



TW

apu

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

11 May 1990

Dear Sonia,

BROADCASTING BILL: PERFORMANCE BONDS

The Prime Minister has seen a copy of the Home Secretary's letter of 3 May to the Chief Secretary about performance bonds. Subject to the views of the Chief Secretary, she would be content to abandon the performance bond requirement in the Broadcasting Bill and instead take powers to impose termination fines on the licensee.

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

Young,

Barry

BARRY H. POTTER

Ms. Sara Dent,
Home Office.

✓



Prime Minister

I understand that DTI

Minister believe these proposals are sensible.

QUEEN ANNE'S GATE LONDON SW1H 9AT

Contact, subject to view of Chief Secretary?

5 May 1990

BHP
915

Dear Chief Secretary

Yes

BROADCASTING BILL: PERFORMANCE BONDS

As a result of recent discussions with the financial institutions and within the broadcasting industry, I have come to the conclusion that the benefits of the system of performance bonds which we currently envisage are likely to be outweighed by the disadvantages. I therefore propose that we adopt instead a simpler alternative.

Following our earlier exchange of correspondence in February, we agreed that the performance bond required of Channel 3 licensees should be set at 7% of qualifying revenue, and should be liable to be called in only in the event of withdrawal of the licence.

A performance bond of this size would range from about £2 million for the smallest company to about £15 million for the largest. Such a bond could be raised in one of three ways.

The first possibility would be an insurance-based bond, under which, in return for regular premiums, the insurance company would undertake to pay the full value of the bond if it were called in. We understand that an insurance company might charge an annual premium of about 8% of the value of the bond. The problem with this arrangement, from the public policy standpoint, is that it does not create the necessary incentive to stick with the licence. Once the licensee has paid the premium, he himself would suffer no further consequences in the event that the bond were called in. The only purpose of a bond of this kind would be to protect the Treasury against the loss of tender payments. Government does not normally insure itself against such risks; and since the premiums, as a known charge on the licensee, would in effect be reflected in lower tender prices at the outset, it is hard to see that the Treasury would benefit from such an arrangement.

The second possibility would be for the bond to be provided by a financial institution on the basis of readily realisable assets held by the licensee. The difficulty here is that companies would not necessarily have sufficient assets to offer as security. New entrants, in particular those planning to operate as publisher-contractors, would be particularly poorly placed. Even where a licensee had sufficient assets, it would not necessarily be sensible to require them to be used in this way, since the companies would in that event be precluded from using them to secure further borrowing.

The Rt Hon Norman Lamont, MP.
Chief Secretary
Treasury Chambers
Parliament Street, S.W.1.

/over....

Bearing in mind that a bond of the size proposed could represent up to 30% of the assets of a large ITV company, this is a very real problem.

The third approach would be for the bond to be provided in the form of cash collateral. The company, or its shareholders, would deposit the necessary amount with a financial institution, which would hold it on deposit and undertake to pay the money to the ITC if the bond were called upon, or to return it to the company at the end of the licence period. Enquiries we have made suggest that, taking account of the fee which would be charged by the institution, and the fact that the deposit would not attract as favourable a rate of interest as that available elsewhere, the licensee would in effect be paying some 4% of the value of the bond each year in order to keep the arrangement in force. Over the whole licence period, therefore, a sum equal to 40% of the value of the bond would be incurred, even though the bond itself was never called upon. A loss of this size would again be reflected in depressed tender proceeds.

Against this background, I question whether bonds of this kind are a sensible way to secure our objective of providing a disincentive to licensees from walking away from their licence obligations. Given that in normal circumstances a company which gets into difficulties or is no longer performing efficiently is likely to be the subject of takeover, it should be a relatively rare situation in which a licence is actually revoked by the ITC with the result that the bond is called in. It is highly questionable whether we should require licensees to incur the heavy price of establishing a bond in order to guard against a situation which we ourselves already recognise to be fairly unlikely.

I therefore propose that we should abandon the bond requirement and provide instead that where the ITC revokes a licence it should have power to impose a termination fine on the licensee of up to 7% of qualifying revenue (the level that the bond itself would have represented). This would mean that a company would have to raise this money only in the event that the licence was revoked. Clearly if that happened because the licensee had gone bankrupt there would be little hope that the fine (which would be enforceable as a civil debt) would be paid. But the bond arrangement was never itself intended to guard against bankruptcy. The intention was to stop the licensee who was capable of providing a service from choosing instead - perhaps because he could see that his future prospects were deteriorating - from walking off the patch. In these circumstances a termination fine would in principle be readily enforceable.

Such a scheme seems to be greatly preferable to the performance bond proposal. It will remove a substantial barrier to entry - a point which Nicholas Ridley raised in the earlier correspondence; it will result in higher tender proceeds; and yet it will retain the essential disincentive effect which the performance bond was intended to offer.

I recognise that, presentationally, abandoning the bond provisions will be difficult. But we would find it impossible, in my judgment, to defend the present proposal in the Bill if it is challenged in the Lords, and there is every advantage in keeping the initiative by coming forward ourselves with a better alternative now, rather than having to do so in response to damaging criticism later.

I hope, therefore, that you and other colleagues will be prepared to agree to this proposed change.

I am copying this letter to MISC 128 colleagues and to Sir Robin Butler.

Yours sincerely

David Dent

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

