



*me from
ceby*

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

27 April 1989

PRIVATISATION OF THE TRANSMISSION SYSTEM

The Prime Minister has seen the Home Secretary's letter of 25 April to the Secretary of State for Trade and Industry. She is content with his proposal for early publication of the Price Waterhouse report.

I am copying this letter to the Private Secretaries to members of MISC 128, Stephen Wall (Foreign and Commonwealth Office) and Trevor Woolley (Cabinet Office).

Paul Gray

Miss Catherine Bannister,
Home Office.

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[Handwritten signature]

cc-PM



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HOME OFFICE
QUEEN ANNE'S GATE
LONDON SW1H 9AT

26 April 1989

*Abbr
RUB
2/4*

Dear Neil Thornton,

PRIVATISATION OF THE TRANSMISSION SYSTEM

WMPG
The Home Secretary wrote to your Secretary of State yesterday (25 April) about the Price Waterhouse study on the privatisation of the television and radio transmission system.

Part of the third paragraph was inadvertently omitted on the version of the letter issued and I would be grateful if you, and copy recipients, could insert the attached revised version of the third paragraph in to your copy of the letter.

Yours sincerely
Celia Boyle

CELIA BOYLE
Assistant Private Secretary

Neil Thornton, Esq
Private Secretary
Department of Trade and Industry

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The immediate question facing us is the publication of the report. Although we have not undertaken to publish it there is a strong expectation that it will be published. I would favour publication, not least because it could be valuable to have expert outside comment on Price Waterhouse's conclusions. The only sensitive point about publication is the report's conclusion that privatisation could lead to an initial increase in transmission charges in order to form a dividend stream for shareholders, which might however be recouped through efficiency savings in the longer term. (At present neither the BBC nor the IBA are required to earn a return on their transmission assets). If there is criticism of the privatisation proposal on this score we can counter it by pointing to the report's conclusion that privatisation would provide a greater spur to efficiency in the longer term.

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BROADCASTING : P.M. pr. 7.



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PRIME MINISTER

PRIVATISATION OF THE TRANSMISSION SYSTEM

You saw the attached letter from the Home Secretary, Flag A, earlier this afternoon.

We had both been struck by the oddity of the sentence at the bottom of the first page. In fairness to the Home Secretary, it now appears a crucial passage had been left out of this paragraph; a revised expanded version at Flag B has just been circulated. This makes a good deal more sense!

Yes

Can I take it you are content to endorse the proposal for early publication of the study?

Sara Howe
(Duty Clerk)

Yes

PAUL GRAY

26 April 1989

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The immediate question facing us is the publication of the report. Although we have not undertaken to publish it there is a strong expectation that it will be published. I would favour publication, not least because it could be valuable to have expert outside comment on Price Waterhouse's conclusions. The only sensitive point about publication is the report's conclusion that privatisation could lead to an initial increase in transmission charges in order to form a dividend stream for shareholders, which might however be recouped through efficiency savings in the longer term. (At present neither the BBC nor the IBA are required to earn a return on their transmission assets). If there is criticism of the privatisation proposal on this score we can counter it by pointing to the report's conclusion that privatisation would provide a greater spur to efficiency in the longer term.

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AK



Prime Minister

QUEEN ANNE'S GATE LONDON SW1H 9AT

Seems a very useful study. Brian Griffiths strongly supports early publication. Content to endorse the Home Secretary's proposal? 25 April 1989

Dear David.

PLC 6
26/4

PRIVATISATION OF THE TRANSMISSION SYSTEM

Price Waterhouse have now completed the study on options of the privatisation of the television and radio transmission system. I attach a copy of the executive summary of their report.

The report identifies 2 options for privatisation. The preferred option would be to privatise the system as 2 separate national companies, each with an even spread of transmission stations throughout the country. These companies would not be the direct descendants of the BBC and IBA transmission operations: the assets would be rearranged in such a way as to disentangle the existing BBC and IBA options. Although Price Waterhouse see this as the best option they note that implementation would not be straightforward. They therefore propose as a fall-back option the privatisation of the BBC and IBA transmission operations in their existing form.

