT and Mercury networks. The cost to the Exchequer of even a limited extension would therefore be considerable and would be difficult to justify against the background of the Government's cable policy, which has always been that cable development should be private sector financed. A second objection to the recommendation is that the extension of BES to corporate investment would act as a fiscal distortion to investment decisions and would be inconsistent with the Chancellor's objective of seeking to minimise such distortions. The extension would also be incompatible with one of the primary objectives of the BES itself, which has been to encourage a wider share ownership through attracting individuals to invest in companies. Finally if companies were permitted to qualify for BES relief, problems of tax avoidance could also arise with some investments qualifying for relief twice. All these considerations point towards rejecting the Panel's proposal, particularly when the existing

consortium relief arrangements already effectively give relief to companies investing in cable operations.

12 The Panel's remaining proposals in this section are equally difficult to justify. The existing Loan Guarantee Scheme only extends to loans of up to £75,000 and is therefore inappropriate in the context of cable. But setting up a new scheme to cover all the costs of a cable system would be open to the same objections as those which apply to the BES proposal. The Panel's third suggestion - that the installation of cable systems should qualify for home improvement grants - falls within the responsibilities of the Department of the Environment. However, we understand that these grants are intended primarily to encourage the improvement and repair of older, sub-standard properties. To extend the scheme to cover the cost of cabling would therefore be inconsistent with its objectives.

RECOMMENDATION 6 : Government should encourage the development of cable technology by the selective funding of a limited number of demonstrator projects

13 The Department agrees with ITAP that selective funding, in the form of a limited number of demonstrator projects, will be required to encourage cable operators to experiment with new forms of interactive service making use of advanced technology. The Department is therefore considering whether it will be possible to include within the revised arrangements for Support for Innovation an allocation to cover this form of funding. However, even if such an allocation can be made, it is doubtful whether the level of support that will be sought could be accommodated within the Department's overall

allocation for SFI without having to introduce unacceptable cuts elsewhere.

RECOMMENDATION 7 : Subject to the views of the House of Parliament, the proposed Parliamentary IT system should be linked with the Westminster Cable network

14 The idea of linking Government offices in Whitehall and the Houses of Parliament with a broadband cable network has been raised by Westminster Cable Company with this Department and with the House Authorities. There has been active discussion of the idea and we have invited Westminster Cable to put a specific proposal to us. This has not yet been received.

15 Ultimately, of course, any decision on the implementation of such a proposal is for the House Authorities and the CCTA. The CCTA are currently undertaking their own study of the non-voice communications needs of Government Departments as a whole with a view to providing an integrated voice and non-voice services network across Government.

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with a view to providing an interested voice and
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