

**INTEGRATED TRANSPORT INFORMATION SERVICES LIMITED RESPONSE TO
OFCOM'S CONSULTATION ON THE ADVERTISEMENT OF A NATIONAL
ADDITIONAL SERVICES LICENCE**

29 November 2010

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Background and interest of ITIS

1. Integrated Transport Information Services Limited ("ITIS") is the current holder of Ofcom's only Additional Services Licence ("AS/1 Licence") which came into force on 1 January 2004 and expires on 31 December 2011. The licence was transferred to ITIS from ITIS Holdings plc on 12th September 2007.
2. ITIS uses the AS/1 Licence to provide a RDS-TMC traffic data service to consumers. This service currently transmits traffic and road travel information to an estimated 2.4 million consumers in the UK via in-car and personal navigation devices.
3. ITIS is registered in England and Wales under company registration number 3258799. Its registered office is at Station House, Station House, Stamford New Road, Altrincham, Cheshire, WA14 1EP.
4. This response has been prepared by ITIS in conjunction with DLA Piper, its legal advisers. All correspondence relating to this response should be sent to this address for the attention of Paul Taylor, General Counsel ITIS.

Executive Summary

5. ITIS agrees with Ofcom's determination that at least the same capacity as is currently available for Additional Services should be made available under the new AS/1 licence. However, ITIS would propose that the current capacity of the AS/1 is slightly increased in line with the RDS-TMC technical standard ISO 14819-1. In addition we would also propose that the current limit on the broadcast deviation level is increased in order to improve RDS reception and increase coverage so as to improve the current level of service.
6. ITIS agrees that the duration of the AS/1 licence should be set so that it can run until the end of the renewed Classic FM sound service licence, INR1. ITIS has established that the continuation of an RDS-TMC traffic data service under the AS/1 licence will not be commercially viable after digital switchover and that this may impact on the effective duration of the licence.
7. The level of PQR inevitably influences the bidding risk. It is not clear however that the impact is the same for ITIS and any other bidders. A low or zero PQR would suggest that any bid by ITIS to protect its business would need to be at a significantly higher level. A high PQR may attract "spoiling bids". The more serious concern is that whatever the level of PQR an element of bias is likely to remain in the auction process to the detriment of ITIS as incumbent licence-holder and its consumers.
8. There are significant exceptional circumstances arising from ITIS' position as incumbent licence-holder which have a critical impact on the interests of consumers and should give rise to the exercise of Ofcom's discretion.

Question 1: Capacity

9. ITIS agrees that the capacity available for the provision of services under the AS/1 licence should not be less than the capacity available under the current licence.
10. Having sufficient capacity is critical to ITIS's business and any reduction in capacity is likely to significantly reduce the quality of service currently offered to UK consumers, principally as a result of a reduction in the coverage of the ITIS service. Reducing the capacity of the AS/1 would reduce the rate at which the data can be transmitted and thus increase the time it takes for a navigation system to receive the full set of information after starting the system. This is a critical time for a driver, and receiving all relevant information at the start of a journey is important so as to ensure the best route is chosen based on all available information.
11. Moreover, ITIS considers that minor amendments to the AS/1 licence would lead to an improved service to the estimated 2.4 million consumers currently receiving traffic information without any material impact on the services available under the Classic FM INR licence.
12. For this reason ITIS submits that the following changes should be made to the additional services licence:

