

Offer to bring forward periods for reviews of
financial terms for Channel 5 and Public
Teletext licences

Statement

13 October 2004

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Summary

- S.1 This statement sets out Ofcom's decision on the offer to bring forward the reviews of financial terms for Channel 5 and Public Teletext licenses, and the valuation methodology to be applied to these reviews.
- S.2 Section 225 of the Communications Act 2003 (the "Act") allows for Channel 3, Channel 5 and Public Teletext licensees to apply to Ofcom for optional reviews of their financial terms for payments to the Treasury.
- S.3 Under the Act, the earliest date on which a licensee can apply for a review of its financial terms is four years prior to the expiry date of its analogue licence. Following a consultation in January 2004 (the "January Consultation")¹ Ofcom decided to offer all Channel 3 licensees the opportunity to align the expiry dates of their analogue licences and, therefore, the dates for their reviews. As a result, all Channel 3 licensees will be allowed to apply for reviews from 31 December 2004.
- S.4 On 29 June 2004, Ofcom issued a consultation seeking views on a proposed valuation methodology for the reviews of financial terms for Channel 3 licences (the "June Consultation")². The June Consultation proposed that the methodology that will be applied to Channel 3 licences should equally be applied for the review of the financial terms for the Channel 5 and Public Teletext Licences.
- S.5 In order to promote further consistency across all broadcasting licences, Ofcom proposed, in a consultation published in July 2004 (the "July Consultation")³, to extend the offer to the Channel 5 and Public Teletext licensees to bring forward the dates of their financial review periods to begin on 31 December 2004. It was also proposed that the valuation methodology proposed for the Channel 3 licences should be applied for the review of the financial terms for the Channel 5 and Public Teletext Licences.
- S.6 The July Consultation sought views on a proposal to offer the Channel 5 and Public Teletext licensees the option to bring forward the dates of the review periods for the financial terms associated with their licences. Without this offer, Channel 5 would have a review period beginning on 31 March 2009 and Teletext would have a review period beginning on 31 December 2007. Responses were invited by 19 August 2004.
- S.7 A statement following publication of the June Consultation has now been published (the "Methodology Statement"), detailing the methodology to be applied to the reviews of financial terms for licences.

¹ Ofcom publication: *Consultation on Reviews of Financial Terms for Channel 3 Licences*, 26 January 2004

² Ofcom publication: *Consultation on methodology for reviews of financial terms for Channel 3 licences*, 29 June 2004

³ Ofcom consultation: *Offer to bring forward periods for reviews of financial terms for Channel 5 and Public Teletext licences*, 22 July 2004

Summary of conclusions

S.8 Ofcom has received three confidential responses to the July Consultation. Having considered all responses, Ofcom has concluded that:

- (a) It is appropriate to offer the Channel 5 and Public Teletext licensees the option to curtail their current analogue licence periods in order to promote further consistency across all broadcasting licences; and
- (b) It is appropriate to apply broadly the same valuation methodology for the review of the financial terms for the Channel 5 and Public Teletext licences as that applied for the review of the Channel 3 licence terms, as set out in the Methodology Statement. The Methodology Statement identifies certain detailed elements of the methodology that should be varied in some respect to recognise the differing positions of Channel 3, Channel 5 and the Public Teletext Licensees.

