



***Response to Ofcom on
“Future pricing of spectrum used for terrestrial
broadcasting”***

October 2006

Introduction

1. On 27th July 2006 Ofcom published a consultation document on the “Future pricing of spectrum used for terrestrial broadcasting”, addressing the issue of whether, how and when spectrum pricing should be introduced for terrestrial broadcasting, with an objective that spectrum pricing should reflect the opportunity cost of using spectrum, so that, in the long term, spectrum is used as efficiently as possible.
2. GCap Media plc submits its response to the consultation. Our response comprises a summary and general observations on the consultation, as well as detailed answers to the specific questions raised by Ofcom.
3. GCap Media would be happy to meet Ofcom to discuss our views in greater depth.

Summary of the Proposals

4. In relation to radio broadcasting, Ofcom proposes to:
 - introduce Administered Incentive Pricing ('AIP') to incentivise terrestrial broadcasters to take decisions that promote efficient spectrum use in the short, medium and long term.
 - introduce AIP for BBC analogue radio services, on the basis of population coverage as soon as possible (commercial analogue services already incur a spectrum charge through WTA fees).
 - introduce a flat AIP fee for community radio stations and RSLs justified by the argument that the economic cost of not extending population based charges to these categories is likely to be minimal, and the administrative costs are likely to be material.
 - introduce AIP for digital radio from 2012, based on a local population coverage as a percentage of national population coverage

Summary of GCap Media's response to the Consultation

5. GCap Media welcomes the opportunity to comment on Ofcom's consultation on the future pricing of spectrum used for terrestrial broadcasting.
6. We agree with Ofcom's view that because "*spectrum is finite and [its] use is exclusionary, use of spectrum for one purpose precludes its use for another*" (Para 3.5).
7. Nonetheless, we are concerned that the impact of the introduction of AIP on the commercial viability of DAB broadcasting has not been fully investigated and reviewed by Ofcom, including whether the additional expenditure will limit the industry's ability to invest in multi-platform broadcasting. We urge Ofcom to undertake further work ahead of the introduction of AIP.
8. We do not agree that Ofcom's proposals for the introduction of AIP will incentivise terrestrial broadcasters to take decisions that promote efficient spectrum use in the short, medium and long term. This is because the current regulatory and legislative environment under which commercial radio operates prevents these broadcasters from taking the steps necessary to achieve efficient use of spectrum. Ofcom should ensure that these restrictions are relaxed as a condition of the introduction of AIP.
9. We agree that AIP should be introduced for BBC analogue radio services on the basis of population coverage as soon as possible to bring the BBC into line with commercial radio. In relation to AIP on digital radio, there must be parity between the BBC and commercial sector.
10. We do not agree with the proposals to introduce a flat AIP fee for community radio stations. We believe there should be parity for licences (whether ILR, community or RSL) on the basis of population size rather than by licence sector. All licences above a certain size, irrespective of sector, should be liable to AIP on a population basis, with a flat AIP fee charged for all smaller licences.
11. We believe that there should be parity between DAB and DTV. We do not believe that it is appropriate, or helpful to the radio industry, for AIP on digital radio to be introduced from 2012, whilst AIP on digital television is delayed until 2014.
12. We have concerns over the methodology for the introduction of AIP on the basis of population, and wish to seek clarification from Ofcom of its intentions.
13. We also have concerns over the potential scale of the AIP fees that Ofcom may levy, and would like Ofcom to clarify how it will set the rates.
14. We seek further clarification as to the mechanics that will be introduced by Ofcom to ensure that any fees relating to access to spectrum payable under the Broadcasting Act (and in this respect we include cash bids and PQR payable by the INRs and PMR payable by national digital multiplexes) to ensure that any such broadcaster is not required to pay twice for the same spectrum access.

