



QUEEN ANNE'S GATE LONDON SW1H 9AT

1 November 1988

*NBLM with Charles
report.
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Dear Nigel,

ITV LEVY FOR CONTRACT EXTENSION PERIOD AND BSB LEVY

This letter seeks your response on the two levy issues above.

ITV Levy

Thank you for your letter of 17 October about the ITV levy for the contract extension period. I have also seen Peter Walker's letter of 27 September and David Young's of 10 October.

I remain concerned about the consequences of moving direct to a levy based solely on ITV revenue for the period 1990-92.

Your letter suggests that the redistributive effects of a revenue levy are not significantly different from those of one based on a mixture of revenue and profits. But we should not overlook the substantial impact on some companies. For example, as figures prepared by your officials show, Central TV would pay an extra £20m a year of its post-levy profits if there was a switch to a revenue levy in 1990, compared with an extra £13m under a mixed levy. In percentage terms, that company could expect a revenue levy amounting to some 70% of its gross profits. It has always been accepted that it would be wrong to introduce fundamental changes affecting ITV investors in mid-contract; and for practical purposes 1990 will be mid-contract. The ITV companies will all have the strongest possible incentives to reduce costs, and I see little prospect of the IBA being able to persuade some to take on others' obligations and associated costs at the same time as it is striving, in accordance with our wishes, to make the networking arrangements more competitive.

You also suggest that ITV would be deterred from reducing programme standards in a way which resulted in reduced viewing figures. But there is of course no direct relationship between the two - nor in the short term between viewing figures and profitability. After 1993 we will have a much more competitive market in which commercial stations who regularly neglect the

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The Rt Hon Nigel Lawson, MP
Chancellor of the Exchequer

satisfaction of viewers and advertisers will be exposed to the financial consequences. Until then I remain concerned that a revenue-only levy would encourage ITV, at little or no risk to itself, to take money out of programming in ways which would not only make the output less attractive in international markets but would also work against the interests of advertisers who already complain that ITV is not achieving the right size or quality of audiences. At a time when we are promoting such a massive liberalisation of television we must guard against the accusation that we are careless of quality. By contrast a scheme which incorporated a profits element would help to maintain a balance of incentives for ITV companies still occupying a monopoly position in terrestrial services.

We also have to consider the link between our decision on this point and the general debate about the regime after 1993. The ITV companies, with their supporters in Parliament, are likely to be our sharpest opponents, because of their fears of competitive tender. I would like to avoid sharpening this opposition still further by our decision on the levy in the interim period. We are going to have a hard ride as it is.

I hope therefore that you might feel able to reconsider the arguments advanced in my letter of 12 September for the compromise solution of a mixed levy. It is already a compromise well tilted towards your point of view, since the mixed scheme would consist of three quarters yield from revenue, and only one quarter from profit. It will, I think, be fairer to both ITV companies such as Central and to viewers while still offering the substantial incentives to efficiency which I am as anxious as you should be achieved.

BSB Levy

... I enclose a copy of a letter I have received from the Chief Executive of BSB seeking guidance about the Government's intentions with regard to the levy.

You will recall that your letter of 17 October about the ITV levy recorded your hopes that BSB should continue to be subject to levy at nil rate, rather than taken out of levy liability altogether as the IBA had proposed.

After 1992, the levy on DBS services will be based on revenue rather than profits, in line with terrestrial ITC services. There can, however, clearly be no question of imposing a positive rate until BSB has achieved cumulative breakeven: the point at which it would only become subject to levy in principle under the present law.

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Assuming that it does so, I would like to be able to tell BSB that in considering whether there were good grounds for moving from a nil to a positive rate we would take into account the factors mentioned in their letter, especially the existence of competition from satellite channels such as Astra not subject to levy liability in any way. To leave the position entirely open or, worse, to tell BSB that we would aim in principle to assimilate DBS to terrestrial services for levy purposes, would make it much more difficult for BSB to secure their next tranche of investment. I would not think it right to go as far as the IBA has proposed; but I have a good deal of sympathy with the BSB argument that it would create an uneven playing field if they carried levy liabilities which Astra or other non-DBS satellite services escaped.

... I enclose the draft of the reply which I would like to send BSB, which I hope you will agree gives an acceptable steer without offering any unnecessary hostages to fortune.

I am copying this letter to the Prime Minister, other members of MISC 128 and Sir Robin Butler.

Yours,

Derry



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17 October 1988

Rt Hon Douglas CBE MP
Secretary of State for
the Home Department
The Home Office
Queen Anne's Gate
LONDON SW1

Dear Home Secretary

The ITV Levy

My colleagues and I look forward to the opportunity of presenting our revised Business Plan to you, Lord Young, Tim Renton and a small group of officials on 27 October. In advance of that meeting I wanted to write about BSB's position under the ITV Levy. This has been highlighted by our financial advisers as an element where clarification will be vital in advance of our raising our Second Round Finance.

It is common ground that BSB will continue to be zero-rated, at least up to the end of 1992. I understand the difficulty which the Government may feel about giving assurances as to the future of the Levy or BSB's position under it when the Levy itself may be substantially changed once again after 1992. However, when we come to produce our prospectus for potential shareholders an indication of the Government's longer term intentions and the principles which it would intend to observe in weighing BSB's position under the Levy is of considerable importance.

