



# Principles for setting Licence Fees and Administrative Charges

**Consultation**

**Closing Date for Responses: 30 September 2004**

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## Section 1

# Summary

- 1.1 Because of the brief time between Ofcom assuming its functions from the old regulators and the start of the new financial year, Ofcom based its 2004/5 tariff principles largely on those of the old regulators. During its consultation on these, a considerable number of stakeholders raised issues that they did not believe had been effectively addressed in the old regulators' principles. Ofcom agreed that many of these issues deserved a further airing and undertook to consult stakeholders, during the summer, on its proposals to address them for 2005/6 onwards.

This is that promised consultation.

- 1.1 Stakeholders have asked us to address five generic issues:

- the appropriate measure to use as the basis of setting tariffs (e.g. revenue versus audience share or profit);
- what types of revenue should be included for the purposes of setting tariffs;
- the structure of tariffs (including the extent to which tariffs should be flat-rate; in line with the operator's respective size; or be progressive, such that larger operators pay proportionately more than small operators/ new entrants);
- implementation of transitional relief to moderate the impact of significant changes to the structure of tariffs on individual operators;
- whether individual operators could repay, in one lump sum, their share of the Government loan which funded the outstanding liabilities of the old regulators and the establishment of Ofcom.

- 1.2 Ofcom is required by law to ensure that its revenues fully cover the costs of regulation; and to raise from each of the television, radio and networks and services sectors its best estimate of the cost of regulating each sector for the year ahead with any under-recovery or over-recovery against the end-year out-turn being reflected in the following year's fees for the respective sector. Ofcom's objective in setting its tariffs is the effective collection of its funding requirements in a fair and equitable manner and with the minimum administrative burden on stakeholders.

- 1.3 Ofcom's proposals to address the issues that stakeholders have asked us to consider seek to meet, to the greatest possible extent, the following criteria:

- **Fairness.** The tariff structure should raise Ofcom's required funding across the regulated sectors in a manner that is equitable;
- **Cost-reflectiveness.** Charges should broadly reflect the underlying cost of regulating each category of stakeholder;
- **Reliability.** The tariff base needs to be stable over time, and not prone to erratic movements. Charges should not move substantially in any one year;
- **Simplicity.** The calculation of charges should be as simple as possible, wherever practicable using data that stakeholders would anyway gather for their own management purposes; and be relatively simple to administer for Ofcom;
- **Be easily verified.** Information required for the setting of charges should be easily verifiable to ensure industry-wide compliance;

- **Adaptable.** Tariff principles and structures should be able to adapt to a changing market environment and be consistent with wider policy; and
- **Relevance.** Charges should cover in full an operator's activities that flow from the licence or authorisation, but only those activities.

## Proposals

- 1.4 Ofcom's proposals which are set out in detail in this document are summarised in the following paragraphs.
- 1.5 Ofcom proposes to retain a revenue measure (Relevant Turnover) as the basis of calculating licence fees and administrative charges for the television, radio and networks and services sector. While other methods each have their individual merits, Ofcom believes that revenue most closely matches the criteria set out in paragraph 4 above.
- 1.6 Ofcom proposes that the tariff structure should have a small degree of progression, so that smaller operators and new entrants pay a lower proportion of their revenues than larger established operators. Larger operators tend to be more profitable than smaller operators / new entrants and the costs of regulation proportionately less significant in their business plans.
- 1.7 Ofcom intends to continue to keep radio and television as separate regulatory sectors with separate tariffs to reflect the differences between the sectors in terms of industry structure, size of operator and business models.
- 1.8 In the television sector, Ofcom proposes to change the definition of Relevant Turnover from being based on Qualifying Revenue<sup>1</sup>, as defined in the 1990 Broadcasting Act, to a new definition as set out in Annex 5 of this document. "Qualifying Revenue" was designed to meet different purposes in the Act; it is not adaptable and can lead to growing inequity between operators as their business models evolve. The proposed new definition of "Relevant Turnover" will include all revenues which flow from the possession of a broadcasting licence including those from advertising, sponsorship, premium rate telephone income, and retail revenue from goods and services. Ofcom proposes that Relevant Turnover should exclude retail revenue earned from the provision of broadcasting platforms (satellite and cable) which is not a licensed activity. It also proposes that Relevant Turnover should replace Qualifying Revenue as one of the components for assessing obligations under the Code on Television Access Services.
- 1.9 Ofcom proposes to introduce a simpler tariff table for television licensees, that removes the distortions caused by the caps that have been placed on licence fees in the past and to introduce a consistent set of tariffs for Public Service Broadcasting (PSB) which are platform neutral, rather than (as at present) having different tariffs which depend on which platform the PSB channel happens to be received on. Ofcom also proposes to modify the tariff structure to reflect market developments and consistency across the sectors. This involves reducing the maximum revenue threshold, beyond which the tariff rate is set to zero, from £400m to £300m and implementing less progressive tariffs than is currently the case. Ofcom is willing to consider the use of transitional relief for the migration of television licence fees onto the new tariff basis, where proposed changes to the tariff structure would produce a significant impact on any individual licensee.

<sup>1</sup> Including multiplex revenue attributable to Digital Programme Service licensees, as defined in section 15 of the Broadcasting Act 1996.

- 1.10 In the radio sector, the fees for new licence applications do not currently cover the costs of granting new licences. The difference has hitherto been met by income from ongoing fees from existing licensees. Ofcom proposes to rebalance this so that income from application fees more closely relates to the cost of granting new licences. Application fees will therefore rise but there will be a corresponding reduction in ongoing fees. This meets the criterion of cost-reflectiveness. Ofcom also proposes to change the definition of Relevant Turnover from being based on Qualifying Revenue, as defined in the 1990 Broadcasting Act, to a new definition as set out in Annex 5 of this document. A modestly progressive tariff structure is also proposed. In the interests of simplicity, Ofcom proposes that licensees whose annual fees would be £100 or less, will not be charged (that is, their tariff rate will be set at zero per cent). Finally, Ofcom proposes to allow a period of transitional relief for the migration of 2004/5 tariffs onto the proposed new tariffs.
- 1.11 In the networks and services sector, Ofcom has analysed the possibility of deducting wholesale costs from Relevant Turnover, but considers that the benefit of this change is outweighed by its complexity, administrative cost and difficulty of verification. Ofcom therefore proposes no alteration to the existing definition of Relevant Turnover and no alteration to the structure of existing tariffs. Ofcom intends to publish a list of those stakeholders whom it considers to be liable to pay administrative charges.
- 1.12 Ofcom has considered whether individual stakeholders should be able to elect to pay their 'share' of the Government loan in a lump sum rather than spread over five years. To do so, however, would require a forecast of that stakeholder's likely Relevant Turnover over the next five years. More important than the administrative complexity is the risk that this forecast could prove to be significantly adrift, which could bear inequitably on other stakeholders. Ofcom is therefore not currently minded to allow elective lump sum payments.