General Observations on the Consultation

15. GCap Media agrees with Ofcom's view that because *"spectrum is finite and [its] use is exclusionary, use of spectrum for one purpose precludes its use for another"* (Para 3.5). However, we do not agree that the *"use of spectrum imposes an opportunity cost on society"*, because we feel that it is not possible to define *"the socially optimal allocation of resources"* and we note that Ofcom have not sought to do so. For the same reason, we do not accept that if spectrum pricing did not exist *"socially sub-optimal decisions will be made"* (Para 2.6).
16. We recognise that the underlying premise of Ofcom's proposals are to create a market economy in spectrum, with licensees paying for the right to use capacity in the most efficient and commercial viable way to maximise value for society.
17. Current legislation and regulation (for example, controls over formats, studio location rules), restrict the ability of licensees to utilise their allocated spectrum in a more efficient manner than they currently do. Licensees cannot adapt to drive efficiencies to recoup this tax. This is particularly pertinent for smaller operators; a large number of whom are currently experiencing a downturn in revenue with the inability to radically change their cost base (in part due to the public service requirements of their licences); as a result the industry has recently seen the first ILR licence being returned to Ofcom.
18. We believe that an unintended consequence of introducing AIP may be a negative impact on investment in digital radio. This is because many licensees, especially the smaller operators are currently facing a torrid time and generating small or no profits, partly because of costs associated with the development of digital radio. These licensees are investing considerable sums in new digital infrastructure and in the development of new services and content, and they incur additional operating costs by simulcasting on digital and analogue. Meanwhile, investment decisions have to be taken with no assurance of the timing of digital switchover. To burden licensees with an additional charge, will push the return on investment yet further into the future, and make investment in digital radio still less commercially attractive.
19. Ofcom states that its goal *"is to ensure that, in the long term and over time, spectrum is being used as efficiently as possible, and is allocated to the most valuable uses, for the benefit of UK citizens and consumers"* (Para 2.10). For radio broadcasters and licensees to have the real ability to deliver this, regulation and legislation over how spectrum is used needs to be relaxed, if not abolished, leaving safeguards to be provided through taste and decency regulation). GCap urges Ofcom to go further than the bland statements in the consultation that AIP *"may cause broadcasters to negotiate with policy makers to reduce constraints on spectrum use"* and to provide reassurance to the industry that such relaxation will be forthcoming.

20. Ofcom implies that its proposals are fair to all sectors, with AIP to be levied on spectrum used for broadcasting (both the BBC and commercial sectors), as well as spectrum used by Government and public agencies. However, Ofcom also identifies that “*The impact of the introduction of AIP on digital radio broadcasters may be proportionally greater than on digital television broadcasters*” (Para 3.41). We agree with this statement and question why Ofcom wishes to introduce proposals which it itself deems to be unfair to radio.
21. In addition, Ofcom fails to highlight that unlike the commercial sector, publicly funded bodies, such as the BBC, the MOD and emergency services are able to recover the additional cost through an increased licence fee and Government funding respectively. These additional costs for commercial radio will simply result in reduced profits and therefore the sectors ability to invest in programming and marketing. At the same time, audio services on other digital platforms, who will fall outside of the scope of AIP, will be able to thrive. Ofcom’s proposals will thus put those broadcasters who use the spectrum at a commercial disadvantage.
22. We are concerned about the proposed timing policies for AIP between DTV and DAB, with AIP to be introduced in 2012 for DAB – 2 years earlier than the proposed 2014 introduction date for DTV. We believe that there should be parity between radio and television, with AIP introduced at the same time, preferably in 2014. As it stands, Ofcom’s policy will unfairly favour DTV at the expense of radio broadcasting.
23. We are concerned with Ofcom’s proposal that RSL and Community Radio licences will be exempt from population based AIP and will be charged a flat fee. We recognise that such services provide social value, in particular where they focus on communities of interest. However, they do use ‘limited spectrum’ and as such incur an opportunity cost. In addition, as these services generate funding through advertising, Ofcom’s proposals would enable these licensees to operate at a commercial advantage (i.e. a lower regulatory cost base) than other broadcasters. We therefore believe that in relation to AIP charges, there should be parity between licences (irrespective of whether from within the ILR or Community sector) in relation to their population coverage.
24. We are concerned about the unquantified cost of introducing AIP to radio licensees:
 - 24.1. There are inconsistencies in the consultation document on the methodology of charging AIP to digital radio, with different mechanics outlined in para 3.18 to those in para 4.38. We request clarification from Ofcom of the proposed methodology.
 - 24.2. We are also concerned as to the potential scale of the charge which is undefined, since we cannot assess its likely impact on our business.