The implementation of either of these options would require the inclusion of enabling provisions in next session's broadcasting legislation. In order to allow time for the preparation of the necessary legislation we need, as I noted in my letter of 19 December, to have decided by the end of June how we wish to take this forward. To this end, I have asked my officials to begin immediate consultations with the BBC and the IBA about the Price Waterhouse report, and then to work up proposals through the MISC 129 machinery for our collective consideration.

No official committee supporting MISC 129.

The immediate question facing us is the publication of the report. Although we have not undertaken to publish it there is a strong expectation that it will be published. I would favour publication, not least because it could be valuable to have expert outside comment on Price Waterhouse's conclusions. The only sensitive point about publication is the report's conclusion that privatisation would provide a greater spur to efficiency in the longer term.

!!!
PLC 6.

/I would

The Rt Hon Lord Young of Graffham
Department of Trade and Industry

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2.

I would see advantage in publishing the report as soon as possible without endorsing its conclusions, rather than delaying publication until we are in a position to say how we propose to take this issue forward. If we decided to delay publication officials would still need to consult the broadcasters in the meantime, and there is an inevitable risk that the report's conclusions would be made public in some form. If you and other MISC 128 colleagues agree, I will therefore arrange for early publication of the report by HMSO. In practice I understand that this should take about a month.

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

Yours,

Douglas

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STUDY OF PRIVATISATION OPTIONS FOR THE TERRESTRIAL BROADCASTING
TRANSMISSION NETWORKS

SECTION 1 : EXECUTIVE SUMMARY

- 1.1 In November 1988 the Government published its White Paper entitled "Broadcasting in the 1990's: Competition, Choice and Quality". Among other things the White Paper said that the Government's intention was to separate the provision of UHF (ie television) services from their delivery (ie transmission). The White Paper went on to say that the Government considered the best arrangement in due course would be a regionally based privatised transmission system designed to promote competition, whilst containing certain common carrier obligations.
- 1.2 As a consequence of the White Paper commitment the Home Office and DTI jointly commissioned Price Waterhouse in February 1989 to examine the options for privatising the terrestrial transmission systems of the United Kingdom. The remit of the study was extended beyond the White Paper, to take account of the radio transmission networks including that for the World Service. The terms of reference required the study to examine options which would allow the transfer of transmission into the private sector, increase where possible the level of competition and take account of the possibility of regionalisation. An overriding consideration was that quality and coverage of service was to be maintained.
- 1.3 From the outset it was recognised that the present arrangements have a number of built in restrictions which may be difficult to remove. In particular, UHF broadcasting takes place via a set of transmission stations, carefully arranged to give full national coverage, which are jointly used by the BBC and IBA.
- 1.4 A second complication has a direct bearing on the timescale within which change can be effected and to which attention was drawn in the White Paper. The BBC transmission responsibilities are rooted in its Charter, which runs until the end of 1996. On the other hand, the Government intends that the Independent Television Commission (ITC) should come into being in 1991 and at that time take over those regulatory activities of the IBA which it is envisaged should continue. That would be the natural time for the IBA's transmission activities to be separated out and possibly moved into the private sector.
- 1.5 This study has been carried out against this background.

THE PRESENT SYSTEM

Programmes

- 1.6 The BBC are responsible for the production of programmes and their transmission. The IBA is responsible for oversight of independent programme companies and providing transmission facilities for them. The BBC transmit two national television channels, 4 Radio Channels, local and regional radio services and the BBC World Service. The IBA are responsible for the transmission of two national television channels, one of which can simultaneously transmit separate programmes in different parts of the country (ITV), together with the independent local radio stations.

SECTION 1 : EXECUTIVE SUMMARY (continued)

Transmission

- 1.7 The requirement for transmitting television and VHF radio signals differs from that for the other broadcasting radio frequency bands. Television and VHF require a virtual line of sight from the transmitting aerial to the receiver. The array of masts for national coverage is therefore large. In practice both can be carried out from the same mast and this is normally the case. The other radio transmission bands need far less sites to give full coverage and are not carried out from the same sites as the television and VHF transmissions.

