Reviews of the financial terms for the Channel 3 and Channel 5 licences - determination

Introduction

Holders of Channel 3 and Channel 5 licences are required to make "additional payments" to HM Treasury. Licensees pay fixed annual cash bids plus a Percentage of Qualifying Revenue (PQR) applied to the appropriate proportion of the licensees' advertising revenue.

Holders of these licences are entitled to seek a review of these financial terms in certain limited circumstances - in this case, the review was triggered by the last Government bringing into force the "must offer" provisions of the Communications Act 2003 ('the Act') which allowed licensees to apply for a review of their financial terms, taking into account the new obligations.

Applications for a review were received from the Channel 5 licensee and the holders of the following regional Channel 3 licences: Anglia, Carlton, Central, Granada, LWT, Meridian, Yorkshire (all owned by ITV plc) and Ulster (owned by UTV plc).

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 financial terms for the Channel 3 and Channel 5 licences* published on 3 March 2010 ('the March statement')[1]. Our methodology reflects the requirement under section 227 of the Act to determine part of the financial terms based on an assessment of the amount each incumbent would have bid were their licence being granted afresh in a competitive auction.

As set out in the March 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, 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 obligation attached to the licences is the requirement to deliver PSB (Public Service Broadcasting) programming. The PSB obligations attached to the Channel 3 and 5 licences can be summarised as follows[2]:

	Channel 3	Channel 5
Quotas		
Regional news (in and outside peak)	✓	
Other regional content	✓	
National and international news (in and outside peak)	✓	✓
Originations (in and outside peak)	✓	✓
Current affairs (in and outside peak)	✓	✓
Independent production	✓	✓

[1] http://stakeholders.ofcom.org.uk/consultations/review_c3_c5_licences/
[2] More detailed information on the obligations attached to each licence can be found in the licensing section of Ofcom's website http://licensing.ofcom.org.uk/tv-broadcast-licences/current-licensees/

Production outside London	✓	✓
Other regulations		
Extra restrictions on advertising minutage	✓	✓
Regulation of terms of trade with independent producers	✓	✓

In return for delivering PSB programming, licence holders benefit from certain rights, such as access to analogue spectrum, reserved capacity on DTT (Digital Terrestrial Television) and the right to 'appropriate prominence' on electronic programme guides (EPGs).

Historically, the value of the right to broadcast on analogue meant we considered that potential entrants would be prepared to make additional payments as well as deliver PSB programming.

The value of the right to broadcast on analogue however has reduced over time as digital listening has increased and digital switchover nears completion. When Ofcom last carried out a review in 2005[3], financial terms for all licences were reduced significantly, some to a nominal amount. This reflected the reducing value of the right to analogue spectrum. In addition, Ofcom's 2009 PSB review recognised that the viability of maintaining significant PSB obligations was reducing over time, concluding that "the current model of commercial public service broadcasting is clearly no longer sustainable"[4].

As set out in the March statement the legislation requires Ofcom to determine two different types of payment for each licence - a fixed annual cash bid plus a Percentage of Qualifying Revenue (PQR) applied to the appropriate proportion of the licensees' advertising revenue.

<u>Conclusion of the current review</u>

Ofcom has reviewed the financial terms for the licences that applied for a review. We reviewed each licence separately. Our conclusion for each of the licences under review was that, on the basis described in the March Statement, a hypothetical new entrant would not be prepared to make financial payments as well as deliver PSB programming in return for the rights attached to the licences. 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 licence. This brings the financial terms for the licences under review into line with the five licences whose terms were already set at a nominal level in the 2005 review.

	Current terms		New terms	
	PQR	Cash bid	PQR	Cash bid
Anglia	10%	£180k	0%	£10k
Carlton	26%	£1120k	0%	£10k
Central	11%	£900k	0%	£10k
Granada	9%	£240k	0%	£10k

[3] 2005 determination:
http://stakeholders.ofcom.org.uk/binaries/consultations/channel3_consultation/statement/ch3ch5fin.pdf

[4] Ofcom's Second Public Service Broadcasting Review, page 1:
http://stakeholders.ofcom.org.uk/binaries/consultations/psb2_phase2/statement/psb2statement.pdf

LWT	21%	£720k	0%	£10k
Meridian	14%	£320k	0%	£10k
Yorkshire	3%	£240k	0%	£10k
UTV	5%	£120k	0%	£10k
Five	8%	£680k	0%	£10k

Next steps

Applicants have until 29 October 2010 to accept or reject the new financial terms. We will update our website after this date with details of which applicants accepted and rejected.