Specific Questions Asked

Question 1: Do you agree with Ofcom's conclusion that AIP should, in principle, be applied to all terrestrial broadcasting uses of spectrum, as to other spectrum uses? Please set out the reasons for your view, and any evidence or analysis that you can provide in support of your position.

25. GCap does not believe that given the current regulatory and legislative environment AIP should be introduced for radio broadcasting. The current environment does not provide licensees with the opportunity to manage or utilise spectrum with any greater efficiencies. The proposals represent the introduction of a spectrum tax which broadcasters can do nothing to mitigate. GCap would only support the introduction of AIP if regulations and legislations were to be relaxed to enable such efficiencies to be realised.
26. Ofcom's consultation sets out a range of economic and theoretical arguments as to why AIP is an appropriate tool for delivering spectrum efficiency. We feel that these arguments, while they might appeal to HM Treasury, fail to take account of the wider social issues.
27. Ofcom states that "*applying AIP will incentivise terrestrial broadcasters to take decisions that promote efficient spectrum use in the short, medium and long term*". However, the current regulatory regime restricts the abilities of broadcasters to make decisions over their spectrum: for example, there are limits on the amount of capacity that can be used for data on multiplexes, and Ofcom awards licences and regulates the number of audio services that broadcast on multiplexes. In addition, it is Ofcom who allocates spectrum to multiplexes; a multiplex owner has no ability to influence how spectrum within a certain band is used in other areas of the UK. Finally, if technical innovations were not to be available, the only possible efficiency options would be reduced provision of services, either in service duration (i.e. a reduction in broadcasting hours) or sound quality (i.e. a reduction in bit rate). This is likely to put commercial radio at a further disadvantage compared with the BBC.
28. Ofcom adds that AIP "*may cause broadcasters to negotiate with policy makers for example to reduce constraints on spectrum use*". This implies that Ofcom are willing to discuss a relaxation that will enable broadcasters to actively efficiently manage their spectrum. GCap believes that by the time AIP is introduced, regulations over the use of multiplex capacity between audio and data, and in the range and scope of audio services should be fully relaxed. If not, then Ofcom should provide a mechanism to re-imburse licensees for the cost of regulatory intervention.
29. Ofcom has provided no evidence of activity or events within the radio broadcasting sector to support its view that "*The use of AIP is none the less, in our view, justified by the benefits that should materialise in the longer term, as better decisions are made in light of increased awareness and appreciation of the value of spectrum*" (Para 2.8).
30. Ofcom highlights that government bodies, such as the MOD and Emergency Services, already pay AIP. As these sectors are publicly funded (through taxes), any increase in their cost base is capable of being absorbed by adjustments in the level of Government funding. The same is true of the BBC, which can seek to recoup the additional cost through the

licence fee (and which was explicit in their Charter Renewal). We do not believe that Ofcom should allow itself to be swayed in its views on AIP by the apparent ability of Government funded bodies to cope with the charges, because the comparison with the commercial sector does not stand up.

31. We believe that the premise of charging broadcasters the opportunity cost for spectrum is flawed. Part of the premise of Ofcom's proposals is that the higher the commercial value of spectrum, the better society will be. This rather simplistic economic viewpoint fails to reflect the public value of what is broadcast. We do not agree that AIP should be introduced without further clarity on how Ofcom intends to intervene *"to secure socially desirable outcomes on the downstream market for outputs"* (paragraph 3.38). We believe there is a risk that AIP will lead to a reduction in the breadth of content broadcast as Broadcasters are driven towards those sectors of the broadcasting economy which represent the highest economic value at the expense of broader social outcomes.
32. We do not agree that *"If the opportunity costs of spectrum use are ignored or discounted, socially sub-optimal decisions will be made – for example insufficient investment will be made in the development and deployment of innovative and more spectrally efficient technologies, inappropriate decisions will be taken about the relative merits of different delivery platforms"*. This is contrary to our experience as innovators, and we are concerned (but not surprised) that Ofcom quote no examples.
33. Unlike Commercial Radio, the BBC is in control of its own spectrum. The BBC Trust has responsibility for ensuring that its allocation is used efficiently. At present, the BBC retains control over spectrum which it currently does not use, but which it retains in case it identifies a future need.
34. In addition, and again unlike Commercial Radio, the BBC will simply be able to recoup the new AIP charges through the licence fee. The Licence Fee bid currently under consideration includes significant sums for spectrum charging, over and above operational increases. Therefore, the only terrestrial radio broadcaster which could genuinely be incentivised to use its spectrum more efficiently (the BBC), has no need to do so and has merely accounted for it as an increase in its broadcast costs.

