

Reviews of the financial terms payable by Classic FM and Absolute Radio – determination 03 February 2017

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), Talk Sport (held by talkSPORT Ltd) and Absolute Radio (held by Absolute Radio Ltd).

All three licences are due to expire in 2018. However, under the Broadcasting Act 1990 (as amended), all three licences qualify for a further five-year renewal. This means that each licensee can apply to extend their licence, rather than having to re-apply for their licence in an open competition.

The licences were originally awarded by an auction process, and the licensees are required to make annual financial payments to the Treasury. These financial payments consist of a cash bid amount, and a specified proportion of the revenue obtained by the licensee. This latter payment is known as the percentage of qualifying revenue, or ‘PQR’.

As the licence renewal process means there is no actual auction of the licences (and therefore no cash bids), Ofcom is required to set new financial terms for each licence. These financial terms consist of an amount which, in our opinion, would have been the cash bid of the licence holder if the licence had been auctioned for the renewal period, together with a PQR.

When the financial terms for these licences were last determined by Ofcom in 2011, they were set at a nominal amount of £10,000 per annum for each of Classic FM, Absolute Radio and Talk Sport (with a nil PQR).

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 17 August 2016 (‘the August statement’)¹. Our methodology reflects the requirement under the relevant provisions of the 1990 Act² 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 to be 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 August 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

¹ Available at: https://www.ofcom.org.uk/data/assets/pdf_file/0018/94104/renewals_statement.pdf

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

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 principal right associated with the licence is the right to broadcast radio using analogue spectrum with national coverage (FM for Classic and AM for Absolute Radio) and the principal obligation is the requirement to simulcast the analogue service nationally on DAB.

Conclusion of the current review

Ofcom has reviewed the financial terms for the licences whose licensees applied for a review. We reviewed each licence separately, based on financial and other evidence from the licensees and other sources.

Our review indicated that Classic FM and Absolute Radio continue and will likely continue to generate profits for the incumbent licence holders, although the profits derived from analogue transmission will continue reduce over time as analogue listening as a proportion of total listening falls³.

A new entrant, however, would incur significant entry costs before it was able to generate analogue profits similar to the incumbent. These entry costs would include, for example, launch marketing costs, other start-up costs (such as dry running costs and capital expenditure) and reductions in revenue in the early years (compared to those generated by the current licence-holders) as audiences take time to build up.

Our review has concluded that for a hypothetical new entrant these entry costs would outweigh the potential profits available from broadcasting nationally on analogue in the five-year duration of the renewed licence.

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

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

³ As set out in the August statement, we estimated the profits attributable to the analogue licence by apportioning revenues and costs on the basis of listener hours.

Next steps

Classic FM has until 28 February 2017 and Absolute Radio has until 30 April 2017 to accept or reject the new financial terms. Acceptance of the terms is required in order for the licence renewal to come into effect. We will update our website at the appropriate time with details of whether the licensees have accepted or rejected the terms.

Talk Sport will shortly apply for its licence renewal. We expect to complete the review of its financial terms before the end of November this year.