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PRIME MINISTER

MISC 128: 29 SEPTEMBER 1987

This meeting has been laid on as quickly as possible after your seminar on broadcasting, to enable you to take stock of that occasion and to give instructions for any work that you want put in hand in the light of it.

The main theme that emerged from your seminar was the need for a framework within which competitive broadcasting could expand and thrive while, on the other hand, the interests of the consumer were protected by a proper regulatory system. Accordingly, therefore, Item 1 deals with the possibilities for new services and Item 2 with the question of enforcing programme standards against satellite broadcasting from overseas. The papers for both these items seek instructions for further work, rather than decisions.

Item 3 brings back to the Group a package of questions about ITV and Channel 4 that they have already considered in principle. Although the Official Group's lengthy analysis has been circulated, the Home Secretary's proposals will not be ready before the weekend, and we do not yet know the line that he will take. However, the main points that you will want to consider will be

- i. whether, in the light of recent briefing about the scale and unpredictability of possible satellite broadcasting in the early 1990s, to confirm the earlier decision in favour of auctioning ITV contracts then;
- ii. whether a limit should be placed on the number of franchises that are allowed to be held in the same hands;

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iii. whether Channel 4 should be turned into a separate broadcasting authority (as the Home Secretary originally proposed) or fully privatised (in which case it would be the only national ^{ITV} channel carrying advertising).

Separate briefs on Items 1 and 2 are attached. A brief on Item 3 will come forward after the weekend.

ALL

A J LANGDON

25 September 1987

Encs

cc BUP
BCA

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1. MATTERS ARISING FROM THE PRIME MINISTER'S SEMINAR

PROVISION FOR ADDITIONAL PROGRAMME SERVICES: MISC 128(87)5 ^{with DRN}

CONCLUSIONS

You will wish the Group to take a view on the choice posed in paragraph 14 of the report from the Official Group - whether to continue to inhibit the emergence of competition with cable and DBS, or to ensure that artificial restrictions on competition are kept to the minimum.

2. If the Group takes a decision in principle to expose DBS and cable to competition, then you will wish to commission the further work that would be needed to enable an informed decision. These studies could not be completed in confidence.

BACKGROUND

3. As you will recall from your recent briefing and from the seminar, the Peacock Committee proceeded on the assumption that spectrum scarcity was one of the central factors in broadcasting policy, and that competition to the BBC and ITV would be represented by DBS and cable for the foreseeable future. In the long term, Peacock saw an interactive cable grid as providing the market he sought, and that looks more and more questionable.

4. At your seminar it was argued that the technology now exists, given the right Government decisions, for a very considerable expansion of programme services in the short to medium term. The possibilities (and they are no more than possibilities as yet) for MMDS emerged from the outside contributors to the seminar. Furthermore, it was argued that there is sufficient room in the UHF spectrum

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to accommodate a fifth channel provided that national coverage was not attempted. The present paper attempts to take all these issues a stage further.

MAIN ISSUES

5. The paper covers a lot of very complex ground, and you will wish the discussion to concentrate on the absolutely essential issues. For that purpose, you may find it helpful to have the following guide to the paper.

MAIN POINTS RAISED IN THE REPORT FROM THE OFFICIAL GROUP

6. Paragraphs 1-10 are a historical summary setting out the growth of policy on cable and DBS to date, noting the decision to allow the direct reception of non-DBS satellite broadcasting and summarising (in paragraph 9) the current plans for the whole range of television broadcasting.

Paragraphs 11-13 describe how cable has run into the doldrums and sketch in the possibilities for MMDS and spare spectrum on UHF.

Paragraph 14 poses the basic choice whether or not DBS and cable should be protected from MMDS.

Paragraphs 15-17 fill out the considerations that need to be taken into account on either side of the question posed in paragraph 14.

Paragraphs 18-20 open up a different dimension of the question. What they ask, in essence, is whether the present public service broadcasting requirements should, over time, be relaxed as ITV faces competition from other broadcasters searching for advertising revenue, and as the licence fee may become harder to justify in a world of highly competitive and varied television broadcasting.

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THE LONG TERM FUTURE OF PUBLIC SERVICE BROADCASTING

7. The question posed at the end of the Official Group's report is obviously a fundamental one that is likely to assume greater importance over the years. For immediate purposes, however, you may wish to set it on one side. The whole work of MISC 128 so far has been to develop mechanisms to encourage efficiency in the BBC and ITV and, on present form, these measures will form a large part of any forthcoming White Paper and Broadcasting Bill. Eventually, the existence and size of the licence fee may well need to be put under radical review, as may the public service broadcasting requirements on the services under the IBA. But such a review is hardly compatible with the assumptions under which all recent decisions have been made. And it would only become necessary if the competitive world of television opens up very quickly and successfully. That may well happen, but equally it may not. I suggest, therefore, that you will not wish the Group to get drawn into discussions at this stage about academic possibilities of policy questions that the Government would only have to face in the 1990s. Having said that, it may well be useful to the Group, at a rather later stage, to develop a working assumption about the period for which the present BBC and ITV arrangements can be counted on to endure.

