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PRIME MINISTER

MINISTERIAL GROUP ON BROADCASTING SERVICES  
THE ITV SYSTEM AND CHANNEL 4: MISC 128(88)2

## DECISIONS

This is the Group's third discussion of the reform of ITV contracts<sup>1</sup>, the special position of ITN<sup>2</sup>, and the future of Channel 4<sup>3</sup>. None of these matters will fall to be legislated before the Bill in the 1989-90 session, but the aim is to produce a comprehensive White Paper before the summer, and you will therefore wish decisions to be taken on all three issues at the present meeting.

2. The Trade and Industry Secretary may suggest that, on Channel 4 at least, decisions should be postponed until the Group has taken a view on additional TV services (a possible fifth channel and/or the authorisation of MMDS services) which the Group will be discussing in early March. While it is certainly true that the emerging policy will need to be reviewed as a whole before the White Paper is published, new issues are continually coming into sight in these broadcasting studies and it is important to keep up momentum. If the Trade and Industry Secretary does suggest postponing a decision on Channel 4, therefore, you may wish to say that the present meeting should at least take a provisional decision, to provide a framework to enable the work to go forward.

## BACKGROUND

3. The Group agreed at the meeting on 20 July last year that ITV contracts from 1 January 1993 should be auctioned, broadly as Peacock had recommended, and that the existing levy on profits

should be replaced by one on revenue. The details of these strategic decisions were then worked up by the Official Committee and, in the event, the papers they put forward proved hard to digest. For the present meeting, however, the Home Secretary has gone to a good deal of trouble to clear the paper in detail with the Chancellor of the Exchequer and the Trade and Industry Secretary and it is very desirable that these points (which are all basically second-order ones) should now be settled.

4. There was deeper division in the Group on the future of Channel 4 (on which the Home Secretary also made proposals in July) and on ITN, which was thrown up in discussion. While the Chancellor was keen to see Channel 4 fully privatised, both the Home Secretary and the Trade and Industry Secretary were afraid that this would drive it down market. On ITN the view was emerging in the Group that the ITV companies should at some future date be free from the requirement to get their news programmes from ITN, but you were anxious that nothing should be done to weaken ITN's position vis-à-vis the BBC news services. On both ITN and Channel 4 the Home Secretary's paper canvasses a range of options.

5. As additional services become available, the present ITV system will have to compete harder for advertising revenue, and increasing strain will fall on the public service broadcasting requirements that currently apply to the ITV system. On present form the next additional services will appear in the autumn of next year when BSB hope to begin broadcasting their three channels of DBS services. This is well ahead of any likely timescale for a fifth channel or MMDS services. It could well be that the situation will have changed so much by the end of the 1990s that the public service broadcasting regime for ITV will then need to be radically changed. But the Group has tacitly assumed that the only practicable basis for present decision-making must be that the ITV companies and Channel 4 retain their present character, for the 1993 contract period at least.

## MAIN ISSUES

a. ITV Contracts

6. Paragraphs 2-15 of the Home Secretary's paper deal with all the points on ITV contracts on which the Group has previously hesitated. You may wish to work through these paragraphs point by point.

i. Ownership of Companies

7. Although the Group recognised that, with competitive tendering and the possibility of takeovers, some multiple ownership of ITV contracts was probably inescapable, you were concerned about the possibility of a few large owners swamping ITV, especially in large cities. The Home Secretary's proposals, in paragraph 4 of his paper, are that no company should own or have an interest in more than two contracts; that a single company should not be allowed to hold more than one contract for the same region; and that a company holding a contract for services with national or cross regional coverage should not be allowed to have an interest in any other ITV contract. These conditions appear to reflect the sort of limitations for which the Group was feeling in the previous discussion.

ii. Quality Threshold

8. The Group agreed at its meeting in July last year that applicants for a contract should first meet a quality threshold and that the contract should then go to the highest bidder. Paragraph 7 of the Home Secretary's paper sets out the basic requirements for the quality threshold, including the test that the applicant must have links with the region which he proposes to serve. These criteria are straightforward.

9. Paragraph 8 of the Home Secretary's paper makes additional proposals that have not previously come to the Group. These are that the applicant's programme plans must have regard to the

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character and market conditions of the region concerned, must provide for at least 25% of output to be supplied by independent producers at the start of the contract and show how this proportion is likely to increase. These provisions about independent producers were jointly suggested by the Chancellor and the Trade and Industry Secretary. You will doubtless welcome them.