Financial arrangements

- 1.8 The transmission functions of both the IBA and the BBC are funded on a cost covering basis. They could be regarded as user cooperatives. Neither organisation has set up its transmission activities as a trading fund. In the case of the BBC management pressures are towards cost reduction; any savings on transmission allow increased expenditure on programme production. In the case of the IBA, the situation is different as the programme makers are entirely separate organisations from the IBA. However any operating surplus must be returned to the programme companies.
- 1.9 Neither IBA nor BBC transmission activities are financed to provide a return on the investment. Since any notional return is returned to the users it is a form of cross subsidy to programmes. There is little genuine financial incentive to cut costs. The integrated nature of the BBC creates greater internal pressure for cost savings than is the case in the IBA.

Regional variations

- 1.10 There are considerable differences in the regional costs of providing transmission services, whether this is measured by the number of people served or the physical area covered. As an example the Crystal Palace transmitting station in London provides television coverage of the whole of the London area and is therefore very cost effective. By contrast, in Scotland and Wales, mountainous terrain means that a large number of transmission stations are needed in order to give geographic coverage in regions where the population density is small.

THE OPTIONS

- 1.11 Whilst a very large number of options might be considered they can be reduced into three classifications based on geography:
- * the present system with two independently operated and maintained, but entwined systems (both a BBC and IBA presence on most television/VHF radio sites)
 - * a number of local monopolies which could be grouped nationally in a variety of ways

SECTION 1 : EXECUTIVE SUMMARY (continued)

* regional organisations, either as groups of local monopolies or as a subdivision of existing arrangements.

- 1.12 None of these feasible options would provide sufficient competition to remove the need for regulation.
- 1.13 In addition the geographic options could each be subject to a requirement to contract out the maintenance work. Also, the ownership could be separated from operations; this would lead to a form of franchising with ownership of the assets of the transmission networks either left in the public sector or considered as part of the franchising arrangements.

The Present System

- 1.14 The White Paper acknowledges that the UHF transmission networks run by the BBC and the IBA give a highly effective service to the public in reaching 99.4% of the households in the UK and providing a reliable high quality signal. There is nothing inherent in the service which demands public ownership in order to maintain standards. Moreover the present system is not structured financially to provide an efficient allocation of capital or correct financial pressures on costs. There is therefore a prima facie case for transferring ownership of the two organisations into the private sector.
- 1.15 The principal disadvantage of so doing is that this would not add direct competitive forces into the market for the present services. Unless there was a major structural change the successor company to be derived from the BBC would continue to provide services for the continuing BBC programming operation. A similar situation would exist for the independent programme companies. Although there could in principle be direct competition between the two new companies in offering new transmission facilities for Channel 5, and possibly in due course, Channel 6, the existing ownership of sites would mean that national coverage would require new agreements between the provider of the transmission service and the landlord of sites on which the transmission company was a tenant. If unconstrained this would negate any competition.
- 1.16 Privatisation would need to be accompanied by price regulation and control over the standards of service provided. Whilst the regulatory body would be able to obtain some information on comparative service standards it would not be based on comparative judgement of users since no user would experience the services of each company (at least prior to the introduction of Channel 5).

Groupings of local monopolies

- 1.17 Each mast from which transmission takes place is a local monopoly, and nationally there are over 1,100 of them. However, most of these are for television and VHF radio broadcasting and are not independent of each other. Broadly they consist of some 51 main transmitting stations to

SECTION 1 : EXECUTIVE SUMMARY (continued)

which are coupled some 800 relay stations whose purpose is to extend the geographic coverage of signals sent out from the main station. Ownership of the transmitting stations is split between the BBC and IBA at present. At present both the BBC and IBA transmit from each station, using the same masts and normally the same aerials.