IMMEDIATE DECISIONS

8. The questions that need to be settled straight away are mainly focused on what needs to be done to enable decisions to be taken whether to allow MMDS to proceed in competition with cable and DBS. The preliminary question is the one posed in paragraph 14a - is there a good case on merits for continuing to protect cable and DBS, and would the Government's position vis a vis these interests be sustainable if new competition were authorised? If it is agreed in principle that further competition is to be encouraged, then there are basically three groups of questions that would need to be resolved before a decision could be taken to enable MMDS or a fifth

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UHF channel to proceed, and these three topics require rather different processing.

i. What is the technical feasibility (including the timescale of any necessary development)?

While there should be sufficient expertise within DTI to provide the necessary advice on spectrum availability for a fifth UHF channel at less than national coverage, that is not true for MMDS. The Department could only advise on this by putting in hand some consultancy study which would certainly become known outside Government. Whatever risks there might be in publicity can probably be taken under cover of following up your seminar, but the Trade Secretary will doubtless have a view on this.

ii. The Financial Regime

Basically, choices would have to be made on the mix that would be allowed of advertising and subscription financing and how advertising-financed services would relate to the IBA. These are questions of a familiar type, and the Group could begin addressing them when the Home Secretary reports on the results of his consultations on the subscription study, which should come back to the Group at the end of October.

iii. The Regulatory Regime

This raises a host of questions about regulation of programme content, whether the services should be local or national, relationship to the IBA or Cable Authority etc. In the first place, these issues are probably best remitted to the Official Group.

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If the Group wishes to drive ahead with the possibility of new services on MMDS and UHF, therefore, the next step would be to commission DTI to put in hand a quick consultancy study on technical aspects, and to remit the question of the regulatory framework to the Official Group. The precise terms of reference of the consultancy study could be settled in correspondence after the meeting. And it would almost certainly be necessary for the Trade Secretary to write to the DBS and cable interests to give them prior notice of what was afoot before they heard of the study from some other source.

NEXT STEPS

9. It is doubtful whether the work suggested above could be brought back to the Group before, say, the end of November, though the Group ought to be able to consider subscription in the meantime. Since so many lines of work have now been started, you might think it useful to ask the Home Secretary to provide a note for the next meeting summarising what further work is needed before a White Paper can be prepared, and when he hopes to publish it.

HANDLING

10. You may wish to begin with some general remarks about your seminar, recognising that the first two papers on the agenda pursue the two main themes that emerged then.

11. You may wish to ask the HOME SECRETARY and the TRADE SECRETARY to speak first. Both of them will be accompanied by officials, and they may wish to leave the intitial introduction of the paper to them.

12. You may then wish to invite the Group to focus on the choice proposed in paragraph 14 of the paper on which, again, the

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HOME SECRETARY and the TRADE SECRETARY will have the main contributions. You will also wish to ask the FINANCIAL SECRETARY, TREASURY to comment whether the Government is inhibited in any way by its past comments on DBS and cable, as summarised in Mr Hyde's letter annexed to the paper.

13. If it is then decided to commission a DTI study of MMDS you will want to ask the TRADE SECRETARY to comment on the time within which it could be completed and on how he might deal with any publicity.



cc: [signature]

3. ITV SYSTEM AND CHANNEL 4: MISC 128(87)7 and 8

CONCLUSIONS

You will wish the Group to take a clear decision whether

- i. to endorse the Official Group's recommendations about the details of auctioning ITV franchises and operating the levy;
- ii. to place a limit of two on the number of ITV franchise contracts that could be held by the same individual or company; and
- iii. to accept the Home Secretary's proposal that Channel 4 should be established as a separate broadcasting authority, responsible for the sale of its own advertising. (An alternative would be the full privatisation of Channel 4, subject to provisions designed to preserve its distinctive remit. But Channel 4 could stay under the IBA, selling its own advertising, as Peacock envisaged.)

BACKGROUND

2. The Peacock Report recommended that ITV franchise contracts should be auctioned, with an annual review of performance by the IBA; and that Channel 4 should be given the option of selling its own advertising time. The Group considered the Home Secretary's paper on these points at their last meeting on 20 July. There was general agreement about the approach to ITV contracts etc, and the Home Secretary was invited to arrange for officials to work up these points in detail. There was also agreement that power should be taken to require Channel 4 to sell its own advertising, as Peacock recommended, but the Group reserved their position on the Home Secretary's proposal that Channel 4 should be set up as a separate broadcasting authority. Some members of the Group felt that it would be better to go further, and completely privatise

Channel 4. The Home Secretary was therefore asked to arrange for an analysis of the arguments on either side, and to report back to the Group.