### Responding to this consultation

- 1.13 The consultation seeks views on the principles and approach that Ofcom should apply to the continued setting of licence fees and administrative charges for 2005/6 and beyond. A draft revised Statement of Charging Principles will be published in November 2004.
- 1.14 Views and comments on any of the matters raised in this document should be made in writing by **30 September 2004** to:

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- 1.15 Ofcom is allowing ten weeks for responses which is the standard period set out in Ofcom's consultation principles.

## Section 2

# Introduction and Background

- 2.1 On 31 March 2004, Ofcom published its Statement of Charging Principles for the year ending 31 March 2005 in accordance with Sections 38 and 347 of the Communications Act 2003. This sets out the basis on which licence fees and administrative charges are calculated. The current fees for 2004/5 are included at Annex 3 to this consultation.
- 2.2 In order to address the additional issues that stakeholders have asked us to address, Ofcom now publishes its second consultation. This review will take an over-arching look at the charging structure of the different sectors, assess the fairness of alternative charging methods and review the economic impact of the alternative approaches. Additionally, the review process will clarify definitions as and where necessary, allowing an adequate amount of time for consideration of responses in line with the consultation guidelines.
- 2.3 In this document Ofcom consults on our proposed changes to the charging regime currently in force. In light of the responses to this document Ofcom will publish a revised draft Statement of Charging Principles for consultation which will then form the basis for setting licence fees for the 2005/6 financial year onwards. The process for setting tariffs for the 2005/6 charging year is laid out below.

**Table 1 Key dates during tariff setting process**

Date	Action
July 26 <sup>th</sup> 2004	Publish consultation paper
September 30 <sup>th</sup> 2004	End of consultation period
November 2004	Publish Draft Statement of Charging Principles
December 2004	Publish Draft Ofcom Business Plan
January 2005	Publish Final Statement of Charging Principles
January 2005 to February 26 <sup>th</sup> 2005	Collection of revenue data (calendar year to December 2004)
31 <sup>st</sup> March 2005	Publish tariff tables for 2005/06 based upon 2004 actual revenues

- 2.4 The setting of spectrum licence fees falls outside the scope of this consultation and the process for setting these fees will continue to be determined by the principles set out in the Wireless Telegraphy Acts 1949 and 1998. Ofcom receives a grant from the Secretary of State for Trade and Industry to cover its costs in relation to spectrum.
- 2.5 The BBC and S4C pay fees to Ofcom to cover the relevant cost of regulating those bodies and the level of these fees have been agreed upon for the 2004/5 charging year. Issues relating to the cost of regulating the BBC and S4C are outside the scope of this consultation.

## Amounts to be raised from licence fees and administrative charges

- 2.6 Table 2 below presents Ofcom's budget for 2004/5, separated into ongoing running costs and repayments of the DTI loan for the purpose of setting up Ofcom. Ofcom is not re-consulting on this apportionment between the regulatory sectors, which is set on

the basis of recovering from each sector the forecast cost of regulating that sector in 2004/5.

**Table 2 Allocation of Ofcom's overall budget into Regulatory Sectors**

	<b>Total (prior to loan repayment) 2004/5 £m</b>	<b>Loan Repayments £m</b>	<b>Total 2004/5 £m</b>
Spectrum, Government grants and other sources	94.4	13.9	108.3
Radio	4.4	0.4	4.8
Television	24.1	2.7	26.8
Networks & Services	22.0	2.5	24.5
<b>Total Costs</b>	<b>144.9</b>	<b>19.5</b>	<b>164.4</b>

- 2.7 Ofcom's tariffs are set separately for the three sectors in order to raise each sector's share of Ofcom's budget requirement.

### **Key outcomes from the February 2004 consultation**

- 2.8 Following the February 2004 consultation, a number of issues were decided. These included the annual timetable for setting tariffs, which requires revenue returns to be completed by licensees and regulated operators for the previous calendar year and to be submitted to Ofcom by 26 February each year. Ofcom also decided the monthly payment schedule for licence fees and administrative payments and has in place a cost allocation methodology to determine the fee requirement from each sector.
- 2.9 In the radio broadcasting sector Ofcom changed the basis of calculation of licence fees for local and national radio stations from the population coverage of licensees' stations to a revenue basis. Ofcom adopted the Qualifying Revenue definition as set out in the 1990 Broadcasting Act as the basis for determining Relevant Turnover. The statutory definition of Qualifying Revenue is set out in Annex 4.

### **Document framework**

- 2.10 In this document, in order to give greater clarity, Ofcom discusses each of the relevant sectors in turn, television, radio and networks and services. However, some issues are relevant to all of the sectors and a separate general issues section has been included to address these.
- 2.11 An assessment of the proposed tariff structures and illustrative tariffs is included at the end of each of the relevant sections. Section 7 of the document sets out Ofcom's key proposals for each of the sectors and provides our overall regulatory impact assessment of those proposals.

## Consultation

- 2.12 The period for this consultation is 10 weeks and Ofcom welcomes responses to the questions set out in this document by 30 September 2004. Following consideration of responses, Ofcom currently expects to publish a draft Statement of Charging Principles for consultation in November 2004, with a final Statement of Charging Principles by the end of January 2005.
- 2.13 Section 8 to this consultation sets out the process for responding to this consultation and Ofcom's consultation principles.
- 2.14 Annex 6 provides a list of questions on which Ofcom is seeking responses. Ofcom also welcomes any more general comments on this document.



## Section 3

# General issues

## Broad tariff principles

- 3.1 Ofcom is required to set tariffs in order to raise sufficient income to support the cost of its regulatory activities. Ofcom's prime objective is the effective collection of its funding requirements with the minimum administrative burden on stakeholders in a fair and equitable manner. It is also important that the tariff structure does not create incentives for regulated businesses that conflict with broad objectives of regulatory policy. Ofcom recognises that, as a zero-sum game, any choice of tariff structure is bound to be unpopular with some. This suggests that it is particularly important for tariffs to be practical and workable.
- 3.2 Ofcom has sought to apply the following criteria in considering the options in this document. As far as possible the tariffs should have the characteristics of:
- **Fairness.** The tariff structure should raise Ofcom's required funding across the regulated sectors in a manner that is equitable;
  - **Cost-reflectiveness.** Charges should broadly reflect the underlying cost of regulating each category of stakeholder;
  - **Reliability.** The tariff base needs to be stable over time, and not prone to erratic movements. Charges should not move substantially in any one year;
  - **Simplicity.** The calculation of charges should be as simple as possible, wherever practicable using data that stakeholders would anyway gather for their own management purposes; and be relatively simple to administer for Ofcom;
  - **Be easily verified.** Information required for the setting of charges should be easily verifiable to ensure industry-wide compliance;
  - **Adaptable.** Tariff principles and structures should be able to adapt to a changing market environment and be consistent with wider policy; and
  - **Relevance.** Charges should cover in full an operator's activities that flow from the licence or authorisation, but only those activities.

