

Review of the financial terms payable by Absolute Radio– determination

9 March 2011

Introduction

There are three Independent National Radio (INR) licences issued by Ofcom under the Broadcasting Act 1990 (“the 1990 Act”). They are the licences for Classic FM (held by Classic FM Ltd), talkSport (talkSport Ltd) and Absolute Radio (held by TIML Radio Ltd). The Digital Economy Act 2010 (“the 2010 Act”) included provisions which amend the 1990 Act¹ to allow the INR licences to be renewed for up to a further seven years rather than be re-awarded under a competitive auction. Each of the INR licensees has applied for a renewal of their licences.

The INR licensees are required to make annual “additional payments” to Ofcom (in turn payable to HM Treasury). Licensees pay fixed annual cash bids plus a Percentage of Qualifying Revenue (PQR) applied to the appropriate proportion of their advertising and sponsorship revenue.

As part of the process of (further) licence renewal, Ofcom is required to set new financial terms for each licence, made up of a cash bid and a PQR. Ofcom has now determined these terms for Absolute Radio, having determined the terms payable by Classic FM and talkSport in January 2011².

How financial terms are set

Ofcom set out the methodology applied in calculating the financial terms for each licence in the statement entitled *Review of the Independent Radio Licences – methodology for review of financial terms* published on 5 October 2010 (‘the October statement’)³. Our methodology reflects the requirement under the relevant provisions of the 1990 Act⁴ to determine part of the financial terms based on an assessment of the amount each incumbent would have bid were their licence for the further renewal period being granted afresh in a competitive auction. It also reflects that we may also revise the PQR a licensee must pay.

As set out in the October statement, the amount the incumbent would bid in a competitive auction would be the minimum required to beat the second-highest bidder, and as such would not necessarily represent the maximum amount the incumbent would be willing to pay. The valuation of each licence is therefore based on the value of the rights and obligations associated with the licence to a hypothetical new entrant, including an allowance for entry costs, since it is this valuation that would determine the amount that the incumbent would have to bid in order to retain the licence in a hypothetical auction.

The October statement also set out that the 2010 Act introduced statutory provisions for the possible early termination of the INR licences depending on the setting of a date for digital

¹ Inserting a new section 103B into the 1990 Act

² <http://stakeholders.ofcom.org.uk/binaries/consultations/renewal-national-licences/statement/classic-talksport-terms.pdf>

³ <http://stakeholders.ofcom.org.uk/binaries/consultations/renewal-national-licences/statement/statement.pdf>

⁴ Section 103A (6) (a) and (7), as applied by section 103B (2)

switchover.⁵ The effect of these statutory provisions is to make the duration of a further renewed INR licence uncertain, in that it may be terminated with two years' notice. The October Statement set out that, to take account of this uncertainty, the licence valuations would be based on the period from the start of the further renewed licence term to 31 December 2015. This represented approximately five years for Classic, four years for talkSport and four and a half years for Absolute.

The principal right associated with Absolute's licence is the right to broadcast radio using AM analogue spectrum with national coverage and the principal obligation is the requirement to simulcast the analogue service nationally on DAB.

Historically, the profits associated with the right to broadcast on national analogue radio meant we considered that potential entrants, even after incurring entry costs, would be prepared to make additional payments in order to access these potential profits over the period of the licence.

The profits associated with the right to broadcast nationally on analogue have reduced over time as digital listening has increased and, in recent years, as national radio advertising revenue has fallen. When Ofcom last carried out a review in 2006, financial terms for each INR licence were reduced significantly which reflected this reducing value to potential new entrants of the right to broadcast radio on analogue spectrum.

Conclusion of the current review

Ofcom has reviewed the financial terms for Absolute Radio based on financial and other evidence from the licensee and other sources.

Our review indicated that the combination of the profits available from operating a national AM licence and the entry costs required to launch the service (e.g. launch marketing costs, other start up costs (such as dry running costs) and capital expenditure) would not be sufficient for a hypothetical new entrant to make a return in the period we were considering for the licence valuation⁶.

Therefore our conclusion for Absolute Radio's licence is that, on the basis described in the October Statement, a hypothetical new entrant would not be prepared to make financial payments in return for the right to broadcast nationally on AM analogue for the period under consideration. As a result, the incumbent licence holder could retain its licence in a hypothetical auction for a nominal amount. Consequently, we have decided to set the financial terms at a nominal amount of £10,000 per annum for Absolute Radio, with a nil PQR. This is what we consider a reasonable view of the approach the incumbent licensee would take to making a nominal bid, looking at nominal cash bids made by bidders and those set by Ofcom in (real and hypothetical) auctions for television and the other INR licences.

⁵ Again, these provisions amend the 1990 Act. They insert new sections 97A, 97B and 105A into the 1990 Act

⁶ As set out in the October statement, we were considering the value of the INR licences to a new entrant in the period from the start of the renewed licence term to 31 December 2015.

	Current terms		New terms	
	PQR	Cash bid	PQR	Cash bid
Absolute Radio	0%	£100k	0%	£10k

Next steps

Absolute Radio has until 7 April 2011 to accept or reject the new financial terms. Acceptance of the terms is required in order for the licence renewal to come into effect. If accepted, Absolute's new financial terms (and licence renewal) would apply from 1 May 2011. We will update this document shortly after this date with details of whether Absolute accepted or rejected the terms.

Update 11 April 2011

Absolute Radio accepted the financial terms by the 7 April deadline and its licence has been renewed. Its terms and renewal will begin from 1 May 2011.