Current Legislative and Regulatory Regime

35. Under the current legislative and regulatory regime:
- Ofcom allocates spectrum between multiplex area, determines the PPA coverage and awards licences on the basis of the extent to which an applicant will cover the PPA
 - Ofcom regulates the number of services and the formats provided on the multiplex through the Licence Annex. Any change of service has to be approved by Ofcom
 - Legislation places restrictions over the use of spectrum between audio and data
36. In Para 2.3, Ofcom states that *"It is therefore increasingly important that all users of spectrum are encouraged to make the most efficient use possible of the spectrum they hold, or to release that spectrum to others who can make better use of it"*. By the way that radio is licensed, a radio operator has only two options – either maintain the spectrum he uses or to release it 100%; there is no middle option whereby he can release spectrum to others. That is not conducive to efficient use of spectrum.
37. In Para 2.7 Ofcom states *"By charging such fees, Ofcom seeks to ensure that the opportunity costs of holding spectrum are fully and accurately reflected by decision makers when decisions are made that could affect future spectrum use"*. We would argue that licensees do not have the ability to make all decisions that affect spectrum use given the restrictions identified above. Only if these restrictions were to be relaxed in their entirety, would this statement be correct.
38. *"By charging AIP, decision makers are encouraged to take the opportunity costs of spectrum fully and accurately into account in their decision making"* (Para 3.9). The decision maker in relation to spectrum allocation in the UK is Ofcom: there is no capacity for broadcasters to make spectrum decisions except in the all or nothing circumstances mentioned above
39. We note Ofcom's statement that it *"acknowledges that terrestrial broadcasters currently have to operate under a range of regulatory constraints that limit the freedom they have to change their spectrum use in the short term. Broadcasters themselves are also free to press for a relaxation of the technical and other constraints on their use of spectrum"* (Para 3.23). Since licensees have not to date been successful in pressing for change, we take this statement as meaning that Ofcom is for the first time ready to contemplate changes at the request of broadcasters. We would welcome confirmation that this is so. We ask Ofcom to confirm that it will support a push for relaxation of restraints to enable licensees to operate in a more efficient manner, or undertake its activities in a manner that will deliver these efficiencies in areas where licensees have no influence.

Proposed Basis of AIP Charging

40. We are concerned by contradictions in the description of the cost calculations which will have significant financial impacts on digital radio.

40.1. At para 4.38, Ofcom states that *"if the level of AIP in 2012 were to be similar to Ofcom's current estimates of opportunity cost, the charge for each national DAB multiplex (for example as currently held by the BBC and Digital One) would likely be of the order of £650,000 per year. The charges for local DAB multiplexes would likely be based on this overall fee level, but scaled in proportion to population coverage"*.

40.2. At para 3.18, Ofcom states that estimates that the "opportunity cost of spectrum currently reserved for terrestrial broadcasting is of the order of: In the case of digital terrestrial radio (DAB), approximately £650,000 per annum for each national multiplex, or group of local multiplexes sharing a common frequency block"

We request that as the pricing differences between these two approaches are quite considerable, Ofcom confirms their proposals as soon as possible.