Section 1

Introduction

Background

Regulatory framework

- 1.1 Section 225 of the Communications Act 2003 (the “Act”) allows for Channel 3, Channel 5 and Public Teletext licensees to apply for optional reviews of their financial terms for payments to the Treasury, which were set by the Independent Television Commission (ITC) at the time of the most recent renewal of their analogue broadcasting licences.
- 1.2 Separately, section 215 of the Act requires Ofcom to offer to replace the current analogue broadcasting licences for Channel 3 and Channel 5 with digital broadcasting licences to take effect from 29 December 2004. Section 221 of the Act sets out the same requirement in respect of Public Teletext. Each licensee’s existing financial terms will carry forward to its new digital licence, in accordance with the statute, and will remain in place until the relevant licensee applies for a review of the financial terms. The period during which each licensee is allowed to apply for a review is based on the expiry date of its old analogue licence.
- 1.3 Under the Act, the earliest date on which a licensee can apply for a review of its financial terms is four years prior to the expiry date of its analogue licence. Following a consultation earlier this year, Ofcom decided to offer Channel 3 licensees the opportunity to align the expiry dates of their analogue licences and, therefore, the dates for their reviews. As a result, the Channel 3 licensees will be allowed to apply for reviews from 31 December 2004.
- 1.4 In order to promote further consistency across all broadcasting licences, Ofcom subsequently proposed in the July Consultation to extend the offer to bring forward the dates of their financial review periods to begin on 31 December 2004 to the Channel 5 and Public Teletext licensees. Without this offer, Channel 5 would have a review period beginning on 31 March 2009 and Teletext would have a review period beginning on 31 December 2007.
- 1.5 In the July Consultation, Ofcom also proposed that the methodology for the review of the financial terms of the Channel 3 licences should equally be applied to the review of the financial terms for the Channel 5 and Public Teletext Licences. The methodology to be applied for the review of the financial terms of the Channel 3, 5 and Public Teletext licences is set out in Ofcom’s statement of 13th October 2004 (the “Methodology Statement”)⁴.
- 1.6 The July consultation closed on 19 August 2004, receiving three confidential responses.

⁴ Ofcom statement *Methodology for reviews of financial terms for Channel 3, Channel 5 and Public Teletext licences* 13 October 2004

Proposals in the July consultation

Timing of the review of financial terms

- 1.7 As stated in paragraph 1.3 above, each holder of a digital replacement licence is allowed to apply for a review of its financial terms during a period of time beginning four years prior to the expiry date of its old analogue licence.
- 1.8 Ofcom aims to promote a more consistent and predictable regulatory environment. In pursuit of this objective, Ofcom decided to offer Channel 3 licensees with analogue licence expiry dates in 2010 and 2011 the opportunity to align the dates for reviews of financial terms for their licences by offering to curtail the analogue licence periods (see Ofcom's consultation 26 January 2004⁵). If the offer were accepted, all Channel 3 licensees would be able to apply for reviews as early as 31 December 2004. Without this offer, the sixteen Channel 3 licensees would have three different review periods beginning on dates ranging from 31 December 2004 to 31 March 2007.
- 1.9 Some respondents to the consultation of 26 January 2004 raised the point that the proposed approach was unfair in various respects to Channel 5 and Teletext. It was also argued that that Ofcom should aim for a more consistent regulatory environment more generally in relation to broadcasting licensees, rather than just for Channel 3 licensees.
- 1.10 In the July Consultation, Ofcom agreed that there was merit in seeking to value all of the broadcasting licences simultaneously, in order to create a more consistent regulatory environment overall. Ofcom therefore proposed to extend the same offer to the Channel 5 and Public Teletext licensees. This proposal would allow Ofcom to take account consistently of any issues related to digital switchover, the issuance of digital replacement licences and Ofcom's review of public service broadcasting in the valuation of licences, for all licensees who accept the offer to bring forward their review periods and apply for a review at the earliest possible date.
- 1.11 Ofcom also considered that to not offer the Channel 5 and Teletext licensees the opportunity to seek a review of financial terms at the same time as Channel 3 licensees could be unduly discriminatory. This reflects the fact that all three of these classes of licensee face similar changes in the regulatory and commercial environment associated with digital switch-over, the issuance of digital replacement licences, and the review of public service broadcasting.
- 1.12 The current analogue licence expiry dates and the implied earliest possible application dates for reviews for Channel 5 and Teletext are as follows:

Licence	Analogue licence expiry date	Earliest possible application date
Channel 5	31 March 2013	31 March 2009

⁵ Ofcom publication *Consultation on Reviews of Financial Terms for Channel 3 Licences*, 26 January 2004

Public Teletext	31 December 2011	31 December 2007
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- 1.13 Under its proposal, Ofcom would offer the Channel 5 and Public Teletext licensees the option to bring forward the expiry dates of their analogue licences to 31 December 2008, which would allow them to apply for reviews of their financial terms as early as 31 December 2004.