Increasing the deviation level

- 12.1 The current setting of the deviation level on the Classic FM bandwidth leads to inefficiencies in the provision of the service. As currently constituted the service has a relatively low deviation level of (+/-) 2-2.5kHz which is far lower than many other radio stations in the UK/Europe operating RDS-TMC services. Most stations in Europe which provide RDS-TMC service have been set up to use an RDS Deviation level of at least 3 to 3.5 and sometimes as high as 4.
- 12.2 A relatively small change to the Audio Programme deviation level of Classic FM would benefit the RDS features on the network and would enhance the TMC service by improving RDS reception and increasing coverage.
- 12.3 Due to the low deviation level currently utilised on Classic FM ITIS transmits its service with 2 immediate repetitions (3 in total) of the same data to ensure a robust reception of the data. A single group error will still leave 2 groups to be received by the receiver and thus allows a correct decode of the data - but this is at the expense of 1/3 of the available bandwidth. Providing an improved deviation level would allow the traffic data to be sent at a faster rate providing an improved service delivery with improved coverage and also enhance the RDS features of Classic FM's programme.
- 12.4 Such a change would allow the AS/1 licence-holder to provide consumers with a level of service equivalent to that offered throughout Europe without any negative impact on the Classic FM service.

Increasing the broadcast rate

13. The RDS-TMC specification (ISO14819- parts 1, 2, 3 and 6) defines the operation of TMC services/receivers. Within Part 1 the definition states that a maximum Broadcast rate for the 8A groups carrying the ODA TMC feature is 2.85 groups/second. This gives a spacing between 8A groups of minimum 3 non-8A groups.

14. The broadcast rate in the current and proposed AS/1 licence is set at 2.4 groups/second. Increasing this to the maximum value defined in the specification would make bring the AS-1 license in line allowing optimal use of the spectrum, and benefits for consumers. The benefit to an RDS-TMC service is that although the traffic data content is limited to 2.5 groups/second by the standards, the remaining data space can be utilised to carry additional tuning data – this is helpful for receivers to retune as they move from transmitter to transmitter while driving.
15. Conceptually an increase in the broadcast rate may have a small impact on Classic FM but this would be so negligible as to be immaterial. Impact on ClassicFM audio/RDS service would be small decrease in AF and/or RadioText repetition rates. This would not be visible or noticeable to listeners.

Question 2: Duration

16. ITIS agrees that the duration of the licence should be until the end of the renewed Classic FM INR licence.
17. Further, ITIS welcomes Ofcom's acknowledgment (at paragraph 4.9 of the Consultation Document) that firms participating in the auction should be able to make an assessment of the interaction between the level of the PQR and the cash bid over the duration of the licence (emphasis added).

Uncertainty in relation to digital switchover.

18. ITIS notes that there is considerable uncertainty about the duration of the licence which, in the context of a closed auction, makes it extremely challenging to value the AS/1 licence.
19. ITIS welcomes Ofcom's recognition at paragraph 3.6 of the Consultation that an additional services licence can only exist where there is a sound broadcasting service on a relevant frequency as this does give bidders some indication of the consequences should the digital radio switchover occur during the licence period. However, this statement is not consistent with the Government's statement on the future of the additional services licence post FM switchover.
20. The Government's statement (referred to in footnote 10 on page 11) indicates that it may be possible for the additional services licence to continue beyond the switchover date. Ofcom have suggested that for this to happen there will be a change in the law. ITIS' reading of the Digital Economy Act does not concur with this view and ITIS would appreciate some clarification on this point.
21. There is also a practical reason why, even if legislation permits, it may not be feasible for the additional services licence to continue beyond the switchover date that neither Ofcom nor the Government appear to have considered. **[Information Confidential to ITIS]**
22. ITIS also notes that Ofcom's interpretation of the relevant legislative provisions (at paragraph 3.8) is that they could lead to a situation where the AS/1 licence would run for less than the intended duration.
23. ITIS considers that the acknowledged uncertainty in relation to the duration of the licence will make it extremely difficult to assess an appropriate level for a cash bid (whether or not in relation to the level of PQR).

24. If there is no switchover the INR licence is cancelled and re-let then we would argue that the AS/1 should continue for the full duration of the licence (6 years 1 month). Obviously if there is no sound service licence then the AS/1 would expire but cancelling the AS/1 because Global loses their licence (given the auction process we have been through) is inequitable.

