

Response to Ofcom's Financial Methodology Consultation

**From the Commercial Broadcasters Association
May 2013**



A VOICE FOR COMMERCIAL BROADCASTERS IN THE UK

Executive Summary

1. The Secretary of State, in her letter to Ofcom in November 2012 regarding the re-licensing of Channels 3 and 5, said that she was “determined to see [PSB] commitments preserved (if not strengthened) in the next ten years”, and that she would expect these commitments to be honoured over the licence period.¹ This followed Ofcom’s 229 report to the Secretary of State, in which Ofcom highlighted that frequent revisions of the PSB licences were “not in the public interest”.²
2. We agree that there is a significant risk that the PSB licence holders will seek to reduce their commitments over the next licence period, and are not aware of any additional steps that are being proposed to prevent this from happening.
3. However, we believe that the licences are being undervalued in the digital era, and that taking their actual value into account would offer Ofcom and the Government a potential way to maintain and possibly strengthen public service commitments. Failing to do so not only risks undervaluing public assets, but also maintaining an uneven playing field between PSBs and non PSBs due to allowing PSBs to receive a commercial advantage without commensurate duties or payments.
4. Specifically, the current approach to valuing the licences does not take into account legacy brand value or the value of cross promoting with other channels within the corporate portfolio of the licence holder. To put this into context, we estimate that the value of just cross promotion is in the 10s of millions, representing more than twice the sum that is being cited in current debates around the appropriate level of payments between PSBs and pay TV platforms for technical platform charges.
5. In its Section 229 Report last year, Ofcom acknowledged that certain benefits arising from the PSB licences are not factored into its calculations of their

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https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/77982/Maria_Miller_letter_to_ed_richards.pdf

² Ofcom, Licensing of Channel 3 and Channel 5, A Report compiled under Section 229 of the Communications Act 2003, May 2012, Section 6.5

value.³ However, Ofcom concluded that it was not “possible practically to quantify these for the purposes of this report.”⁴

6. Ofcom did not elaborate on its reasons for this decision, but we do not accept that it is not possible to calculate the value of any benefits that are currently excluded. We commissioned a report from independent consultants Communications Chambers to look at how to quantify, amongst other areas, the legacy brand value and the cross promotional value of the Channel 3 and 5 licences. The report, which we have presented to Ofcom, found that ITV and Five together received a benefit of £22m per annum just in terms of the value of cross promoting onto their portfolio channels.⁵
7. Such benefits have a very real impact on the market, and a clear value to PSB licence holders. The PSB portfolio channels account for 19% of total TV viewing, the majority of this being viewing of commercial PSB portfolio channels.⁶ In our view, their exceptional growth has in part been driven by their relationship with their PSB main channels.
8. We therefore ask Ofcom to either clarify why it is unable to quantify such benefits, including the cross promotional benefits to other channels, or to consult with industry on whether it is possible to do so and, if so, the best approach.
9. In calculating the value of the licences, we believe Ofcom already has the power to take into account a wider set of benefits, including revenues accruing to other channels within a corporate group as a result of their relationship to a PSB channel. This would seem to be supported in Ofcom’s evaluation in the consultation paper of the benefits for PSB licence holders, which include reserved capacity on PSB multiplex 2. For ITV, this includes capacity for four channels, one of must be provided to Channel 5 at a commercial rate, and therefore takes into account the value to other parts of the business as a result of holding the PSB licence.
10. We have also raised this matter with the Secretary of State and DCMS.

³ Ofcom, Licensing of Channel 3 and Channel 5, A Report compiled under Section 229 of the Communications Act 2003, May 2012, Section 1.15

⁴ Ibid, Section 6.5

⁵ Valuing the Benefits of Channel 3 and Channel 5 Licensing, Communications Chambers, February 2012, page 12

⁶ Ofcom, Communications Market Report 2012, Figure 2.7

Introduction

1. The Commercial Broadcasters Association (COBA) is the industry body for commercial sector broadcasters in the UK. Its members are Bloomberg Television, BSkyB, Chinese Channel, Discovery Networks, Fox International Channels, NBCUniversal, QVC, Sony Pictures Television, Turner Broadcasting System, Viacom International Media Networks, and The Walt Disney Company.
2. COBA members are significant investors in the UK. They contribute more than £4 billion a year to the UK economy in GVA, through content investment, employment and other expenditure.⁷ In addition, the sector is growing strongly, doubling the size of its workforce over the last decade.⁸
3. As part of this investment, COBA members invest £624m per annum in UK television content, an increase of 27.9% on 2009 levels.⁹ This has helped drive growth in overall investment in new UK TV production in recent years from all sources. Funding for first-run national network originations has increased from £2.8 billion in 2009 (the earliest year available) to £2.9 billion last year, even factoring in relatively flat investment at PSBs.¹⁰
4. Additionally, COBA members, who include many of the world's leading multinational broadcasters, invest more in the UK than any other European market by some distance. This helps ensure the UK is a leading European media hub.¹¹
5. **For further information please contact Adam Minns, COBA's Executive Director, at adam@coba.org.uk or 0203 327 4101**