MAIN ISSUES

i. Auctioning ITV franchises and operating the levy

3. Paragraphs 2-6 of the paper by the Official Group, MISC 128(87)8, summarise the proposed arrangements that have been worked out in detail between Departments, including the Treasury. Briefly, tenders for contracts would be invited on the basis that applicants would have to pass an initial quality threshold; the levy would be based on advertising revenue per television household in the contractor's area, at a progressive structure of rates; Peacock's suggestions of reserve prices for contracts and a lengthening of the contract period to 10 years are not recommended; but it is proposed that there should be an annual performance review on the lines that Peacock suggested. All these points are much in line with what the Group envisaged at their last meeting, and I do not think that you need spend long on the small print now.

4. You may, however, wish the Group to pause for a moment to confirm that nothing in the volatile developments on broadcasting which emerged during the preparations for your seminar has caused them to reconsider the correctness of going down the auction route. It may be that, until all the briefing work was put in hand for the seminar, it was not fully realised how large, close and uncertain were the possibilities of competition through DBS, other satellite broadcasting and MMDS. The potential contractor in 1991 may find it very hard to predict the broadcasting environment during 8 years running from 1993. It can be argued, however, that this very volatility makes it more, rather than less, important that the choice of contractors should be settled by the discipline of the market, and the Home Secretary firmly recommends in favour of pursuing the auction policy already agreed in principle.

ii. The maximum permissible number of franchises

5. The recent work by the Official Group has thrown up one point that had not previously surfaced. This is that under an auction regime it is hard to justify the exclusion of one company from holding more than one franchise - whether acquired by original bidding or by takeover (which would certainly have to be contemplated under the new regime). The Home Secretary recommends that an arbitrary limit of two should be placed on the number of ITV contractors in which any one individual or company is allowed to have a controlling interest. He also proposes a 10 per cent limit on the shareholdings that such an individual or company might hold in third or additional contractors. It seems inescapable that some limit should be applied, but the Group will no doubt give careful attention to the Home Secretary's proposal that it should be pitched as low as two.

This is asserted, not argued.

iii. Channel 4

6. It will be common ground in the Group that Channel 4 should be required to sell its own advertising (not simply given the option to do this, as Peacock proposed). What needs to be decided is how far down the road of separation and competition Channel 4 should be pushed. In his earlier paper, the Home Secretary proposed that Channel 4 should be reconstituted as a separate broadcasting authority, partly because this was the best guarantee of its maintaining its present remit, and partly because it would weaken the IBA's role, which might otherwise become over-dominant with the emergence of DBS broadcasting.

7. The Home Secretary accepts the Official Group's advice that the route of privatising Channel 4 under its existing board does not, in practice, offer much help, since there would be no defensible way of protecting the privatised channel from a takeover. He suggests that the choice is, therefore, between his original proposal and providing for straightforward privatisation, with the contract being awarded by competitive tender. In the

latter case, however, it would be important to build in provisions to preserve Channel 4's present remit.

8. You may think that the first point to establish with your colleagues is whether they do, in fact, put a great deal of weight on Channel 4 continuing to operate under its present remit. If they do, then it is inevitable that any privatisation would have to be on the basis of tough provisions to ensure the maintainance of the Channel's present style, and prevent it being driven downmarket in pursuit of advertising. The Official Group believed that such provisions would be feasible, but the Home Secretary suggests that what may be just as important is whether they would be believed to be effective. He believes that the policies that MISC 128 is drawing up for ITV are rigorous enough without the additional turbulence that would flow from the full privatisation of Channel 4.

9. You will no doubt remember that both at the previous MISC 128 meeting and at your briefing for the seminar the Trade Secretary expressed some worry about the potential strength of the competitive position that would be occupied by a fully privatised Channel 4, since it would then be the only national contractor carrying advertising.

10. If the Group as a whole is not very enthusiastic about full privatisation, you will wish it to come back to the Home Secretary's proposal that the Channel should be reconstituted as a separate broadcasting authority. This arrangement is not the inevitable consequence of the Channel being required to sell its own advertising. It would be quite possible to leave it as a fully owned subsidiary of the IBA, as it is at present. While the Home Secretary is doubtless right to have his worries about the dominant position that might be occupied by the IBA with the emergence of DBS broadcasting, simply setting up Channel 4 as yet another quango in this field may not necessarily be the best way of addressing that problem.

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HANDLING

11. You will wish to ask the HOME SECRETARY to introduce his paper. The FINANCIAL SECRETARY, TREASURY might be asked in particular whether he is content with the proposed auction and levy arrangements. The TRADE SECRETARY will be keenly interested in all the points raised in the paper.