Questions 3 - 7 : PQR

25. Questions 3-7 PQR – ITIS agrees that the PQR should be set at 4%, the same level as under the current Additional Services licence. The basis for this is that whilst ITIS does not fully agree with some of the rational discussed by Ofcom, overall we do believe that a 4% PQR will ensure the process accords with the legislative objectives of the auction
26. ITIS agrees with Ofcom's statement (at paragraph 4.25) that "[t]he one shot nature of the auction ought to encourage firms to bid the full amount that they value the licence."
27. ITIS also notes that at paragraph 3.45 of the Methodology for review of financial terms in relation to the Renewal of the Independent National Radio Licences, dated 9 July 2010 (the "INR Consultation"), Ofcom recognised that the value of a licence to a particular bidder will depend on the identity of that bidder.
28. As incumbent licence-holder ITIS is in an entirely different position from other bidders such that bias in the auction process is unavoidable because, whatever the level of PQR, the overall value placed on the licence by ITIS is likely to be greater than the other bidders who do not have an existing business or sunk costs to lose.
29. The auction process is therefore likely to force ITIS to submit an excessively high cash bid in order to sustain its business.
30. There are two types of risk faced by bidders in relation to bidding for the AS1 licence; these may be defined as commercial risk (i.e. the risks associated with establishing a business based on the licence) and bidding risk (i.e. the risk associated with winning or losing the auction).
31. ITIS is well-placed to assess the commercial risks associated with purchasing the licence because it knows the extent of the business, the likely income it can generate from the licence and it has an established framework for monetising the licence including an existing customer base. The commercial risks associated with acquiring the licence can therefore be said to be low for ITIS in comparison to its competitors. **[Information Confidential to ITIS]**
32. By contrast, all of the other bidders as potential new entrants do not know the scale of the business that they are likely to be able to achieve and face significant investments in establishing themselves. This is particularly true where the new entrant plans to use the licence for a business other than the provision of traffic information. A new entrant's commercial risk could therefore be said to be high.
33. In relation to the bidding risk, ITIS as incumbent clearly has the most to lose. A new entrant that does not have an existing business stands to lose nothing if it does not win the bid. In fact, for a competitor it has nothing to lose by bidding, but much to gain as it can force the incumbent to increase its bid thereby driving a competitor's cost up.
34. The inclusion of a PQR element appears to address only the commercial risk and will have no direct impact on the bidding risk.
35. **[Information Confidential to ITIS]**

36. The experience of the 1991 franchise auction for ITV franchises highlights this concern. In those auctions, two of the incumbents lost their licences having submitted bids almost twice as high as their nearest competitor because they were found by the ITC to have unrealistic business plans. In order to sustain its business ITIS will be forced to bid a similarly excessive amount for the licence.
37. Ofcom should be aware that the PQR does not bear any relation to the estimated 2.4 million existing consumers serviced by ITIS as the licence holder only receives revenue in respect of new customers. As such no financial value is placed on the fact that a bid by the incumbent ensures that all existing consumers would continue to be serviced alongside new customers, while any new licence holder would only be in a position to service new consumers and existing customers would be left without access to a service.

The risks associated with a PQR rate of zero

38. If the PQR were set to zero, the parties' assessment of the bidding risk is likely to be the main determinant of the prices bid for the licence. As discussed above, ITIS as incumbent faces a substantially higher risk than the other parties and is therefore likely to be forced to over-bid for the licence.
39. ITIS faces the possibility that a frivolous or malevolent bidder who has no intention of operating a service will bid simply to disrupt ITIS's business or push up its costs. This risk is increased where the PQR rate is zero.

The risks associated with a high PQR rate

40. A high PQR rate reduces the level of commercial risk faced by new entrant bidders and therefore substantially increases the likelihood of more bids. Ofcom seems to suggest at paragraph 4.13 of the Consultation that high PQR might lead to fewer bids but ITIS does not consider this to be the case. Reduced commercial risk is likely to lead to a greater number of new entrant bidders and this increased competition is likely to lead to higher bids. At the same time, although a high PQR would make the business that ITIS stands to lose less profitable (or even unprofitable) the reduced commercial risk for new entrants is likely to increase the likelihood of them bidding and thus to increase pressure on ITIS to overbid in order to be sure of securing the licence.
41. **[Information Confidential to ITIS]**
42. A high PQR is therefore likely to increase the potential for frivolous bids.

