

## Response to Ofcom's Consultation on Administrative Incentive Pricing

### Background

1. The RadioCentre formed in July 2006 from the merger of the Radio Advertising Bureau (RAB) and the Commercial Radio Companies Association (CRCA). Its members consist of the overwhelming majority of UK Commercial Radio stations, who fund the organisation.
2. The role of the RadioCentre is to maintain and build a strong and successful Commercial Radio industry - in terms of both listening hours and revenues. As such, the RadioCentre operates in a number of areas including working with advertisers and their agencies, representing Commercial Radio companies to Government, Ofcom, copyright societies and other organisations concerned with radio, and working with stations themselves. The RadioCentre also provides a forum for industry discussion, is a source of advice to members on all aspects of radio, jointly owns Radio Joint Audience Research Ltd (RAJAR) with the BBC, and includes copy clearance services for the industry through the Radio Advertising Clearance Centre (RACC).

### Introduction

3. Commercial Radio is concerned by Ofcom's proposals for the introduction of AIP to terrestrial radio broadcasting. The plans for AIP charges to DAB could, without further significant work:
  - impact on the commercial viability of DAB broadcasting in the medium term and limit Commercial Radio's ability to invest in multi-platform broadcasting.
  - fail to deliver the stated objective of efficient spectrum use in radio.
  - disadvantage Commercial Radio compared with the BBC and other media.
  - offer insufficient certainty in terms of actual cost proposals and potentially disadvantage local DAB over national DAB.

### Impact on commercial viability of DAB

4. Commercial Radio has, with the BBC, driven take up of DAB to impressive levels. There are 3 million sets in the UK, 13.6% of radio listening is via digital platforms, of which 54% is to DAB<sup>1</sup>.
5. However, DAB continues to be a significant financial drain on the industry: in addition to high transmission costs, the industry is providing new services as well as simulcasting existing services. Whilst Commercial Radio is taking a greater share of listening in the digital world, this is not yet providing revenues to compensate for the increased levels of investment required by digital infrastructure and new content.
6. Loading additional costs onto DAB broadcasting, at both a national and a local level, will simply push the return on investment timetable still further into the future. Thus **an unintended consequence of Ofcom's AIP policy may be a negative impact on investment in digital radio.**

### Impact on multi-platform delivery of radio

7. Radio is a secondary medium, that is, it is consumed while doing other things. This attribute is greatly to radio's advantage in that radio content can be integrated into many new types of technology, such as iPods, websites, mobile phones and

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<sup>1</sup> RAJAR Platform Survey & RAJAR Q2 2006

televisions. Perhaps in the future it will also be integrated into kitchen appliances or public transport. Radio can be consumed in environments where TV cannot be viewed and websites cannot be surfed.

8. But these opportunities also present a challenge for the industry. In order to achieve the ubiquity essential to radio's success in a multi-platform, multi-media world, radio arguably needs to make itself available in more places, in more ways, than any other medium. True ubiquity as a secondary medium can only be achieved if every device which delivers a primary medium also delivers radio. The same is not true in reverse (i.e. not all radios need to have TVs in them). This results in a cost and innovation burden for the industry. If, in addition, existing platforms become more costly to operate, it becomes more difficult to invest in new ones.
9. It could be argued that the additional cost of the existing platforms (i.e. if AIP is applied to DAB) should encourage providers to consider whether those platforms should be abandoned or investment in them downscaled. In the case of DAB this is difficult to contemplate since, with legislative encouragement, DAB investment has been at the forefront of Commercial and BBC Radio's forays into digital broadcasting and consumer adoption of digital listening.
10. We therefore consider that **the introduction of AIP will negatively impact on Commercial Radio's ability to compete as a multi-platform medium.**