**Question 1:** Are Ofcom's proposed criteria for designing the tariff structure appropriate?

## The basis of setting tariffs

- 3.3 Historically, television and networks and services tariffs have been based upon a revenue measure but tariffs in the radio sector, before 2004/5, were based upon a population measure. The change to revenue in the radio sector for 2004/5 has had a considerable impact on some individual licence fees and during the first consultation Ofcom did receive a number of alternative suggestions. Ofcom has assessed the different approaches in line with Ofcom's criteria for setting tariffs as outlined above and given the impact and importance of the proposed change presents its assessment in Table 3 below.

**Table 3. Assessment of the alternative bases of charging licence fees and setting administrative charges**

Tariff measures	Advantages	Disadvantages
Revenue measure	The revenue basis has been used to set licence fees for television broadcasting and calculate networks and services charges. The revenue measure is reasonably stable over time, relatively simple to administer and verify. It can also be applied consistently across the various sectors and is adaptable to market changes.	It is more complex than some measures (e.g. flat rate tariff) to administer.
Population measure	The radio industry has been accustomed to a population based measure. It changes slowly and more predictably than revenue.	A population measure for radio and television is becoming more out dated as their reach expands through new platforms. Population may be perceived as an unfair measure as it penalises those niche broadcasters in large population areas in favour of mainstream local broadcasters. Not a suitable measure for networks and services.
Audience measure	An audience measure more closely matches the financial performance of a broadcaster than population, although the value of audiences will still vary according to the audience profile.	Radio industry audience figures are provided by RAJAR, but are significantly disputed by some industry members. Reliable and timely audience data for television (particularly for smaller and overseas channels) may be difficult to obtain. Not a suitable measure for networks and services.
Flat fee	A flat charge would be simple to administer. Total costs of regulating each sector could be divided by the number of regulated operators to calculate a flat charge. At a conceptual level, some regulatory activities fall evenly upon individual regulated operators.	A flat charge would be highly disproportionate, incurring significantly higher relative costs to smaller regulated operators. Many regulatory activities do not fall evenly across individual operators.
Profit measure	A profit measure is more closely linked to the value of a licence. It has been suggested that this would be fairer for operators with different cost structures.	Profit is too volatile a measure to ensure that Ofcom can raise its required funding without erratic tariffs.

3.4 On the basis of the assessment set out above Ofcom believes that revenue provides the best option. A revenue basis can be applied consistently across the three regulated sectors; it is relatively stable over time, is more easily verifiable than some of the other options and is adaptable to market changes. On balance therefore Ofcom

considers revenue to be the most appropriate base on which to set licence fees and administrative charges for the television, radio and networks and services sectors.

- 3.5 In addition, most responses to the first consultation were in favour of switching to or retaining revenue as the basis of charging.

**Question 2:** Do you agree with Ofcom's view that revenue should be the basis of setting tariffs? If not, which alternatives would you prefer and why?

## Tariff structure

- 3.6 The current tariffs for 2004/5 for television and radio broadcasting, and networks and services are presented in Annex 3. The tariff structures vary between sectors, reflecting the different sector characteristics. The key differences are summarised in the table below: Table 4 Comparison of current tariff characteristics across regulated sectors

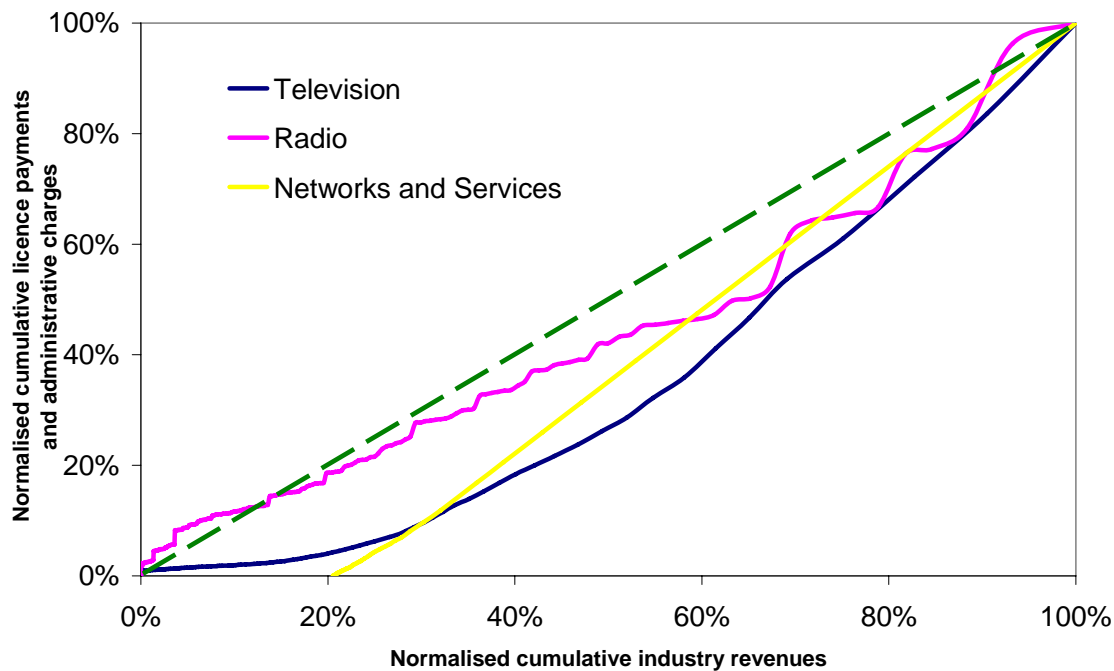
**Table 4 Comparison of current tariff characteristics across regulated sectors**

Tariff attribute	Networks and Services	Television	Radio
Minimum revenue threshold	£5m	£0	£0
Number of bands	15	5	1
Rounding to lowest point within band	Yes	No	No
Progression	Moderate, as a consequence of minimum threshold	Moderate	None <sup>*1</sup>
Progressive scale addition <sup>*2</sup>	No	Yes	No
Maximum revenue threshold	No	£400m	No

\*1 The radio sector tariffs were progressive with respect to population, but would be proportionate with respect to revenue (without considering the transitional arrangements in place in 2004/5)

\*2 Progressive scale addition means that higher tariffs are only charged upon incremental revenues above banding thresholds

- 3.7 There is a choice between tariffs that rise in line with the size of an operator's revenues, or a progressive tariff which raises proportionally more from larger operators.
- 3.8 The degree of progression in the 2004/5 Ofcom tariffs is illustrated in the chart below. This shows the normalised cumulative collection of fees, in relation to normalised cumulative industry revenues. Tariffs are more progressive the further away (to the right) they move from the diagonal (proportionate) line. Actual 2004/5 fees were calculated using caps for both the television sector and the radio sector and hence the chart below does not exactly represent the underlying tariff structure. In the case of television this is unlikely to make a significant difference, but in the case of radio the underlying structure is a straight-line proportionate tariff (following the diagonal line in Chart 1).