BSB would submit, especially in the developing competitive climate envisaged for broadcasting in the 1990s, that the arguments normally advanced in support of the ITV Levy do not support changing BSB's zero-rated status. Before going through these arguments I should make a general point about the scale of risk and investment involved in BSB as compared with the risk and start-up costs for an ITV

contractor. I understand that the start-up cost for a new medium sized ITV company at the start of the last franchise period were some £10 million - the basic transmitter network already being in place. The pre-operational costs of TV-AM were £5 million. I understand that, despite the much publicised crises which shook that enterprise, they had only to sustain losses of £20 million before turning the corner into substantial profitability. By way of contrast, BSB will face a far more competitive environment - without the technological advantage of instant access to the full universe of homes - and will have to finance a total investment of some £900 million. Thus, for BSB to be subject to the Levy in the period after 1992 and especially before real terms pay back has been achieved would seem wholly wrong. It would involve paying what is popularly seen as an excess profits tax to the Exchequer before our own shareholders have received their initial funding back. The imposition of Levy would have a major impact on rates of return through the project period and the Government's position is, therefore of major importance to our existing and future investors.

I now turn to the three justifications normally advanced for the ITV Levy and suggest that they have limited relevance to BSB.

- i) A tax on monopoly profits: BSB will enjoy no monopoly or dominant position in the sale of advertising. It will face competition from ITV, Channel 4, perhaps Channel 5, Astra and, ultimately, locally-based MMDS services.
- ii) Payment for the use of a public asset (the broadcasting frequencies): While it is true that BSB will use scarce frequencies we are doing so after a competition to determine which potential operator offered the best service for the UK public and using only private investment. I would remind you that the DBS project in France has, for example, absorbed some £300 million in public money and that BSB is the only entirely privately financed DBS project in Western Europe or Japan. The DBS frequencies are virtually without value in advance of a vast investment in satellite hardware and a ground infrastructure. The frequencies will, thus, only be of substantial value after BSB's investors have borne the risk and developed them. It is relevant to note that frequencies for direct to home satellite transmissions are not as scarce as was once envisaged since changing technology has opened telecommunications frequencies for this purpose.
- iii) A prompt to greater efficiency: The changes in the Levy which the Government has recently proposed are clearly intended to exact an efficiency squeeze on ITV contractors. Although companies like Tyne Tees, Ulster and Thames have made strides in improving working practices there is still some way to go to ensure that more advertising revenue is spent on better programming rather than being frittered away on restrictive practices. When such practices arise from a monopoly

position it may be justifiable in the short term to use taxation as what amounts to an instrument of an interventionist industrial policy. However, extracting Levy from BSB could hardly be justified on such grounds. BSB has indeed, been an instrument for improving efficiency in the rest of the industry - as recent reforms in working practices at ITN have shown. BSB will commission the great majority of its programming out of house. It would be wrong, therefore, to penalise BSB for historic inefficiencies in the rest of the industry.

If, in the longer term, a Levy remains and the Government contemplates changing our zero-rating then there is a further issue which should be addressed. BSB is not only in competition with terrestrial broadcasters but also with other satellite operators either using other nations' DBS frequencies or telecommunications satellites. Operators on Astra and, potentially Eutelsat II, see the UK as amongst their prime target markets. If the Government is to avoid placing BSB, as the UK's official satellite operator, at a disadvantage it will need to devise a Levy to catch such operators whose start-up costs, as well as their commitment to the UK viewer, will be substantially lower than BSB's.

BSB is a uniquely ambitious project which will help to deliver a number of the Government's stated broadcasting objectives. The operating period needed to see investment in the project repaid is already a lengthy one. The potential rewards for investors are good but far from dramatic when seen in the context of the risks undertaken. For there to be uncertainty about the Levy would dissuade a significant number of potential investors when BSB raises its next major tranche of funding.

I am sorry not to have written directly at the time of your consultations with the IBA. It seemed only right, however, for us to precede our representations with a thorough revision of our own Business and Funding Plans. I hope that the Government will be prepared to give publicly useable guidance as to its intentions in regard to BSB and the Levy.

I am copying this letter to the Director General of the IBA.

Yours Sincerely

Anthony Simonds-Gooding
Anthony Simonds-Gooding

Draft letter for signature by the Home Secretary to:

Anthony Simmonds Gooding, Esq
Chief Executive
British Satellite Broadcasting Ltd
70 Brompton Road
LONDON, SW3 1EY

LEVY

Thank you for your letter of 17 October.

I fully understand your wish to have publicly usable guidance about the Government's future intentions with regard to the levy, bearing in mind your need to attract additional investment.

The liability of operators of commercial television services to levy reflects their use of a public resource in the form of internationally assigned and protected frequencies. I therefore see no grounds for amending the present law so as to exempt BSB (or any other DBS contractor) from such liability.

However, I have already made clear, as you know, that if DBS services were to be subject to a levy based on revenue rather than profits they would continue to be zero-rated during the period to the end of 1992. In the light of the points made in your letter I am able to set out the approach we would propose to adopt in the subsequent period. First, we would not contemplate anything other than a zero rate for so long as BSB was not in cumulative profit. The possibility of payment of levy would not

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of course arise under the present law unless this were the case. Second, once BSB had achieved cumulative profit, consideration would need to be given in the circumstances at the time by the Government of the day to the case for moving beyond a zero rate. In considering whether such a move was justified, we for our part would want to have regard to the following factors: the scale of investment required, the time required to achieve breakeven, the levels of risk involved and the existence or otherwise of competition from operators of television services not subject to levy liability.

I hope that this is helpful. It does not give an unqualified assurance that BSB will continue to be zero-rated for levy in all circumstances, but we want to be satisfied that it would be fair and reasonable to depart from this position before doing so.

I am copying this letter to the Director General of the IBA.

BROADCASTING : BBC Finance

PTA.