#### The plans will fail to deliver the stated objective of efficient spectrum usage

11. The consultation sets out a range of economic and theoretical arguments as to why Administrative Incentive Pricing is an appropriate tool for delivering spectrum efficiency. Since adoption of these principles is likely to result in the Treasury receiving more money for making available exactly the same amount of spectrum, Government is likely to support Ofcom's proposals.
12. However, introducing new spectrum charges is only one side of this particular solution to efficient use of spectrum by broadcasters. This is because **spectrum charging cannot deliver spectrum efficiency unless it is tied to the deregulation of spectrum use and allocation.** Ofcom's proposals promise only an opportunity to discuss such relaxations and therefore, in themselves, will have no impact on the efficiency of spectrum usage. Furthermore, the propositions put forward depend on the introduction of other methods by which to support the delivery of socially important outcomes of broadcasting (outcomes which are also regulated by Ofcom), such as universality of access to a diversity of services from a plurality of providers.
13. Progressing with only one aspect of a proposal to improve spectrum efficiency represents an irresponsible approach for a regulator with social as well as economic responsibilities, and instead passes to industry the burden of finding the full solution. Put simply, we are faced with the choice of accepting these new charges silently or having to take on the task of encouraging Ofcom and Government to find creative ways to offset the new charges in order to minimise commercial damage to our businesses and social damage to our listeners (described in the consultation as 'focusing intervention on the downstream market for outputs, rather than discounting the level of spectrum fees'<sup>2</sup>). Since either approach raises costs for our industry (and delivers neither social nor commercial benefit), and we have no guarantee that pursuing the latter approach will be successful, we must anticipate the former. We must therefore decline the path of silent acceptance.
14. As presently proposed, the plans will mean that our industry is faced with paying additional charges simply for providing the services it is already providing. Commercial Radio has negligible short or medium-term control of how much spectrum it uses, since its licences with Ofcom dictate the duration and geographical use of spectrum.
15. Indeed, Ofcom's most recent statement on digital radio 'The Future Licensing of DAB Digital Radio' focuses on the need for applicants to maximise the population to be reached by proposed services. Ofcom makes it clear (in 3.7) that the award of multiplex licences will be significantly influenced by the scale of transmission, rather than the efficiency of spectrum usage, proposed.

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<sup>2</sup> Para 3.41

16. In 3.23 it is suggested that broadcasters are free to press for relaxation of the constraints imposed by regulators on use of spectrum. However, if Ofcom or government declines to implement such relaxations, or if technical innovations are not practicable, the only possible alternatives will 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 (see below).
17. It is inadequate simply to offer the opportunity to discuss relaxations; **if AIP is to be introduced, it must be accompanied by a simultaneous relaxation of the restrictions on spectrum usage by broadcasters.**
18. 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 has control of spectrum which it currently does not use, but which it retains in case it identifies a future need.
19. 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 might valuably and genuinely be incentivised to use its spectrum more efficiently (the BBC), will not be.**
20. In launching Classic FM, Commercial Radio had to use its spectrum efficiently because the Radio Authority decided to 'double up' the use of 100-102FM by also licensing regional radio stations within the sub-band. We doubt whether an additional cost of £180,000 per annum<sup>3</sup> (which, multiplied by four, represents just 0.3% of the BBC's radio programming budget<sup>4</sup>) would represent sufficient incentive for the BBC to make the same efficient use of the spectrum allocated for each of its four national FM stations, particularly if the cost can simply be recouped from an additional rise in the licence fee.

#### The plans disadvantage Commercial Radio compared with the BBC & other media

##### *Television*

21. We are concerned that **the planned timing of the introduction of AIP on digital radio is disadvantageous compared with the timetable set out for digital television.** Digital television is considerably further down the road to switchover than radio, not least because it has benefited from a concerted and co-ordinated Government campaign and the promise of significant government funding to achieve this objective. Yet we see from Ofcom a proposal which would involve digital radio meeting AIP costs a full two years before digital television. This is incongruous and unacceptable.
22. In addition, Ofcom identifies (in 3.41) that 'the impact of the introduction of AIP on digital radio broadcasters may be proportionally greater than on digital television broadcasters'. We agree. Because radio has a lower production cost model than television, the impact of spectrum pricing is likely to be felt more acutely. We therefore question why Ofcom plans to implement a set of proposals which it itself has identified as intrinsically imbalanced.

##### *BBC Radio*

23. Within radio too, Commercial Radio operates on a lower cost basis than the BBC and therefore will be more significantly affected by additional charges. It seems entirely inappropriate that the heaviest financial burden of this new spectrum charging policy should fall on the smallest sector regulated by Ofcom and this suggests to us that the 'one size fits all' approach is flawed.

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<sup>3</sup> On page 32 of the consultation, Ofcom estimates that the value of the spectrum occupied by Radios 1, 2, 3 & 4 is £220,000, although since the BBC currently occupies *exclusive* use of each of the 2.2MHz reserved for each national service, the fee would actually be closer to £400,000.