**Chart 1 Distribution of Ofcom's charges (2004/5)**

3.9 Table 5 below sets out a range of advantages and disadvantages of the different tariff characteristics.

**Table 5 Advantages and disadvantages of various tariff characteristics**

Tariff attribute	Advantages	Disadvantages
Minimum revenue threshold	Using a minimum revenue threshold removes the smaller regulated operators. Where there are a significant number of smaller operators this reduces administration costs.	Tariff payments not recovered from smaller operators. A small regulatory fee provides a reminder that the regulatory regime is still relevant for smaller operators.
0% Allowance	A zero-rated revenue band has the same impact as the minimum revenue threshold, but it also introduces a more progressive scale (because licensees just above the 0% band have lower average payments than much larger licensees).	Modest additional complexity to administer. Step change in fees for operators who shift either side of the revenue threshold from year to year.
Number of bands	Banding is usually required to introduce a progressive scale.	Too many bands can introduce unnecessary complexity.
Rounding to lowest point within band	Simplifies billing as many invoices are the same figure. A small inaccuracy in revenue information would have no financial impact.	Creates jumps in tariff payments, when revenue thresholds are exceeded.
Degree of progression	Progressive tariff scales reduce the financial impact upon smaller operators. Smaller operators tend to have a lower profitability. Reduces entry/exit conditions (marginally)	Moves away from a strictly proportional tariff basis. The degree of progression is subjective.

	and generally pro-competitive.	
Progressive Addition	A progressive scale reduces significant jumps in tariffs when higher bands are reached because a higher rate is charged only on incremental revenue above the higher threshold. Few bands are required.	Additional complexity to administer.
Maximum revenue threshold	Beyond a certain point, regulatory activities may diminish with size. The maximum revenue threshold mitigates the problem of different overall licence fees comparing the situation of a group holding many smaller licences with a group holding one large licence (specifically an issue in television).	Increases the financial impact upon medium sized operators.

- 3.10 Ofcom intends to use tariff structures that are as simple as possible, consistent across the three regulatory sectors, but also allow for sector differences where necessary. Ofcom proposes that tariffs should have a mild progression, so that larger operators pay a slightly higher proportion of charges than smaller operators/new entrants. Larger operators tend to be more profitable than small operators/ new entrants and the costs of regulation are proportionately less significant in their business plans.
- 3.11 Ofcom does not want to be constrained to the tariff structures that were developed by its predecessor organisations, but it does not want to pursue change for little or no benefit. Ofcom welcomes responses to its general approach to tariff structures.

### Question 3:

- a) Do you agree with Ofcom's general approach to tariff structures?
- b) If not, are there any other tariff structures which Ofcom has not considered?
- c) Do you agree that there should be mild progression within Ofcom's tariffs?

## Regulatory sectors

- 3.12 One response to the February 2004 consultation suggested that the costs of regulating both radio and television should be recovered as one regulated sector and through one tariff for all broadcasting licensees.
- 3.13 Ofcom does not consider this as appropriate on the grounds that:
- television and radio are different industries with different business models, revenues streams and cost structures;
  - the regulatory activities required for television and radio are different; and
  - aggregating discrete regulatory levels to this extent would be inequitable.
- 3.14 Regulatory tiers are the distinct categories within the three regulatory sectors (television, radio and networks and services) to which Ofcom's costs are allocated; because they represent a discrete and identifiable regulatory activity. They are usually, though not invariably, defined by different classes of licence or authorisation; tariffs are set for each tier to cover the costs of regulating that tier.

- 3.15 Ofcom does propose some alterations to the regulatory tiers within sectors, but these considerations are contained within the separate industry sections later in this document.

**Question 4:** *Do you agree with Ofcom's view that television and radio should not be combined into one overall regulatory sector for the purpose of tariff setting?*

### **Loan repayment**

- 3.16 A number of the respondents to the first consultation expressed an interest in paying for their share of the allocation of Ofcom's loan from the DTI in one upfront payment.
- 3.17 Ofcom considers that this will introduce an unnecessary amount of complexity to the tariff calculations, which would have to distinguish, for future charges, whether to include or exclude an allocation of the loan repayment. It would also be necessary to forecast the stakeholder's Relevant Turnover over the loan repayment period, with a significant risk that the forecast could prove inaccurate, thus potentially introducing unfairness to the setting of tariffs as between stakeholders. Ofcom intends to continue allocating the cost of the loan over the period in which it is amortised. The terms on the loan are favourable, so tariff payments contain only a very small interest component.

### **Electronic Communications Service provision**

- 3.18 Ofcom is currently considering the exact scope of the definition of Electronic Communication Service provision under the Communications Act 2003, and the relationship between the broadcasting transmission market and ECS provision. Ofcom hopes to provide further guidance on this issue later in the year.

## Section 4

# Television

### 4.1 The key issues for this consultation are:

- the definition of Relevant Turnover for tariff setting use, and in particular the treatment of vertically integrated cable and satellite licensees, shopping channels and various interactive services;
- the structure of tariffs; whether to move to a simpler tariff basis that distinguishes between licences according to whether they are PSB in nature or not, with the associated regulatory burdens and costs, and whether to change the structure to reflect recent market developments;
- the movement of digital terrestrial multiplex licences into their own category of tariff;
- whether to operate transitional relief provisions when licence fees change substantially; and
- proposals to use a new definition of Relevant Turnover in place of a definition based on Qualifying Revenue for the purpose of assessing obligations under the Code on Television Access Services.

### Definition of Relevant Turnover

- 4.2 Television licence fee tariffs have generally been set using the statutory definition of Qualifying Revenue – the only exceptions being ITC tariffs for local delivery (cable) systems which are no longer licensed, restricted service licences and restricted event licences, which are based on the capacity of the relevant venue.
- 4.3 The main advantage hitherto for the use of Qualifying Revenue as the basis for determining Relevant Turnover is that the data has been relatively simple to collect for licensees and there is a statutory definition of Qualifying Revenue. This statutory definition of Qualifying Revenue is provided within the Broadcasting Act 1990 for the purposes of calculating additional payments and setting the maximum level of financial penalties. It is set out in Annex 4. In addition, further information on the principles followed in the calculation of qualifying revenue is available<sup>2</sup>.
- 4.4 As technology develops and services provided evolve, the definition of Relevant Turnover needs to be updated so that tariffs do not unfairly discriminate between operators who have chosen different business models. Those should be a matter of market choice for the operators and not influenced by Ofcom's tariff structures. Ofcom considers that it is appropriate to have a separate definition of Relevant Turnover for tariff-setting purposes in order to better reflect the range of services now provided under television licences, and to ensure that revenue from activities which are not licensed is not caught. For example, the retailing of pay TV services is not an activity for which a licence is needed, but such subscription revenue could be caught as Qualifying Revenue under the statutory definition.
- 4.5 Recent innovations in the provision of services, such as shopping channels and the use of premium rate telephone services to earn revenue are not expressly covered by the statutory definition of Qualifying Revenue.

