



Determination between Digital 3 & 4 Limited and
Channel Five Broadcasting on charges payable for services
on DTT Multiplex 2.

Non-confidential summary

28th July 2010

Summary

- 1.1 This document is a non-confidential summary of the determination by Ofcom of the price payable by Channel 5 Broadcasting Ltd to Digital 3 and 4 Limited (“D3&4”) for the use of reserved capacity on Multiplex 2.
- 1.2 The summary outlines the background and legislative framework to the determination. It also sets out the overall approach and methodology that Ofcom have adopted in this determination.
- 1.3 The determined price and contract information have been redacted on grounds of commercial confidentiality to the parties.

Background

- 1.4 Channel 5 Broadcasting Ltd, which operates as “Five”, is the holder of the Channel 5 licence.
- 1.5 D3&4 is the multiplex operator for digital terrestrial television (“DTT”) Multiplex 2. It is a joint venture between ITV Network (acting on behalf of the regional Channel 3 licensees) and Channel 4.
- 1.6 Under Condition 7 of the D3&4 Multiplex Licence, DTT capacity is reserved for the holder of the Channel 5 licence. Further, under this condition, in default of agreement between the parties as to the payments to be made by Five to D3&4, Ofcom will determine those payments.
- 1.7 D3&4 commenced carriage of Channel 5 for a 24-hour videostream (“the core videostream”) on Multiplex 2 on 30th September 2009 and the parties entered into a broadcasting services contract (“the carriage contract”) on [3<]. However, the parties have been unable to reach agreement on financial terms of that carriage contract and have referred the matter to Ofcom.
- 1.8 The parties have also asked Ofcom to determine the charge that Five should pay to D3&4 for the provision of regionalised services, i.e. for the transmission of Channel 5 on a regional (as opposed to national) basis.

Legislative and Regulatory Framework

- 1.9 The Television Multiplex Service (Reservation of Digital Capacity) Order 2008 (the “2008 Order”) provides the legal basis for Ofcom to make this determination. Amongst other things it requires Ofcom to vary the Multiplex 2 licence so as to reserve capacity for the holder of the Channel 5 licence. It also requires Ofcom to secure that the Multiplex 2 licence holder, in consideration for the making of payments by the holder of the Channel 5 licence, as agreed between them or in default of agreement determined by Ofcom, will use this reserved capacity for the broadcasting of the Channel 5 service.
- 1.10 However, the 2008 Order and the provisions of the licence reflecting the 2008 Order do not contain any indication as to the methodology that should be used in making a

determination. Within the framework established by the 2008 Order, and subject to its statutory and general public law duties, Ofcom has a wide discretion to set the methodology for making this determination.

Overall Approach

- 1.11 For the purposes of making this determination, Ofcom has used a market price based approach. Ofcom has decided on this approach after taking into account a range of factors, including:
- The historical context in relation to the reservation of DTT capacity for PSBs. This indicates that the payments to the multiplex holders should in the first place be determined following a normal commercial negotiation.
 - The analytical framework in the ITC's 1998 determination and Ofcom's 2005 determination, both of which related to the price payable by Five for reserved capacity on Multiplex A. In the 1998 determination, the ITC indicated that the charges payable by Five to SDN should be set using a commercial approach. However, given DTT was in its infancy, the ITC decided that a cost-based approach was a reasonable reflection of opportunity cost to SDN at that point in time. Similarly, in the 2005 determination, Ofcom considered that opportunity cost was the relevant conceptual approach and that the capacity guaranteed for Five on Multiplex A should be valued on the basis of a commercial approach.
 - The contract for the use of reserved capacity between D3&4 and S4C. As the multiplex 2 licence contains a non-discrimination clause, we considered whether any difference in the methodological approach taken in this determination is objectively justifiable. We consider that the position of S4C and the nature of the D3&4/S4C contract differs significantly from Five and the D3&4/Five contract so that any difference in the methodological approach would not result in unlawful discrimination; and
 - Ofcom's general duties. We consider that a market price based approach would be consistent with our duty to secure the optimal use of spectrum, and would encourage investment and innovation and promote competition in relevant markets. While we recognise that a market based price could lead to a price which might be more difficult to reconcile with certain other duties, we have carefully weighted all relevant factors in the manner we consider appropriate and consider that any conflict is best resolved in the circumstances by adopting a market based approach.

Methodology

- 1.12 In relation to the charge for the core videostream, Ofcom focused on the opportunity cost to D3&4 in relation to the use of the capacity reserved for Five for the provision of TV services by broadcasters as opposed to any other alternative uses of that digital capacity.
- 1.13 Ofcom considered that the most appropriate way of implementing an opportunity cost approach was to develop a benchmark for the price of commercial DTT capacity. We considered that the relevant benchmarks were DTT contracts agreed

in the 12 months prior to the date of the Five / D3&4 contract, were for a duration of at least two years, were for a 24/7 national videostream and were for a nation-wide videostream. We took the average of the prices of contracts meeting these criteria to generate a commercial benchmark for the market price for DTT capacity.

- 1.14 We assessed whether this commercial benchmark needed to be adjusted to reflect changes in expected supply or demand for mux capacity between the date of the benchmark contracts and the date of the Five/D3&4 contract. We adjusted the commercial benchmark to reflect the changing forecasts for overall industry advertising revenues during that period.
- 1.15 We assessed whether the commercial benchmark needed to be adjusted to reflect particular circumstances of the carriage contract. We made an adjustment to reflect the full resolution setting accorded to the Channel 5 service, as this required higher average use of capacity compared to the services in the commercial benchmark.
- 1.16 Finally, we adjusted the commercial benchmark to reflect the additional coverage that Five received as a result of being carried on a PSB DTT multiplex. In the absence of specific market benchmarks for additional PSB coverage, we considered a number of approaches to calculating this adjustment that would be in line with our opportunity cost framework. We concluded that it would be appropriate for the price for the incremental PSB coverage to include a reasonable contribution to the common costs incurred by the mux operator in the provision of the additional PSB coverage.
- 1.17 In relation to the charge that Five should pay to D3&4 for the provision of regionalised services, Ofcom also considered that the opportunity cost to D3&4 was relevant to determine the price for regionalisation. In the absence of specific market benchmarks for regionalisation services, Ofcom considered that the payment should be based on the cost to D3&4 of providing this service to Five.

Charges

- 1.18 For the first year of the contract, Ofcom has determined that the charge payable by Five for carriage of its service on Multiplex 2 should be [X].
- 1.19 Going forward, this base price for carriage should change in line with the annual change in RPI inflation where such change has a positive value.
- 1.20 In terms of the charge for regionalised services, Ofcom has determined that the charge payable by Five in the first year of the contract should be [X] as well as a fee of [X] per additional region in which Channel 5 is transmitted as a different regionalised service.
- 1.21 Going forward the price per additional region should change in line with the annual change in RPI inflation where such change has a positive value.

Duration of the Determination

- 1.22 The determination is intended to apply for the duration of the carriage contract and shall cease to have effect upon the expiry of that contract in [X].