<sup>4</sup> The BBC Annual Report 2005-06 detailed spend on radio (not including newsgathering, marketing & PR, on-air trails, research & transmission) as £217.5m.

### *Community Radio*

24. We disagree with the proposal to adopt differing approaches to AIP for Commercial Radio and Community Radio. Ofcom argues that 'Community Radio stations serve only limited populations in relatively small areas .... Their use of spectrum is therefore of limited impact on others'. Ofcom also suggests that 'The costs of administering a population-based system of spectrum fees ... would also be material given the relatively large number of them' and therefore proposes to implement a flat fee system.
25. We fail to see why, for example, a commercially licensed small station serving a rural community should be charged the full AIP for its spectrum but a Community Radio station reaching tens, if not hundreds of thousands of people in London should pay a flat fee. It seems to us that the latter's use of spectrum would have a considerably greater impact on others' spectrum use than the former's.
26. **If Ofcom believes there is a size of station below which it is administratively impractical to apply AIP then that threshold should apply to all radio, not just Community Radio stations.**

### *Non-broadcast users of spectrum*

27. We note Ofcom's statement that other users, such as the emergency services and MOD, pay the opportunity cost of their spectrum. However, these bodies recoup their operating costs through the Treasury so any spectrum charges applied to their usage will simply be provided out of public funds: a valueless process as far as the tax payer is concerned.

### Concerns over costing proposals

28. In addition to our concerns over the proposed implementation timetable explained above, we note that Ofcom considers its estimates of the cost to be applied to be 'subject in some cases to quite large degrees of uncertainty'. We therefore note that **it is similarly difficult for the industry to comment with any authority as to how the implementation of these uncertain charges will impact on our ability to support digital broadcasting in the future.**
29. **There is inconsistency in the proposals for scaling AIP charges for local multiplexes.** For example, 4.38 states that they would be 'scaled in proportion to population coverage' whereas 3.18 states that the national charge would be divided between a 'group of local multiplexes sharing a common frequency block'. Our calculations show that, if this latter approach is taken, the charge per head of population could vary between 1p and 23p.

### Proposed plan of action to improve outcomes of AIP for Commercial Radio

30. We recommend that, as a first step, **Ofcom should defer the proposed introduction of AIP for DAB broadcasting** until a more thorough evaluation of the impact on Commercial Radio, and the range of possible solutions, is explored.
31. Having deferred implementation **Ofcom should commission an independent economic evaluation of the impact of AIP on Commercial Radio and on the development of DAB radio and digital radio.**
32. Following publication, RadioCentre staff and board members should meet with Ofcom & Government officials to identify and agree the particular challenges for Commercial Radio relating to the introduction of AIP. This should include a full evaluation of 'downstream market interventions' where appropriate.
33. This would then result in an agreed action plan to tackle these challenges, including appropriate output related market interventions where required.

### **Summary of conclusions and recommendations**

34. Commercial Radio and its shareholders have played, and continues to play, a significant role in developing digital radio in the UK.
35. A negative impact on investment in digital radio may be an unintended consequence of the policy of AIP.
36. The introduction of AIP will negatively impact on Commercial Radio's ability to compete as a multi-platform medium
37. Ofcom's proposals for implementing AIP represent an irresponsible approach for a regulator with social as well as economic duties. This is because they depend on the future introduction of other methods by which to support the delivery of socially important outcomes of broadcasting (such as universality of access to a diversity of services from a plurality of providers).
38. If AIP is to improve efficiency of spectrum usage, it must be accompanied by a simultaneous relaxation of the restrictions on spectrum usage by broadcasters, not simply a promise to discuss such relaxations.
39. Other Ofcom policies are at odds with the objective of efficient spectrum usage, for example its statement on the licensing of future local DAB multiplexes which reward licensees for achieving maximum coverage rather than using spectrum efficiently.
40. The BBC is presently the only terrestrial broadcaster in control of its own spectrum usage yet, since it will recoup its AIP costs through the licence fee payer and because the proposed charges represent a relatively small proportion of its budget, it will not be genuinely incentivised to use its spectrum more efficiently.
41. Given the relative progress made towards switchover in digital radio and television, the implementation of AIP for Commercial Radio should be deferred until after, at least, the implementation for digital television.
42. A proper independent evaluation of the impact of AIP on digital radio should precede any decisions from Ofcom as to the level or timing of the introduction of AIP for radio.