<sup>2</sup> Qualifying or Multiplex Revenue Statement of Principles (2001) - [www.ofcom.org.uk/static/archive/itc/itc\\_publications/codes\\_guidance/qualifying\\_revenue/index.html](http://www.ofcom.org.uk/static/archive/itc/itc_publications/codes_guidance/qualifying_revenue/index.html)

- 4.6 To provide greater flexibility and certainty, Ofcom proposes to move away from this statutory based definition for the purposes of tariff setting and to use a new definition of Relevant Turnover.

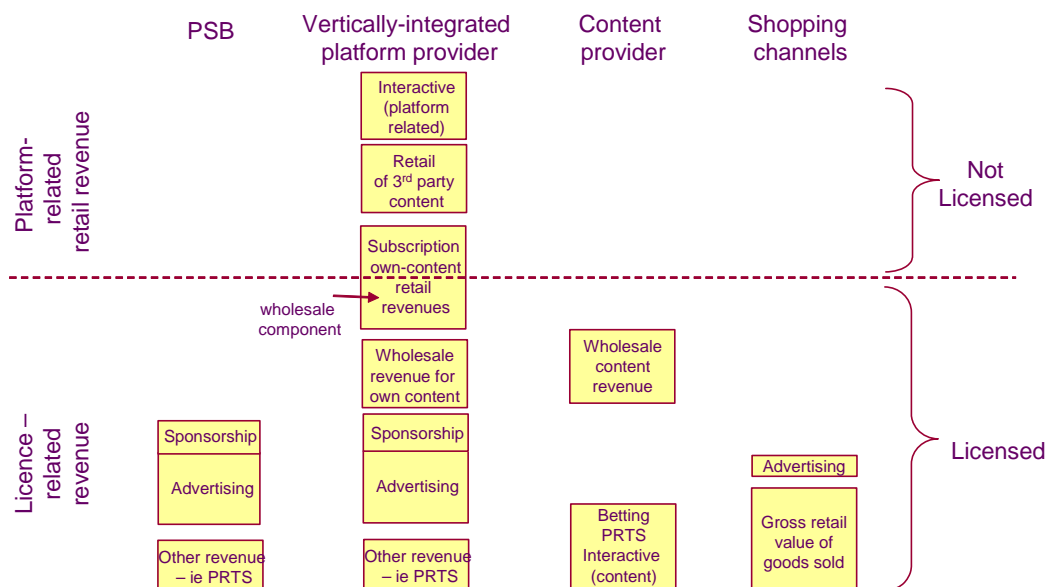
### Proposed definition of Relevant Turnover

- 4.7 The proposed Relevant Turnover definition should:

- ensure that the revenue earning potential of every licence is included in the definition;
- provide a non-discriminatory approach that covers the broad range of services provided by licensees; and
- ensure that the definition measures the consumer's exposure to licensees in a consistent way, regardless of the business model of the licensee.~

- 4.8 Ofcom proposes to use a definition that includes all revenues attributable to the licensed service. This includes advertising revenues (after deduction of sales rebates, commission, value added tax and other taxes directly related to revenue), sponsorship revenues, subscription and pay-per-view revenues (after deduction of a retail component), the sales value of goods and services sold directly using the licence and other sales revenues derived from the licence such as betting, PRTS and interactivity. This is graphically illustrated below, where Relevant Turnover is diagrammatically represented by the revenue from licensed activities beneath the line in Chart 2. Annex 5 provides Ofcom's proposed definition of Relevant Turnover in greater detail.

**Chart 2 Illustration of revenues contained within the proposed definition of Relevant Turnover**



- 4.9 One category where different business models are used is that of shopping channels. These sell a range of goods and services in a wide variety of ways. One model is the approach adopted by large television channels, who act as a retailer of goods, using television as a retail channel. Other licensees such as smaller travel channels advertise holidays for sale and earn commission based on the level of sales. From a consumer's perspective, the business model adopted by the licensee does not affect the payment they make. The definition of Relevant Turnover is therefore proposed to



include the price (net of VAT) paid by the consumer for such goods and services, irrespective of the business model of the channel.

- 4.10 Under the statutory definition of Qualifying Revenue a service which is retailed within the same company or group of companies will have a higher level of subscription revenue than one that receives wholesale revenue only. The activities of cable and satellite platform operators are not licensed by Ofcom, and so to achieve a non-discriminatory approach it is proposed to treat the revenues from services provided on different platforms in a consistent manner, and to treat services provided by platform operators consistently with those provided by third parties. To achieve this Ofcom proposes to allow the retail element of revenues to be deducted in calculating subscription revenues, where the licensee is also the retailer of the service.

**Question 5:** *Do you agree with Ofcom's proposal to allow retail revenues to be deducted when calculating subscription revenues where the licensee is also the retailer of the service?*

**Question 6:** *Do you agree with Ofcom's proposed definition of Relevant Turnover in the television sector?*

### **Additional payments**

- 4.11 A key difference between Channel 4 and the other PSB licensees is that Channel 3, Channel 5 and the Public Teletext licensee make Additional Payments to HM Treasury. This is based upon an annual "cash bid" fixed sum that rises in line with inflation and a percentage of qualifying revenue (PQR). The Additional Payments were first set when the licences were initially auctioned, but were then reset by the ITC on a non-competitive basis, but at a rate as if the licence had been auctioned.
- 4.12 During 2004, Ofcom will be setting the terms of the replacement digital licences for all analogue television services. Ofcom is also expecting to conduct reviews of financial terms of certain of these licences during early 2005. If reviews are requested by licensees, Ofcom will determine new cash bid and a new PQR. For the purpose of valuing the licences and setting new Additional Payments, Ofcom's licence fees will be a deductible cost.
- 4.13 A licensee making Additional Payments has suggested that it is effectively paying twice, because it is paying Ofcom fees against revenue that it pays over to the Treasury. It claims that there is a lack of fairness between those licences that make Additional Payments and those that do not.
- 4.14 Their proposed solution would be to allow Additional Payments to be deducted from the revenue measure in setting tariffs.
- 4.15 The argument against allowing the deduction of Additional Payments is that they reflect an economic rent extracted by the government and were set assuming Ofcom's existing licence fees. Ofcom's tariffs are an operating cost for licence holders (i.e. Ofcom's fees are a deductible item in the process of setting Additional Payments). To allow Additional Payments in turn to be a deductible item for the purposes of setting Ofcom's fees would be unfair to other licensees.
- 4.16 Ofcom's view is that Additional Payments should not be deducted from Relevant Turnover for the purpose of setting television tariffs.