### iii. Lengths of Contracts and Review of Performance

10. Under present arrangements ITV contracts normally run for 8 years (except for the special extension to 1993). The Home Secretary proposes that the contracts beginning in 1993 should be normal 8-year ones. Peacock, however, suggested 10 years and at the meeting on 28 October you thought that there might be something to be said for that. Given all the changes that are bound to occur in broadcasting during the 1990's (see paragraph 5 above) you may not wish to insist on the longer period.

11. At previous meetings the Group had a good deal of discussion about the details of formal reviews and rights of appeal. The Home Secretary now proposes (paragraphs 9-11 of his paper) that there should be automatic reviews by the IBA at 2<sup>?</sup> years and 5 years, with any further reviews the IBA thinks necessary at other times, and that there should be no formal right of appeal, since the IBA's removal of a contractor would be subject to judicial review. This seems simple and sensible.

12. You may, however, wish to pause for a moment on the Home Secretary's suggestion (in paragraph 10) that further study might be given to the idea of performance bonds. The thought behind this is that contractors would have little incentive to keep up their programme standards towards the end of a franchise period, and that their minds would be wonderfully concentrated if they had been required to put up a bond at the outset. If declining programme standards are indeed a probable threat, then a scheme of this sort would give the IBA more teeth. On the other hand, the normal obscenity law will have been extended to ITV contractors by

1993, and the Broadcasting Standards Council will be in place. So there should be no risk of declining standards in that sense. It may also not be too easy to attract bids for the 1993 franchises, given the uncertainties of competition from DBS and other satellite broadcasting, a possible fifth channel and MMDS. You may conclude that the risk of declining standards at the end of a franchise was not so great as to justify the added deterrent of a performance bond on top of the auction. ✓

#### iv. Financial Terms

13. Since the meeting on 20 July the Home Secretary and the Chancellor have agreed that the tendered lump sum should be payable as a yearly rental. The Group agreed on 20 July that the present levy on profits should be replaced by a levy on advertising revenue. Corporation Tax will be payable on subsequent profits after these payments.

14. The Group has been clear from the outset that the present profits levy has not succeeded in bringing downward pressure to bear on costs and that a revenue-based levy is required for that. In order to be effective in creaming-off buoyant monopoly income, however, a revenue levy would have to operate at progressive rates. The technical difficulty about this is that the growth of advertising revenue will not be constant between different geographical regions and that progressive rates set by reference to national advertising revenue risk either being too harsh on the poorer regions or not taking enough money from the richer ones. At the meeting on 28 October it was suggested that the fairest way of dealing with this problem was to set the rates by reference to the number of television households in each region, but the Treasury are now having some doubt whether that model stands up to analysis. Paragraph 13 of the Home Secretary's paper, therefore, simply proposes that the White Paper should set out the problem in a general way and leave the details to be teased out with the industry (who cannot in any event be very meaningfully consulted on this until the rest of the White Paper package is made known to them). The Chancellor has given his personal attention to this,

and agrees that the matter cannot be taken any further at this stage than the Home Secretary proposes. You will probably also wish to agree.

15. You may also wish to note that the Chancellor is about to write to the Home Secretary proposing that the short 1990-92 contract period should also be subject to a levy based on revenue rather than profits. This will not give rise to the technical problems summarised in the previous paragraph, since the contractors will not be changed for the 1990-92 period, and their revenue baseline is already known. An early switch to a revenue based levy is probably something that you will support in principle, provided the contractors are given proper notice, but decisions on this are not required at the present meeting.

#### v. Networking

16. The networking arrangements operated by the ITV companies have, in effect, constituted a limited cartel of privileged large contractors. The Group agreed in correspondence last year that this should be tackled in two stages, with quick improvements to last until the end of the 1990-92 period, and more substantial changes thereafter. The IBA instituted a review last year and this led to an agreement last October between the ITV companies that will give a better deal to the small companies as from September 1988. Specifically, the number of hours reserved for the big five companies without competition was reduced; the number of hours open to competition was correspondingly increased; the small companies were represented on the Group that constructs the network schedule; and an agreement was reached on common pricing. This is all welcome progress but, as the Group previously agreed, more needs to be done to settle the criteria for an acceptable networking arrangement after 1992. Home Office and DTI officials are working up proposals on this. For the moment, paragraph 15 of the Home Secretary's paper simply sets out the need for a clearer and more competitive market after franchises are auctioned. Although the networking regime is not formally part of the contract with ITV companies it clearly needs to be clarified well

before tenders are sought for the 1993 franchise period. You may wish to confirm that the Home Secretary and the Trade and Industry Secretary foresee no problems in working up an enforceable and genuinely competitive regime post-1992.