Methodology for the review of financial terms

- 1.14 Under section 227 of the Act, following an application for a review, Ofcom must determine a fixed annual cash amount to be paid for the licence and a percentage of qualifying revenue (PQR) payable for each year of the licence period. Specifically, the Act requires that Ofcom determine the amount that, in its opinion, would have been the cash bid of the licence holder were the licence being granted afresh. This means that Ofcom is required, in practice, to reproduce the effects of a hypothetical auction of the licences.
- 1.15 The Act is not prescriptive about every aspect of the process that Ofcom must follow in order to determine the amount that would be bid for each licence in a auction. However, the same statutory provisions apply to a review of the terms of Channel 5 and Public Teletext licences as to a review of the terms of a Channel 3 licence.
- 1.16 In the July Consultation, Ofcom therefore proposed that the methodology proposed for reviews of the Channel 3 licences should also be applied to Channel 5 and Public Teletext licences, in order to ensure a consistent and equitable approach. Details of the methodology proposed for the Channel 3 licences had been set out in the June Consultation.

Summary of Ofcom's proposals

- 1.17 In the July Consultation, Ofcom asked for comments from interested parties on two proposals:
- (a) Ofcom proposed to offer the Channel 5 and Public Teletext licensees the option to bring forward the expiry dates of their analogue licences to 31 December 2008, which would allow them to apply for reviews of their financial terms as early as 31 December 2004; and
 - (b) Ofcom proposed to apply the methodology that will be applied to the review of the financial terms for the Channel 3 licences to the review of the financial terms for the Channel 5 and Public Teletext Licences.
- 1.18 Section 2 of this document provides a summary of the responses to the July Consultation, and sets out Ofcom's conclusions in light of these.

Section 2

Responses to proposals and conclusions

Background

- 2.1 As discussed in Section 1, Ofcom proposed in the July Consultation to bring forward the dates of the financial review periods for the Channel 5 and Public Teletext Licences to begin on 31 December 2004. Ofcom also proposed that the methodology for the review of the financial terms of the Channel 3 licences should equally be applied for the review of the financial terms for the Channel 5 and Public Teletext Licences.
- 2.2 Ofcom received three responses to the July Consultation. This section first discusses the arguments for and against Ofcom's proposals raised in response to the July Consultation. Thereafter, this section sets out Ofcom's conclusions on the July Consultation proposals.

Key issues raised by respondents:

- 2.3 The following section sets out the arguments provided by respondents in respect of the three questions set out in the July consultation.

Question 1: *Is it appropriate to offer the Channel 5 licensee the option to curtail its current analogue licence period, as described, in order to promote further consistency across all broadcasting licences?*

Question 2: *Is it appropriate to offer the Public Teletext licensee the option to curtail its current analogue licence period, as described, in order to promote further consistency across all broadcasting licences?*

- 2.4 One respondent stated that Ofcom's view that a Channel 5 licensee would be disadvantaged if the reviews were not aligned was not correct and that alignment of all licences would advantage Channel 5 over Channel 3 licensees. This is based on the respondent's view that as a result of different market conditions, the renewal of the Channel 5 licence (in 2003) produced financial terms that are more favourable than those set for Channel 3 licensees in 2000. Thus the Channel 5 licensee faces comparatively little pressure to apply for a review of financial terms and could choose to observe the results for those who have little choice but to apply. The same respondent also pointed out that in the event that Channel 5 declined the terms offered in a review, it would benefit from a long period before the earliest possible date for expiry of its licence (March 2013, compared with 2009 if a Channel 3 licensee refuses revised terms).
- 2.5 Responses from the two other respondents strongly supported the proposals to curtail the analogue licence periods as described.
- 2.6 All respondents agreed that the proposal to offer the Channel 5 and Public Teletext licensees the option to curtail current analogue licence periods would

promote consistency of treatment by Ofcom across licensees, particularly in light of the proposed issuance of Digital Replacement Licences.

- 2.7 Accordingly, Ofcom considers that aligning all licence periods at this stage is appropriate.

Question 3: *Is it appropriate to apply the same valuation methodology for the review of the financial terms for the Channel 5 and Public Teletext licences as that applied for the review of the Channel 3 licence terms?*