**Question 7:** *Do you agree with Ofcom's view that Additional Payments should not be subtracted from Relevant Turnover for the purpose of setting television tariffs?*

## Proposed tariff structure

- 4.17 Ofcom proposes to simplify the tariff structure in the television sector which was inherited from the ITC and which has been rolled forward for two years using a cap on fees in relation to the previous year's licence fees. If the 2004/5 tariffs were applied in 2004/5 without the cap, Ofcom would raise an amount substantially in excess of Ofcom's funding needs from the television sector. However, to ensure the appropriate level of licence fees is recovered from the sector and that increases across the sector are proportionate, a capped increase of 32% has been applied in 2004/5.
- 4.18 The use of caps on the increases in licence fees has resulted in some anomalies. The profile of growth in revenues for licensees has varied over the period of the licence fee caps, with some faster growing licensees and other slower growing licensees. Furthermore, the migration of analogue revenues to TLCS (formally STS<sup>3</sup>) licences has not been even across Category A licences. This means that after two years of implementing licence fee caps some faster growing licensees are proportionally paying less than slower growing licensees.
- 4.19 In future years it is Ofcom's intention that the tariff table should generate the required level of revenue without the need for such a cap. This will remove the problems created when using caps and will make the application of the tariff table significantly simpler.
- 4.20 Furthermore, Ofcom proposes a number of changes to the structure of television tariffs. These are considered below:
- setting separate tariffs for PSB and non-PSB revenues;
  - reducing the upper £400m revenue threshold beyond which the tariff is set to zero; and
  - reducing the degree of progression, built into the existing 2004/5 tariffs.

## PSB revenue basis for tariff setting

- 4.21 Ofcom's existing categorisation for the purpose of setting tariffs involves three regulatory tiers for television – Categories A, B & C. The current categories for each type of television licence are presented below:

<sup>3</sup> Satellite Television Service licence

**Table 6 Existing television licence categories**

Licence Category Description	Total in Issue	Tariff Category
Channel 3	16	A
Channel 4	1	A
Channel 5	1	A
Commercial Additional Service	3	B
Digital Television Addition Service	21	B
Digital Television Programme Service	33	B
Digital Terrestrial Multiplex Service	5	A
Public Teletext Service	1	A
Restricted Television Services Licence	19	C
Television Licensable Content Service (TLCS)	561	B
Total	661	

Source: Ofcom

- 4.22 The current tariffs payable are set out in Annex 3. The difference in tariffs between Category A and Category B is due to the amount of regulation that falls on each of the licence types. Principally, the Category A licences include the public service broadcasters (C3, C4 and C5) who are subject to a significantly greater degree of regulation under the Communications Act 2003 than the non-Public Service Broadcasters (e.g. regional, news and current affairs, origination and independent production quotas; the programme commissioning codes; public service remits and statements of programme policy in respect of non-quantifiable PSB obligations; networking arrangements etc).
- 4.23 Currently TLCS licences held by both PSB and non-PSB broadcasters are included under Category B. However the cost of regulating PSB is very largely platform independent. To reflect these differences Ofcom proposes to split category B between PSB and non-PSB, with different tariffs for each. This means that the PSB licensees (C3, C4, C5, etc) will pay the same tariff rate on their revenues irrespective of the platform that the revenues were generated on<sup>4</sup>. Other Category B licensees will pay the lower tariff for non-PSB revenues to reflect the lower costs of non-PSB regulation.
- 4.24 This approach does mean that (as now) a proportion of regional C3 only regulatory costs are spread across all PSBs. The distortion this may cause is believed to be minor. An alternative approach would be to use 4-5 different mini-tariffs for each of Ofcom's regulatory functions, but Ofcom proposes that the PSB split is the most significant split, and the benefit of further splits would not be worth the administrative complexity.

### Reducing the maximum revenue threshold

- 4.25 The original television tariff structure was developed by the ITC before the fragmentation of viewing shares between alternative distribution platforms such as analogue terrestrial, DTT and satellite. It contained a £400m maximum revenue

<sup>4</sup> PSB licensees with both terrestrial licences and TLCS licences will still need to apportion their revenues into Categories A and B. This is because the progressive tariff structure means that revenues cannot be combined, even if they attract the same tariff rate.

threshold, beyond which the tariff was set to zero, which was designed to mitigate some of the distortion caused when comparing the licence fees of single channel licensees with multiple licensees associated with a single channel. Without the maximum threshold single channel licensees would pay significantly higher proportionate licence fees than licensees who share a channel and who collectively gain more from the progressive nature of the tariff.

- 4.26 As a consequence of the migration of television revenues away from analogue licences, falling analogue revenues have rendered this £400m maximum revenue threshold less effective. Ofcom therefore proposes to reduce the maximum revenue threshold to £300m.

### Reducing the degree of progression within television tariffs

- 4.27 The original television tariff structure was also developed by the ITC before the significant concentration in licence ownership that has recently occurred. Ofcom has therefore reviewed the degree of progression and proposes to implement less progressive tariffs than the existing 2004/5 tariffs (and that are also broadly consistent with the tariff structure proposed for the radio sector).

### Overall impact of proposed changes to television tariffs

- 4.28 Taking account of the proposed revenue definition, the creation of a PSB tariff and non-PSB tariff and the other proposed structural changes, illustrative tariffs for 2004/5 are presented below. These tariffs are purely illustrative as actual tariffs for 2005/6 will reflect changes in the industry revenue, Ofcom's costs and any under/over recoveries for 2004/5.

**Table 7 Illustrative Category A and B Licence Fees**

		Illustrative tariff structure		
Qualifying Revenue		Category A PSB Revenues	Category B PSB Simulcast Revenues	Category B Non-PSB Revenues
Bands				
£0m -	£10m	0.3770%	0.3770%	0.0382%
£10m -	£35m	0.5655%	0.5655%	0.0764%
£35m -	£75m	0.8482%	0.8482%	0.1528%
£75m -	£300m	1.2723%	1.2723%	0.3056%
Over	£300m	0.0000%	0.0000%	0.0000%

Source: Ofcom calculations

**Question 8:** Do you agree with Ofcom's proposed structural changes for television tariffs?

### Digital multiplexes

- 4.29 Digital multiplex service licences provide access to a scarce resource on a platform that is central to the future of terrestrial television broadcasting in the UK. However the current revenue definitions are not suited to revenues from the transmission of channels, especially given the variety in business models of multiplex operators (ie integrated broadcasters do not record transmission revenue separately). Furthermore,

digital multiplex service licences do not attract the content regulation of PSB services. Ofcom therefore proposes an alternative approach for setting tariffs for the digital multiplex service licences which involves moving them out of Category A into a new, separate Category D.

- 4.30 It could be argued that the costs of regulating the digital multiplex service licences are presently high. However, Ofcom considers that it would be disproportionately burdensome to engage in a cost allocation exercise to identify the costs that should be recovered from this category, especially as these activities tend to be closely linked to other aspects of wider broadcasting policy. The multiplex service licences are analogous to the national digital radio multiplex licence. This is currently licensed on the basis of an annual £10,000 recurring fee. Ofcom proposes to set the same £10,000 fee for each television multiplex service licence.
- 4.31 As the proposed £10,000 fee is due to a change in category, and where multiplex operators typically paid the minimum fee, Ofcom does not propose to allow transitional relief in the cases when this new fee results in a large percentage increase in the tariff payable.