⁷ This figure is for broadcast operations only, so excludes activities that are part of wider corporate groups such as studio ownership and ISP divisions.

⁸ Skillset, Television Sector – Labour Market Intelligence Profile

⁹ COBA 2012 Economic Impact Report, Oliver & Ohlbaum Associates for COBA, September 2012. Copy available on request.

¹⁰ UK Commissioning Trends, Oliver & Ohlbaum Associates for COBA. Figure excludes commissioning specifically for Nations and regions.

¹¹ Ibid.

Response to Questions

Q1 Do you agree that the overall valuation methodology remains appropriate for the determination of the PQR and cash bid element of the renewed licences? If you do not please explain why you view that methodology as inappropriate and what justification exist for suggested alternatives.

- 1.1 The commercial PSB licences should contain a balance between duties and benefits. This is important in ensuring that the tax payer secures an appropriate value from these public assets, and to prevent the PSBs from being able to compete on an undue basis with other non PSB services.
- 1.2 We believe, however, there is a significant risk that the PSB licences are being undervalued in the digital era. The current approach to valuing the licences does not take into account certain significant factors, namely legacy brand value and the value of cross promoting with other channels within the corporate portfolio of the licence holder. In the digital era, benefits accruing to PSB portfolio channels from the PSB status of their sister channels are increasingly valuable, as we will detail.
- 1.3 To put this into context, we estimate that the resulting lost value is in the 10s of millions, representing more than the twice the sum that is being cited in current debates around the appropriate level of payments between PSBs and pay TV platforms for technical platform charges.
- 1.4 In its recent Section 229 Report last year, Ofcom acknowledged that certain benefits arising from the PSB licences are not factored into its calculations of their value. The report stated:

“We also note that the existing licensees do not acknowledge any value in intangible factors linked to PSB status. We consider that there are benefits to the licence holders arising from certain elements – including the additional media coverage PSB programme schedules receive and viewer awareness of channel brands. Although they are difficult to quantify, we consider the potential loss of these benefits could represent a risk to an incumbent broadcaster.”¹²

¹² Ofcom, Licensing of Channel 3 and Channel 5, A Report compiled under Section 229 of the Communications Act 2003, May 2012, Section 1.15

- 1.5 However, Ofcom concluded that it was not “possible practically to quantify these for the purposes of this report.”¹³ Ofcom did not elaborate on its reasons for this decision, but we do not accept that it is not possible to calculate the value of any benefits that are currently excluded. While some benefits may not be readily quantifiable, we do not believe this is the case for all of them. We commissioned a report from independent consultants Communications Chambers to look at how to quantify, amongst other areas, the legacy brand value and the cross promotional value of the Channel 3 and 5 licences. The report, which we have presented to Ofcom, found that ITV and Five together received a benefit of £22m per annum just in terms of the value of cross promoting onto their portfolio channels.¹⁴
- 1.6 To reach this estimate of £22m per year, Communications Chambers developed a ratio of 2:1 – i.e. a 2% viewing loss on the parent PSB channel would result in a 1% loss for the associated portfolio channel. The level of the ratio may be subject to further analysis, but our point here is that it is possible to develop a model to estimate this value, and that the potential financial benefit is considerable. However, any methodology would we assume be subject to industry consultation as part of Ofcom’s thinking around valuing the licences.
- 1.7 Such benefits have a very real impact on the market, and a clear value to PSB licence holders. The PSB portfolio channels account for 19% of total TV viewing, the majority of this being viewing of commercial PSB portfolio channels.¹⁵ In our view, their exceptional growth has in part been driven by their relationship with their PSB main channels. This is in part from cross promoting through advertising, but also in repeats of shows that have had exposure on the main PSB channel and intrinsically linked shows such as ITV2 spin off show The Xtra Factor. Indicating the genuine market impact of this benefit, Communications Chambers’ report noted that PSB portfolio channels have grown strongly over the last decade in terms of viewing share, while the multichannel sector as a whole lost ground in terms of share of viewing.
- 1.8 We therefore ask Ofcom to either clarify why it is unable to quantify such benefits, including the cross promotional benefits to other channels, or to consult with industry on how best to do so.

