

## Reviews of the financial terms payable by Classic FM and talkSport – determination

20 January 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 Act<sup>1</sup> 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 Classic FM and talkSport (Absolute Radio will apply for renewal at a later date and we will complete this review in April).

### 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’)<sup>2</sup>. Our methodology reflects the requirement under the relevant provisions of the 1990 Act<sup>3</sup> to determine part of the financial terms based on an assessment of the amount each incumbent would have bid were their licence being for the further renewal period 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 switchover.<sup>4</sup> 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

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<sup>1</sup> Inserting a new section 103B into the 1990 Act

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

<sup>3</sup> Section 103A (6) (a) and (7), as applied by section 103B (2)

<sup>4</sup> Again, these provisions amend the 1990 Act. They insert new sections 97A, 97B and 105A into the 1990 Act

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 and four years for talkSport.

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 talkSport) 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 these licences 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 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 the national analogue licences continue and will likely continue to generate profits for the incumbent licence holders, although these analogue profits will reduce over time as analogue listening as a proportion of total listening falls<sup>5</sup>.

A new entrant, however, would incur 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 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 time period we were considering for the licence valuation<sup>6</sup>.

Therefore our conclusion for each of the licences under review was 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 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 set the financial terms at a nominal amount of £10,000 per annum for each of Classic FM and talkSport (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

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<sup>5</sup> As set out in the October statement, we estimated the profits attributable to the analogue licence by apportioning revenues and costs on the basis of listener hours.

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

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	6%	£50k	0%	£10k
talkSport	0%	£100k	0%	£10k

### Next steps

Classic FM and talkSport have until 18 February 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, Classic's new financial terms (and licence renewal) would apply immediately,<sup>7</sup> while talkSport's terms and renewal would apply from 1 January 2012. We will update our website shortly after this date with details of whether licensees accepted or rejected the terms.

Absolute Radio will apply shortly for licence renewal. We expect to complete the review of its financial terms before the end of April 2011.

### Update 20 February 2011

Both Classic FM and talkSport accepted the financial terms and their licences have been renewed. Classic's terms and renewal will begin from 1 March 2011 and talkSport's from 1 January 2012.

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<sup>7</sup> Either from 1 February or 1 March depending on the precise date of Classic FM's acceptance