10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

4 May 1990

Dear Sara,

LOCAL DELIVERY LICENCES

The Prime Minister has seen a copy of the Home Secretary's letter to the Secretary of State for Trade and Industry on local delivery licences.

Subject to the Industry Secretary's views, the Prime Minister would be content to take the line on the two amendments to the Broadcasting Bill set out in the Home Secretary's letter.

I am copying this letter to the Private Secretaries to other members of MISC 128 and to Sonia Phippard (Cabinet Office).

Yours

Barry

(BARRY H. POTTER)

Ms. Sara Dent,
Home Office.

QUEEN ANNE'S GATE LONDON SW1H 9AT

2 May 1990

Dear Secretary of State

LOCAL DELIVERY LICENCES

I am writing to seek your agreement, and that of other colleagues, to the line we should take on two amendments which have been tabled for the Report Stage of the Broadcasting Bill. As these amendments may be reached on 8 May, I should be grateful for a response by close of play on Friday, 4 May.

The first point concerns the transitional arrangements for cable operators licensed under the existing law. Those operators who obtained franchises before the date of publication of the White Paper will be able to opt to become local delivery operators. Any operators who take up this option will benefit from the renewal provisions in clause 72 of the Bill: that is, they will be able to apply for renewal of their licenses; and the ITC will be obliged to grant renewal provided the licensee agrees to pay an annual amount set by the ITC (representing its estimate of the market value of the franchise), unless it proposes to change the franchise areas. But those operators who obtained their franchises after publication of the White Paper - the great majority - will simply have their cable licences honoured. These licences last 15 years. Those operators with 23 year Telecommunication Act licences will be able to apply for an eight year extension to their cable licences at the 15 year point, as the existing law already provides. But when the cable licences finally expired - whether after 15 or 23 years - these operators would have to apply afresh for a licence under the law then prevailing. This would mean bidding in a competitive tender for the right to continue their business.

A delegation led by Peter Blaker and Ray Whitney, and including representatives of almost all the major North American investors in cable, has met David Mellor to express serious concern about this. They argue that most cable operations will barely have moved into cumulative profit after 15 years. Investors will therefore need to be confident either that the operator will have his licence renewed provided he has performed satisfactorily, or that he will be able to sell his cable system to the new operator who replaces him. The Bill clearly cannot provide any certainty on the first point since the new licence would be allocated by competitive tender. Nor does it offer certainty on the second since, under the technology-neutral framework in the Bill, the new operator might use MVDS and thus have no need for a cable system. Faced

The Rt Hon Nicholas Ridley, MP.
Secretary of State for Trade & Industry
Department of Trade & Industry
1-19 Victoria Street
LONDON, S.W.1.

/over....

with this prospect, Peter Blaker's delegation said that investors would simply not commit funds. They therefore urged that all existing cable operators should be subject to the clause 72 renewal procedure provided they had performed satisfactorily. Peter Balker has tabled an amendment to this effect.

Although the amendment as it stands cannot be accepted, I think we should indicate that we agree with the underlying point, for two reasons. First, David Mellor's assessment is that the anxieties of investors have to be taken seriously. It may be that they have underestimated the likelihood that a cable operator would win a new licence at the 15 year point; officials' assessment is that they would be in a strong position in the competitive tender. But the key point is that investors plainly consider there to be sufficient uncertainty as to constitute a barrier to investment. Given the difficult history of cable until recently it would be unfortunate if any provisions in the Bill, albeit inadvertently, deterred the major investment which now appears to be coming forward.

Second, quite apart from any anxieties in the industry, there seem to be good arguments on the merits for the proposal they have put forward. Given the huge investment required to construct a cable system, and the long pay-back period, it seems right that operators should enjoy a reasonable certainty of tenure, provided that they perform adequately. The position of cable operators can be distinguished from that of the ITV companies, on the basis that the main asset which would remain to them if they lost their licence - their cable systems - is not as marketable as programme libraries or studios, and might in some circumstances become worthless.

The second point, on which Peter Blaker has also tabled an amendment, is the part which the level of coverage proposed by applicants should play in the procedure for the allocation of local delivery licences. As the Bill stands, the pre-qualification conditions in clause 69 - the counterpart to the quality threshold for Channels 3 and 5 - do not stipulate minimum coverage levels. They simply require the ITC to satisfy itself that the technical means by which the applicant would achieve his proposed level of coverage would be acceptable. It follows that an applicant proposing a cable system with 100% coverage could fail to win the licence if narrowly outbid by one proposing to "cherry-pick" lucrative areas and achieve only, say, 50% coverage. Indeed, it can be argued that the Bill skews the franchise award procedure in favour of applicants of the latter type since their lower capital costs will put them in a position to submit higher cash bids.

The fact that the scheme in the Bill could have this consequence has been widely criticised. David Mellor resisted amendments at the Committee Stage which would have enabled the ITC to specify minimum coverage requirements when advertising franchises. I am clear that we should not go down

/cont.....

this road: the lesson from the experience of the present regime is that high coverage levels imposed by regulation can raise entry costs to the market and hold back the development of delivery systems. It is preferable that operators should be able to specify their own coverage targets.

I am, however, equally clear that the Bill needs to take more explicit account of the fact that applicants may propose very different coverage levels. In the example cited above, I think it would be generally agreed that it would not be desirable for the franchise to be awarded to the applicant proposing 50% coverage. Such an outcome would be against the interests of viewers, the providers of programme services, and advertisers. To the extent that we hope that local delivery operators will in due course provide competition to BT in the local loop, it would also frustrate our telecommunications policy objectives. It would certainly be difficult to continue defending in Parliament a scheme which could have these results. Arguably, the ITC would as the Bill stands be able to award the licence to the applicant proposing 100% coverage, by using the "exceptional circumstances" proviso, since it would be obliged, in determining whether or not the circumstances were exceptional, to be guided by its duty under clause 2 (2)(a)(i) to "ensure that a wide range of such services is available throughout the United Kingdom". But if we want the ITC to be able to do this, there is a strong case for sending it clearer statutory signals. Peter Blaker's amendment would do so by providing explicitly that the ITC could regard circumstances in which an applicant was proposing substantially higher coverage than the highest bidder as exceptional.

Although the amendment as it stands is unacceptable, I am attracted by the underlying principle. I do not think that it would make the franchise award procedure subjective or opaque since coverage is objectively measurable. I would, therefore, welcome agreement that we should undertake that the Government would bring forward an amendment on these lines in the Lords. My officials would, of course, consult yours about the terms of the amendments.

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

Yours sincerely
Iain Sproat

(Approved by the Home Secretary and signed in his absence.)