- 1.18 Ownership and operations could be rearranged so that a particular main site and its relays would be owned and operated by a single body hence removing the present entwinement. In practical terms therefore the largest number of local monopolies for television and VHF radio would be 51, ie each of the main transmission stations with their associated relay stations. There would be some loss of economies of scale in having such fragmentation. However the 51 local monopolies could be combined in a number of ways to gain economies of scale whilst encouraging competitive forces.
- 1.19 The competitive forces would not be direct and regulation would again be needed. New entrants to the market would be unlikely because of the limited opportunity for additional masts although some old masts previously used for 405 line television are now under-utilised. Comparison between suppliers would arise because programme companies would in most cases have to contract with more than one independent transmission company, particularly where the programme was to be given nationwide coverage. The programme companies would have a direct measure of service provided. This would be an important element of the regulatory system, providing pressure to reduce costs whilst maintaining, or even improving, standards of service.
- 1.20 The minimum number of groupings which would allow competition by comparison would be two, provided that each had sites equitably distributed through the country. Two such national monopolies would retain maximum economies of scale. A two company arrangement would retain the manpower and organisation of the present IBA and BBC. The change would be in ownership of sites and elimination of their dual operation and involve additional overheads. They would require new management structures. Smaller groupings would give some additional competition by comparison but would lose some of the economies of scale.

Regional organisations

- 1.21 The groupings of local monopolies could be arranged on a competing regional basis. In that case the comments on the alternative arrangements described above would still apply. Alternatively the regional arrangement could be a set of regional monopolies. This is not an attractive approach:
- * It would do nothing for competition. Differences in local geographic circumstances would render competition by comparison largely ineffective.
 - * A second problem, which would also apply to many groupings of local monopolies, would be the difficulty of handling regional cost variations. If the present cross subsidisations were to be continued the ITC would need to act as the customer for transmission facilities on behalf of the independent programme companies.

SECTION 1 : EXECUTIVE SUMMARY (continued)

Contracting out

- 1.22 Obligatory contracting out of maintenance offers the immediate attraction of direct competition, as companies formed out of the existing organisations could compete with each other to maintain the networks and would provide an incentive for new companies to enter the market. But there is a risk of failing to maintain the essential level of highly skilled people. Some contracting out might be acceptable but the judgement should be a matter for management. Where management contracted out voluntarily and achieved cost savings, such savings could be shared with users through the regulatory process.

Ownership and franchising

- 1.23 Franchising of operations and maintenance could be achieved if the assets were left in the public sector. That would deny true privatisation and prevent market allocation of capital. A form of franchising whereby a franchisee took ownership of the assets for a fixed period is attractive at first sight. However there would be serious difficulties in deciding on asset transfer values and ensuring that franchisees maintained the assets in good order particularly in the run up to a tender competition.

OTHER CONSIDERATIONS

- 1.24 Three further considerations are worth noting:

Training

- 1.25 The maintenance and operation of television and radio networks relies on a high degree of technical skill. Whatever option is chosen, continuation of technical competence should not be put at risk. Both the BBC and the IBA have extensive training programmes which are most likely to continue in large successor organisations.

Programme distribution

- 1.26 The process by which radio and television signals are taken from studios, either to other studios to be combined with further elements of the programme or to transmitting stations, is complex. It largely takes place through links provided by British Telecom. At present programme suppliers deal with a single organisation (either the BBC or the IBA) in order to have these arrangements put into effect. If the industry were to be fragmented into a significant number of transmission companies programme suppliers, particularly those seeking national coverage, would face significant added organisational complexities.

Research & development

- 1.27 Both the IBA and BBC undertake research which in part is directed at ensuring that terrestrial broadcasting remains competitive against emerging technologies such as cable or Direct Broadcasting by Satellite. Whilst this could be funded through a trade organisation it could be at risk if the industry were to be over fragmented.

SECTION 1 : EXECUTIVE SUMMARY (continued)

CHOICE OF OPTION

1.28 We reached a preferred option by making a judgement on the balance between:

- * economies of scale
- * practicability
- * the need for competitive pressures
- * the need to be attractive to investors
- * preservation of a skilled workforce
- * minimisation of organisational complexity and disruption
- * the need for continuation of some research and development.

1.29 In our view the balance would be best achieved by having two similarly sized organisations each responsible for approximately half of the transmitting sites in the UK equally distributed throughout the country. Each company would have responsibilities for both TV and radio transmissions. The companies could each be described as a patchwork quilt of local monopolies. Each national programme company would need to deal with each of the two transmission companies. Some local programme companies would deal with one transmission company only.