Ofcom's historical approach to PQR

43. There is some recognition from Ofcom in its earlier licensing consultations that it can take account of regulatory changes in determining PQR. In its Methodology for review of financial terms in relation to the Renewal of the Independent National Radio Licences, dated 9 July 2010 Ofcom proposed to take into account regulatory developments including those arising from digital radio switchover which gave rise to uncertainty in the duration of the licences (see paras 3.31, 3.34 and question 2).
44. Ofcom recognised that there were various early termination scenarios arising from the digital switchover provisions. In that case it proposed to set the PQR at the same rate throughout the full duration of the licence (see paras 3.83-4 and question 8).

45. At para 3.59 Ofcom acknowledged that it faced a wide range of uncertainties in determining the PQR including structural change in the industry associated with digital switchover.
46. In its 2004 Consultation on Reviews of Financial Terms for Channel 3 Licences, Ofcom noted that the ITC's approach to PQR payments was to aim to recover approximately 75% of the surplus value of each licence via PQR payments and the remaining 25% via the annual fixed cash sum.
47. The new financial terms determined as a result of the 2004 consultation provided for PQR payments to be made only in respect of revenues for analogue-only homes and therefore to decline progressively with digital take-up.
48. In the 2004 consultation, Ofcom also increased the weighting of the licence payments towards PQR.
49. In its Reviews of the financial terms for the Channel 3 and Channel 5 licences dated 3 March 2010 Ofcom recognised that although rights and obligations are considered separately, where possible the valuation of a licence should take into account any significant consequential effect that the presence of one right or obligation has on another (see para 3.13). This seems to be directed at situations where acquisitions of packages of rights are possible, but surely it could be argued to cover the situation here where the value of the AS/1 licence is to some extent dependent on the duration of the INR1 licence.
50. In the INR Consultation Ofcom proposed to take into account the trends in listening to the INR services including the impact of the development of digital listening, and changes in the UK radio advertising market (i.e. falling revenues) when deciding the PQR payable. It also proposed to take into account regulatory developments including those arising from digital radio switchover which gave rise to uncertainty in the duration of the licences.

Additional Information

51. ITIS welcomes Ofcom's commitment (in paragraph 5.11) to invite submissions from bidders and any other interested parties about Ofcom should exercise its discretion in relation to exceptional circumstances.
52. ITIS considers that all bidders will need to take into account exceptional circumstances when assessing the level of any bid even if Ofcom follows its proposed two-stage process. This is because the bidder with the higher monetary bid will need to consider carefully the likelihood of an appeal based on exceptional circumstances. Bidders are therefore already in a position to provide this information to Ofcom. ITIS would expect Ofcom to invite submissions on exceptional circumstances as part of the initial bid document and to consider as part of the initial process for awarding the licence in the initial phase.
53. By carrying out the assessment of exceptional circumstances in a two-stage process, Ofcom is very likely to be merely delaying the award of the licence. Ofcom has an overriding statutory duty to ensure that "all of the spare capacity available for the provision of additional services...is used" (section 115) and to "further the interests of citizens in relation to communication matters" (section 3(1)a of the Communications Act 2003). These duties override any financial value placed on the licences it grants, just as Ofcom must ensure that any bidder for a licence must be a "fit and proper person" (section 86(4) of the 1990 Act). As with the TV licences, Ofcom must take all the details of the bid into account, not just the bid value but also the type and scope of the service to be provided (indeed section 116(3) requires Ofcom to consider the technical plan indicating the nature of any Additional Services) and any exceptional circumstances that might apply. It would be in breach of its statutory duty if

Ofcom were to apply a two stage process, where stage one only considers the bid value and does not address exceptional circumstances (if any).

54. [Information Confidential to ITIS]

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