**Question 9:** *Do you agree with Ofcom's view that television multiplex service licences should be moved to a new Category of licence? Is £10,000 an appropriate annual fee?*

### Code on Television Access Services

- 4.32 The Code on Television Access Services uses qualifying revenue as one factor in assessing the ability of licensees to afford to pay for television access services (subtitling, signing and audio description). Ofcom considers that it would be appropriate to replace Qualifying Revenue with Relevant Turnover when this data is available. The alternatives, which Ofcom does not consider would be proportionate, would be to continue to require licensees to submit declarations of Qualifying Revenue or to seek additional declarations of operating costs or profitability in a standardised form. Ofcom considers that the process of standardising such declarations would require intrusive enquiries into the finances of licensees, and would add to the burdens on licensees.

**Question 10:** *Do you agree with Ofcom's view that, for the purposes of assessing obligations under the Code on television Access services, Qualifying Revenue should be replaced by Relevant Turnover?*

### Effect of Ofcom proposals

- 4.33 Ofcom's proposals can affect licensees in two ways:
- the administrative effect covers the time and resources required to comply with the tariff setting information requirements; and
  - the tariff effect on individual licensees. This requires analysing the cost of the tariffs to ensure fairness across the sector.

#### Administrative effect

- 4.34 The administrative impact has been minimised by taking the following steps:
- basing tariffs upon revenue, which should be readily available; and

- not allowing deductions for additional payments.

4.35 However, the inclusion of additional revenue sources within the Relevant Turnover definition may increase the administration cost for licensees, compared to a more narrowly defined definition. There is a trade-off between fairness and administrative complexity.

4.36 Ofcom welcomes any comments on how the process of receiving information from and invoicing licensees can be improved.

### Tariff effect

4.37 The range of percentage impacts of the illustrative tariff in comparison to the current 2004/5 capped tariffs is provided below.

**Table 8 Impact of illustrative television tariffs**

Type	PSBs	Non PSBs
Decrease in fees		
<b>-100% to -75%</b>	<b>0%</b>	<b>3%</b>
<b>-75% to -50%</b>	<b>0%</b>	<b>3%</b>
<b>-50% to -25%</b>	<b>0%</b>	<b>4%</b>
Broadly constant		
<b>-25% to 0%</b>	<b>42%</b>	<b>77%</b>
<b>0% to 25%</b>	<b>16%</b>	<b>2%</b>
Increase in fees		
<b>25% to 50%</b>	<b>5%</b>	<b>2%</b>
<b>50% to 75%</b>	<b>21%</b>	<b>2%</b>
<b>75% to 100%</b>	<b>5%</b>	<b>0%</b>
<b>More than 100%</b>	<b>11%</b>	<b>6%</b>

Source: Ofcom calculations

4.38 As can be seen from Table 8, 58% of the PSB licensees would face relatively small changes in fees as a result of the restructure. The main change will be for licensees which have had their fees distorted as a result of revenue growth over the past three years combined with the capped increase set by both the ITC and Ofcom.

4.39 79% of the non-PSB licensees will face either a small change or a decrease in fees as a result of the restructuring. The larger changes will affect licensees which have had significant revenue growth over the past three years combined with the capped increase set by both the ITC and Ofcom.

### Transitional arrangements

4.40 Ofcom intends to use transitional arrangements only when they are strictly necessary and where the benefits outweigh the administrative complexity. As a general guideline Ofcom proposes to use transitional arrangements when individual licence fee increases exceed 50%, which is likely to occur in some instances with the illustrative tariffs above. This would suggest that Ofcom should use transitional relief for the migration onto new tariffs in this instance. If transitional relief is introduced the largest proportionate reductions would be capped as a consequence.

- 4.41 Transitional relief would not be available for those licensees currently paying or moving to the minimum tariff, or for licensees whose payments increase significantly because of a re-categorisation of revenues.

**Question 11:** *Do you agree with Ofcom's view that transitional arrangements should be used to migrate television sector tariffs on a new basis? Is 50% a sensible threshold for licence fee increases to judge when transitional arrangements are appropriate?*

## Section 5

# Radio

5.1 The key issues in the radio sector are:

- the introduction of a new definition of Relevant Turnover. This includes whether to take account of Additional Payments and differences in the cost structure between licensees;
- changes to the tariff structure, particularly whether to introduce a more progressive tariff, akin to the television and networks and services sectors;
- rebalancing of tariffs, particularly raising the cost of applications, with a commensurate reduction in licence fees; and
- the impact of the proposed new tariffs, and whether any transitional arrangements should be made to migrate from the existing tariffs (which are already subject to transitional arrangements in 2004/5) to the new tariff structure.

### Definition of Relevant Turnover

5.2 The definition of Relevant Turnover for the purpose of tariff setting in 2004/5 is based on Qualifying Revenue. Qualifying Revenue (for the purposes of national radio analogue licences) is defined in the Broadcasting Act 1990, and the statutory definition is set out in Annex 4. In its 2004/5 Statement of Charging Principles Ofcom also applied the same definition for national radio analogue licences to local radio analogue licences.

5.3 As in the case of television, Ofcom proposes to move away from a statutory Qualifying Revenue basis of defining Relevant Turnover for the purposes of tariff setting and to use a Relevant Turnover definition that is specifically designed for tariff setting purposes

5.4 Ofcom intends to base its definition of Relevant Turnover on the existing definition and guidelines for Qualifying Revenue, but it does intend to include new revenue streams that are becoming more of a possibility as the sector develops. This definition is provided in Annex 5 and is closely aligned with the definition for television.

**Question 12:** *Do you agree with Ofcom's proposed definition of Relevant Turnover in the radio sector?*

### Additional payments

5.5 A key difference between local radio licences and national licences is that national licences pay Additional Payments to HM Treasury. This is based upon an annual "cash bid" fixed sum that rises in line with inflation and a percentage of qualifying revenue (PQR). The Additional Payments were first set when the licences were initially auctioned, but were then reset by the Radio Authority on a non-competitive basis (at the time when all three national licences were renewed for a further eight-year period due to the fact that their holders were providing a digital simulcast on the national commercial multiplex), and at a rate as if the licence had been auctioned.

5.6 In the first consultation, one response suggested that the independent national radio licence holders (INR) are effectively paying twice, because they are paying Ofcom fees



on revenues that are paid over to the Treasury. The respondent claimed that there is a lack of fairness between those licences that pay Additional Payments and those that do not.

- 5.7 A proposed solution would be to allow Additional Payments to be deducted from the revenue measure in setting tariffs. There would be a redistribution of tariff payments from those who pay Additional Payments to those who do not.
- 5.8 The argument against allowing the deduction of Additional Payments is the same argument for the same issue that arises in television: Additional Payments reflect an economic rent extracted by the government and were set assuming Ofcom's existing licence fees. Ofcom's tariffs are an operating cost for licence holders (Ofcom's fees are a deductible item in the process of setting Additional Payments). To allow Additional Payments in turn to be a deductible item for the purposes of setting Ofcom's fees would be unfair to other licensees.
- 5.9 Ofcom's view is that Additional Payments should not be deducted from Relevant Turnover for the purpose of setting radio tariffs.