Regional companies

1.30 Whilst each of these transmission companies could be split up into regional activities it seems unlikely to produce significant benefits whilst there is likely to be some loss, albeit modest, of economies of scale. But there are no technical reasons why it could not be achieved. There would also be added disruption and the need to find new management teams.

Distribution of programme signals

1.31 A separate decision is required on the functions for which transmission companies might be responsible. Whilst there is no doubt about the transmission of signals once they have been delivered to transmitting stations, there is room for debate about responsibility for the delivery of signals from studios to the transmitting stations and possibly between studios. At present the operational responsibility for this is largely a matter for British Telecom. Other operators, with the exception of Mercury Communications, are barred from offering facilities, although in certain instances this function is carried out by the BBC and the IBA under licence where British Telecom and Mercury Communications are unwilling or unable to do so.

1.32 If transmission companies were allowed to provide these facilities they would be more attractive to investors and in due course could provide extra competition in communications more generally. This is a matter which should be taken into account in the forthcoming duopoly review. Meanwhile it would seem sensible for there to be no restructuring of the transmission arrangements which would prevent entry by the new companies into the distribution business if that were to be favoured by the review.

SECTION 1 : EXECUTIVE SUMMARY (Continued)

TIMING CONSIDERATIONS

- 1.33 Re-organisation along the lines of local monopolies would take time and would also require a change to the BBC's Royal Charter in order that assets could be redistributed as necessary between the BBC and IBA systems. There would be some reorganisation costs compared with present arrangements in order that each new organisation had appropriate spares to cover the wider range of equipment which each would need to maintain. There would also need to be some re-engineering of the monitoring and control systems. It would be expected that these costs would be recovered in due course through added efficiency. In all these changes might take as long as four years to bring into effect.
- 1.34 We believe that the option we have selected would be in the best interests of all parties concerned. However, if changes to the BBC's Royal Charter are impracticable and, given the need to find a solution for the IBA in the short term, we consider that the transmission systems could be privatised along the lines of the existing arrangements.
- 1.35 Both the preferred two company option based on groupings of local monopolies and leaving the structural arrangements as at present could be regionalised. There are risks to standards of service in so doing and no immediately obvious benefits.

TRANSMISSION FACILITIES FOR THE WORLD SERVICE

- 1.36 The operation and maintenance of the World Service transmission facilities are an integrated part of the BBC's overall transmission activities. The assets in the UK and most of those overseas are the BBC's but two overseas stations belong to the Foreign Office and will continue to be bound by international treaties.
- 1.37 Apart from the matter of this foreign ownership there is an underlying difficulty in attempting to transfer ownership of the assets into the private sector. The World Service is funded by the Foreign Office from money voted by Parliament. Whilst the past record suggests long term continuity the Foreign Office is not in a position to guarantee at any particular time continued need for the facilities for more than the three years of the Public Expenditure Survey. Any sale would effectively be that of a short term income stream and would be very unattractive.
- 1.38 The way forward would be to leave the assets in the public sector. The management, operation and maintenance could then be contracted out to one of the new transmission companies.



FILE
EAM

cc PJ

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

25 April 1989

Dear Catherine,

BROADCASTING MEETINGS

In the light of yesterday's MISC 128 discussion, the Prime Minister has considered further the possibility of an informal meeting at No 10 on quality in broadcasting, to which representatives of smaller regional ITV companies and others might be invited (your letter of 14 April to Andrew Turnbull suggested some possible names). The Prime Minister has concluded that it would not be appropriate to pursue this possibility further.

The next meeting of MISC 128 itself is currently scheduled for 11 May. The Prime Minister understands that the Home Secretary would like George Russell to make an opening presentation at that meeting; she would be content for Mr Russell to come to the first part of the meeting for that purpose.

I am copying this letter to the Private Secretaries to members of MISC 128 and to Sir Robin Butler.

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Yours,
Paul

PAUL GRAY

Miss Catherine Bannister
Home Office

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