#### ITN

17. ITN have recently concluded an arrangement with BSB to supply their news services for the first three years from 1989. They thus have a clean sweep of all IBA television national news services including those on Channel 4, which they supply under contract. In order to attract more capital than the ITV companies will make available, and thus to develop their international activities, ITN still hope to establish a profit margin and obtain independent minority shareholders. As the Home Secretary's paper points out, this can be done without legislation.

18. The question to be decided is whether the ITV companies should be allowed to obtain their national news services from other sources. Such a decision might, or might not, require legislation, depending on what could be agreed with the IBA. The essential point on timing, however, is that if the ITN monopoly is to be broken, then it must be done with effect from the beginning of the 1993 contract period.

19. In practice it is probably not very likely that many, or any, ITV companies would wish to incur the heavy costs of providing their own national news services. The arguments either way are, rather, ones of general principle. On the one hand, you put a high premium of guaranteeing ITN's continued and effective existence, as a bastion of impartial news services. On the other hand, it does run contrary to a good many of the Government's basic principles to allow the continuance of such an unashamed monopoly, especially as the area it covers is increasing. It is also very relevant that ITN's costs are continuing to go up, and there can be no guarantee that the introduction of new capital (which will involve a profit margin) will necessarily lead to keener pricing. You will particularly wish to listen to what the

Chancellor and the Trade and Industry Secretary have to say on this issue. If you do decide that the monopoly can safely be ended, it will be important to present the decision in a way that does not damage ITN or appear to be critical of it.

*Unless we keep ITN with - the total monopoly will probably go to BBC.*

## CHANNEL 4

20. The Home Secretary's original position on Channel 4 (at the meeting on 20 July) was that Channel 4 should be made responsible for its own revenue and, to protect its special character, should be established as a separate broadcasting authority. You believed that the possibility of fully privatising Channel 4 had not been sufficiently discussed, and commissioned further work. At the meeting on 28 October the Home Secretary came forward with another variant of his earlier proposal (under which Channel 4 would get a defined proportion of national advertising revenue), and he stated that he regarded the full privatisation of Channel 4 on a profit-maximising basis as being the worst of all options. The Group agreed that Channel 4's characteristic remit needed to be protected, but could not reach agreement whether privatisation would damage this. Paragraph 25 of the Home Secretary's paper now includes an option, proposed by the Chancellor, under which preservation of Channel 4's character would not be spelt out in the primary legislation but would, rather, be enforced by the IBA as part of the contract conditions. The Home Secretary is inviting the Group to choose between this latest option and his two previous ones.

21. The Chancellor has been a proponent of full privatisation throughout the Group's discussions of Channel 4. Both the Home Secretary and the Trade and Industry Secretary, however, fear that, whatever safeguards are erected, full privatisation and the pursuit of advertising revenue are bound to drive Channel 4 down market. In saying this they will be able to point to Jeremy Isaac's recent comments on public record to the effect that if he knew that the Channel's financing by advertising revenue depended on his programming decisions, then his judgement would be bound to be affected. At the end of the day, this can only be a matter of of



judgement. You will wish to bear in mind that what is described as the "Channel 4 remit" is much more the particular character that Channel 4 has built up since its inception than any prescribed reflection of the rather vague language in the Broadcasting Act. Critics of privatisation would certainly claim that there could be no guarantee that the IBA would be able to enforce the continuance of anything like the present Channel 4 if it was auctioned to other bidders whose instincts took them to another style of programming, and there is no way of settling the argument one way or the other short of trying it out in practice after 1992.

22. The Trade and Industry Secretary is not only concerned about protecting Channel 4 from being driven down market. He is also worried that, as the only national advertising-financed service, Channel 4 would have the potential of becoming a dominant competitor to the other ITV companies. In fact, these anxieties are the other side of the same coin. If the IBA were successful in restricting a privatised Channel 4's programming to the present format, its audience and revenue would remain on the present scale. But insofar as specialised programming could not be enforced in practice, then Channel 4's national status would indeed be a massive advantage.

23. All the three options set out in paragraphs 23-25 of the Home Secretary's paper are technically feasible, and the option at paragraph 23 makes specific provision for funding the Welsh channel S4C. Whichever choice the Group makes, you will wish to ensure that the funding of S4C is safeguarded.

## HANDLING

24. You may find it convenient to take the item in three sections - ITV contracts; ITN; and Channel 4. On each section you may wish to ask the HOME SECRETARY to introduce his paper, and the CHANCELLOR and the TRADE AND INDUSTRY SECRETARY will wish to comment.

A J L

5 February 1988

A J LANGDON