- 2.8 Respondents accepted that the key principles proposed for the methodology for reviewing the terms of Channel 3 licences should also be applied to Channel 5 and Public Teletext licences. However, a number of specific comments were made on the exact methodology that should be applied to the review of the financial terms for the Channel 5 and Public Teletext licences.
- 2.9 All the respondents stated that some differences existed between Channel 3 and Channel 5 and Teletext and that these should be reflected in the reviews.
- 2.10 One respondent suggested that a separate public consultation on the financial terms for the Channel 5 and Public Teletext licences should be issued by Ofcom.
- 2.11 One respondent also advised of its concern that licensees are effectively expected to apply 'blind' to the outcome, given that Ofcom had proposed significant changes in the process compared to that operated in the past by the ITC.
- 2.12 Finally, in respect of obligations attached to the ownership of a license, one respondent argued that there was a disparity between the past treatment of the Channel 5 licensee (which the respondent felt was lenient) and proposals made in the June Consultation for the Channel 3 licensees (which the respondent felt were onerous). This respondent argued that the last review of financial terms for the Channel 5 licence had assumed that the licensee would meet its licence obligations in full, but that this was not in fact the case. This had resulted in a benefit for Channel 5.
- 2.13 The respondent contrasted this with Ofcom's proposal in the June Consultation to take account of a potential easing in licence obligations for Channel 3 licensees even if these had not been confirmed definitively by the date of application for the review. The respondent proposed that to ensure consistency of treatment, future reviews should assume that existing licence obligations are maintained throughout the duration of the licence, and any reduction in obligations should only be taken into account if it has gained final regulatory consent.
- 2.14 Ofcom deals with these points in turn below.
- 2.15 Ofcom agrees that differences exist between the businesses of Channel 3, Channel 5 and Public Teletext licensees, but Ofcom does not consider that these differences are such as to undermine application of the same basic approach to licence reviews. Ofcom therefore proposes to use the same underlying methodology (set out in the Methodology Statement) but to vary

aspects as needed to reflect relevant and material differences in the circumstances of these different classes of licensee.

- 2.16 The Methodology Statement describes those aspects of the methodology that Ofcom considers require some variation. The most significant issue arises in relation to the Public Teletext licensee, and this is discussed in Section 5 of the Methodology Statement. Ofcom does not therefore consider it necessary to issue a separate public consultation on the methodology for the Channel 5 and Public Teletext licence reviews.
- 2.17 Ofcom does not consider that licensees are being invited to apply 'blind'. Ofcom has taken a number of steps to provide information and guidance to licensees on its approach to these reviews, including the June and July Consultations and the Methodology Statement. Ofcom does not consider that it is appropriate to continue with the previous ITC approach to conducting reviews of licence terms, under which formal applications were only lodged at the end of a lengthy informal process. There is no statutory requirement for such a process (see also Ofcom's April statement⁶).
- 2.18 However, Ofcom considers that it is necessary for it to be able to take into account any information relevant to deciding the revised licence payments that is or becomes available up to the date of determination. Ofcom accepts that it is a significant commercial decision for holders of digital replacement licences to apply for a review. Ofcom has therefore decided that in order to ensure a fair and equitable process an applicant should have the opportunity to withdraw its application in light of information that becomes available after the date of application but before the determination of new financial terms by Ofcom. An application may only be withdrawn by a licensee up to the date of determination. Any such licensee may reapply within the same review period.
- 2.19 Finally, Ofcom has noted the observations made by one respondent on the issue of future licence obligations and compliance with these. The treatment of obligations is discussed in detail in Section 5 of the Methodology Statement. In setting new terms under these reviews, Ofcom will endeavour to ensure that the valuation takes account of realistic forecasts and assumptions about future costs, revenues, rights and obligations. Ofcom will seek to ensure that it takes a consistent approach in this respect to all licences under review. However, it would not be appropriate (for the setting of future licence terms) to seek to punish or reward licensees for past behaviour.

Conclusions

- 2.20 In light of the responses to the July Consultation, and for the reasons discussed in paragraphs 2.3 to 2.19 above, Ofcom believes that its original proposals should stand. As such Ofcom has concluded that:

- (a) It is appropriate to offer the Channel 5 and Public Teletext licensees the option to curtail their current analogue licence periods in order to promote further consistency across all broadcasting licences; and

⁶ See Ofcom publication *Statement on Timetable for Reviews of Financial Terms for Channel 3 Licences*, April 2004

(b) It is appropriate to apply broadly the same valuation methodology for the review of the financial terms for the Channel 5 and Public Teletext licences as that applied for the review of the Channel 3 licence terms, as set out in the Methodology Statement. The Methodology Statement identifies certain detailed elements of the methodology that should be varied in some respect to recognise the differing positions of Channel 3, Channel 5 and the Public Teletext Licensees.

2.21 Administrative details concerning the timetable and general approach to the reviews as set out in Section 6 of the Methodology Statement.