¹³ Ofcom, Licensing of Channel 3 and Channel 5, A Report compiled under Section 229 of the Communications Act 2003, May 2012, Section 6.5

¹⁴ Valuing the Benefits of Channel 3 and Channel 5 Licensing, Communications Chambers, February 2012, page 12

¹⁵ Ofcom, Communications Market Report 2012, Figure 2.7

- 1.9 We believe Ofcom already has the power to take into account a wider set of benefits, including those accruing to other parts of the business. While the definition of qualifying revenues in the Broadcasting Act 1990 restricts payments to income directly to the licence itself, we do not believe this to be the case for the purposes of calculating the fixed annual cash payment. This would seem to be supported in Ofcom's evaluation in the consultation paper of the benefits for PSB licence holders, which include reserved capacity on PSB multiplex 2. For ITV, this includes capacity for four channels, one of must be provided to Channel 5 at a commercial rate, and therefore takes into account the value to other parts of the business as a result of holding the PSB licence.
- 1.10 We note that, in its 229 report to the Secretary of State, Ofcom highlighted that frequent revisions of the PSB licences were "not in the public interest".¹⁶ The Secretary of State, in her letter to Ofcom in November 2012 regarding the re-licensing of Channels 3 and 5, responded that she was "determined to see [PSB] commitments preserved (if not strengthened) in the next ten years", and that she would expect these commitments to be honoured.¹⁷
- 1.11 We agree that there is a significant risk that the PSB licence holders will seek to reduce their commitments over the next licence period, and are not aware of any additional steps that are being proposed to prevent this from happening. With this in mind, we believe that taking such factors as cross promotion into account would make Ofcom better placed to hold PSBs to their duties over the next licence period, even if the regulator decided not to increase those duties as a result of these additional benefits.
- 1.12 We have also raised this matter with the Secretary of State and DCMS.

Q2 Are there any other rights, obligations or regulations associated with the Channel 3 and Channel 5 licences that we should consider, or any other factors that may affect the valuation? If so, please explain how we should take them into account and provide any relevant data or analysis to support your suggestion.

¹⁶ Ofcom, Licensing of Channel 3 and Channel 5, A Report compiled under Section 229 of the Communications Act 2003, May 2012, Section 6.5

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https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/77982/Maria_Miller_letter_to_ed_richards.pdf

- 2.1 As we have outlined in response to Question 1, we believe there are a range of benefits that currently are not taken into account in valuing the licences, most notably cross promotion value for other portfolio channels and brand value. Our report from independent analysts Communications Chambers puts forward methodologies for calculating both, but we would expect this to be subject to industry consultation.

Q3 Do you agree with Ofcom's proposed approach to valuing the rights associated with the Channel 3 and Channel 5 licences as outlined above? If not, please explain why and what alternative approaches would be available (providing any relevant data to support your view). In particular, how should we value the right to appropriate EPG prominence to a new entrant (please provide relevant data to support your response)?

- 3.1 We agree with the approach to valuing rights, with the caveat that certain benefits are currently excluded.

Q4 Do you agree with this approach to assessing opportunity cost associated with PSB programming obligations? If not, please explain why and what alternative approaches would be available (providing any relevant data to support your view).

- 4.1 We agree with this approach.

Q5 Do you agree we should take into account the extra restrictions on advertising that apply to PSB licence holders alongside the right to appropriate EPG prominence? If not, what alternative approaches are available? What data or evidence exists to indicate the effect on advertising impacts or revenue of the advertising minutage restrictions on the Channel 3 and Channel 5 licences?

- 5.1 We agree that extra restrictions on advertising should be taken into account in valuing the PSB licence. In terms of whether this should be linked to EPG prominence as Ofcom proposes, we would welcome clarification on how Ofcom currently makes this calculation.

Q6 Do you agree with Ofcom's approach to valuing the uncertainties outlined above? If not, please explain why and what alternative approaches would be available. Please provide any relevant data or analysis that could assist Ofcom.

6.1 Yes.

Q7 Do you agree that a real, pre tax discount rate of 9.2% is appropriate? If not, then please set out what other considerations Ofcom should have in determining the discount rate.

7.1 No comment.