41. We are also concerned by the high level of ambiguity as the potential charge. Whilst Ofcom states that *"the charge for each national DAB multiplex would likely be of the order of £650,000 per year"* it adds that *"these are only Ofcom's current estimates of the opportunity cost and are subject in some cases to quite large degrees of uncertainty"* Para 3.19). Given the significant impact that AIP will have on licensees, the uncertainty as to the potential level of fees is of concern and we request further clarification and suggest that an AIP cap is introduced, similar to that introduced when changed the methodology of levying licence fees.
42. Ofcom indicates at Para 4.23 that where a licensee has to make payments to access spectrum under the Broadcasting Act (such as the INR and national commercial multiplex licensees) that adjustments will be made to ensure that broadcasters do not pay twice for the same spectrum. We request further clarification as to the mechanics that will be introduced to ensure this.

Question 2: Do you agree with Ofcom's proposals for the timing of introduction of AIP on spectrum used for terrestrial broadcasting? Please set out the reasons for your view, and any evidence or analysis that you can provide in support of your position.

43. GCap provides a view on the introduction of AIP in relation to digital radio. We offer no view as to its introduction for television.
44. At para. 4.5 Ofcom provides five options as to the date from which AIP could be applied. Given the uncertainties behind AIP that we have detailed in our answer to Question 1 (in particular that Ofcom proposes a fee to ensure licensees use spectrum in an efficient manner without providing licensees with a regulatory environment that will allow them to make changes to use spectrum in an efficient manner), we believe that the introduction of AIP should be delayed until regulation and legislation is suitably relaxed. We note at para. 4.11 that Ofcom believes that a postponement will leave *"the industry unsure as to when, if ever, AIP is to be introduced – another instance of increased regulatory uncertainty that is unlikely to be in the best interests of citizens and consumers"*. We do not believe that this would be worse for citizens and consumers than the alternative of the introduction of spectrum charging while denying licensees the ability to manage their spectrum. If Ofcom wishes to reduce regulatory uncertainty, it could of course start with proposals for digital switchover.
45. In addition, we believe that the proposal to introduce AIP for digital radio ahead of digital television (2012 against 2014) is unreasonable and detrimental for BBC and commercial radio.
- 45.1. Government has already established the switch-over process and timetable for digital television. By 2012 all terrestrial television will be digital. The date of 2014 was set for television to mark the end of the licence terms.
- 45.2. To date, Government (and Ofcom) has refused to set out even the criteria to set a timetable for digital radio. The industry has argued for several years that without either of these, radio will lag television in its switch to digital. There is currently no public forecast of DAB penetration by 2012 (the DRDB forecasts 40% household penetration by 2009; extrapolating this data forward, household penetration by 2012 may be around 70%).
- 45.3. Ofcom provide no reasons why DAB digital radio, the smaller relation to digital television, should have to bear the AIP taxation ahead of its larger and financially stronger digital television, especially as the spectrum carrying radio services on Freeview would not be liable to AIP until 2 years after radio services through DAB – in this respect Ofcom appears to be favouring the DTV platform for digital radio over DAB. Before Ofcom develops its plans further, we request further information as to its thoughts in this area.
- 45.4. The 2012 date proposed for radio bears no recognition to the licence terms (and therefore the contracts of service providers) of DAB multiplexes apart from passing reference to the end of Digital One's licence term in 2011. The majority of local DAB multiplexes licences end between 2013 and 2016.

46. We welcome Ofcom's intention to extend the existing system of population-based spectrum fees to the broadcasting of all national, regional and local analogue radio stations, including the BBC. However, we are concerned that Community Radio stations will be charged an unquantified flat fee rather than a population-based because "these services cover only limited populations in relatively small areas" and that "the costs of administering a population-based system of spectrum fees for these licensees would also be material" (para 4.28).
- 46.1. A number of community services operate in major metropolitan areas (where demand for spectrum is high) and where whilst the geographical size may be small, the population covered can be significant.
- 46.2. We also believe that it is unreasonable to enable these small scale community services to pay a flat fee, whilst similar sized ILR services will be required to pay a potentially higher population-based spectrum fee.
47. Finally, we do not believe that Ofcom should be able to decide to charge a certain category of licences on a different charging model because of the administrative hurdle. This would seem to be contrary to its overall view of ensuring that spectrum is used efficiently. All similar sized services (irrespective of the licensing regime under which they operate) should be charged on the same basis. The economic cost of not extending population based charges to smaller scale ILR services is likely to be minimal, whilst the administrative costs are likely to be material.