**Question 13:** *Do you agree with Ofcom's view that Additional Payments should not be subtracted from Relevant Turnover for the purpose of setting radio tariffs?*

### Cost differences

- 5.10 A number of responses to the first consultation were concerned that the impact of licence fees would fall disproportionately, depending upon varying cost structures across licensees. Examples were provided which included higher transmission costs to rural areas and higher production costs for more expensive formats.
- 5.11 Ofcom does not intend to assess costs for individual licensees. Licence holders choose the format of the licence for which they apply and must meet the costs associated with the particular format that they choose. This is not a matter for Ofcom to consider when setting tariffs. To the extent, however, that rural licences generate less revenue than urban licences, those with rural licences should benefit from Ofcom's proposal to introduce a modest degree of progressiveness to the radio tariff structure.

**Question 14:** *Do you agree that operating costs should not be subtracted from Relevant Turnover for the purpose of setting radio tariffs?*

### Proposed radio tariffs

#### Rebalancing of tariffs

- 5.12 Ofcom has recently undertaken an internal review of the relationship between fees and costs for the variety of different regulatory activities in relation to radio. The principal conclusions of this review are that:
- most of the costs that we incur in relation to radio regulation are connected to analogue licence applications and awards, but application fees for these licences currently recover only a minority of these costs. The balance of these costs is recovered from the annual licence fees paid by existing licensees;

- relative to analogue radio, Ofcom incurs modest costs in connection with the licensing and regulation of DAB radio. However, the fees for these licences are currently set below cost recovery levels;
- most of the costs connected to Restricted Service Licences (RSLs) are incurred in association with the processing of applications for short-term RSLs. Fees for these applications are at present set below cost. The shortfall is recovered from the daily charge paid by short-term RSLs, which is above cost; and
- a number of commercial radio licensees with very low turnover pay small licence fees. The costs of collection of these fees are high and can exceed the payment received by Ofcom.

5.13 Ofcom recognises that alignment with cost is only one factor to be taken into account when judging the detailed structure of fees. Other objectives also need to be considered, including the impact of fee levels on the incentives of licensees, and the interaction with Ofcom's goals for the development of the sector, for example in relation to digital radio. That said, Ofcom considers that it is now timely to review the structure of licence application fees in the radio sector, to see if a different balance would be more equitable and support the objectives of regulation better.

5.14 Ofcom's indicative proposals for the tariff for 2005-6 are set out below. Please note that these figures are illustrative and are subject to further review. The final fees set may vary from these to reflect more up-to-date information and further policy decisions.

### **Analogue application fees**

5.15 First Ofcom proposes to rebalance its tariffs to recover more of the cost of the licensing process from application fees. This will require an increase in application fees for new analogue commercial radio licences. In particular, from 1 April 2005, Ofcom proposes to increase the application fees for new FM licences from £12,000 to approximately £25,000 for licences with an measured covered area (MCA) of 1-4.5 million, from £5,000 to approximately £10,000 for licences with an MCA of 0.4-1 million, and from £1,500 to approximately £5,000 for licences with an MCA of less than 0.4 million.

5.16 In Ofcom's view, the present level of cross-subsidy from existing licensees to applicants for new licences is no longer appropriate. The justification may have been strong in the past when the key task facing the commercial radio industry was the expansion and development of the analogue market. But in Ofcom's view this justification no longer has much force, given that only modest further expansion of the analogue commercial FM sector is possible. The present level of cross-subsidy seems excessive and may be unfair to existing licensees that do not apply for new licences. The larger increase proposed for smaller licences compared to large licences reflects the costs of making different types of licence award better than the present structure.

5.17 The increases proposed still fall short of full cost recovery. The increases required to achieve full cost recovery for licence applications would be much larger. Ofcom considers that larger increases could be destabilising to the industry in the remaining period of analogue FM licensing, and could also deter applicants from applying for new licences altogether. Ofcom has made major changes to the licensing process for awarding new FM licences, with the aim of increasing clarity for the industry and reducing the costs that applicants incur in preparing bids.

## **RSL fees**

5.18 Ofcom proposes to restructure licence fees for RSLs. Ofcom expects to increase the application fees for all types of short-term RSL from £200 to approximately £400 from 1 April 2005. Ofcom proposes, however, to reduce the daily rate charged for short-term RSLs, as follows, for Broadcasting Act licences:

- from £15 to about £10 per day for short-term (up to 28 days) AM licences
- from £26 to about £10 per day for short-term FM licences up to 1Watt
- from £44 to about £30 per day for short-term FM licences 1-25 Watts

## **Analogue licence fees**

5.19 Commercial local analogue tariffs were altered following the first consultation. The published Ofcom tariff for local commercial analogue licences is based upon a proportion of revenue, although the tariff of 0.627% of revenue is rarely applied directly, because of transitional arrangements, but it represents the level which all licensees will move to over time.

5.20 Ofcom expects that, in part as a consequence of the changes proposed above, it should be possible to reduce the tariff charged to commercial licensees for holding a licence. The exact size of the change will depend on a number of other factors, including Ofcom's budget for 2005/6 and the forecast number of licence applications. However our initial estimate is that it should be possible to reduce the rate of 0.627% to 0.470%. The effect of the reduction will depend upon three further points considered below:

- a de minimis threshold on radio licence fees;
- the possible introduction of a progressive tariff instead of the flat percentage rate; and
- the application of transitional relief.

5.21 Ofcom proposes to introduce a de minimis threshold of £100 for the fees that it will collect from radio licensees. This would remove a number of the smallest licensees from the requirement to pay fees, with a corresponding saving in administration costs both to Ofcom and the licensees. Ofcom proposes to set the threshold at this level in recognition also of the fact that the smallest licensees tend to be very marginal businesses.

5.22 Ofcom could keep the existing flat percentage rate or could introduce a more progressive tariff structure for the analogue licences; Chart 1 in Section 3 illustrates that the radio sector has the least progressive tariffs of the three sectors. Illustrative tariffs are presented below. They are based upon Ofcom's projections for industry revenue in 2004, Ofcom's costs in 2005/6 and anticipated application levels in 2005/6. Clearly there is potential for any of these variables to move away from our expectations, and hence the tariff below is purely for illustrative purposes:

**Table 9 Illustrative radio sector tariffs**

Relevant turnover band	Current tariff % of Relevant Turnover 2004/5	Illustrative rebalanced tariff 2005/6	Illustrative progressive tariff 2005/6
Up to £1m turnover	0.627%	0.470%	0.298% (if licence fee is less than £100 then tariff is 0.000%)
From £1m up to £5m	0.627%	0.470%	0.447%
Beyond £5m	0.627%	0.470%	0.671%

Source: Ofcom calculations

5.23 The illustrative progressive tariff has been selected on the basis that there is a 50% increase in the tariff when moving up to a higher band.

### Other licence fees

5.24 Ofcom does not expect to make major changes in the structure of tariffs for any of the following classes of licence:

- application fees for AM local licences;
- application fees for national licences;
- application and licence fees for national and local radio multiplex licences;
- application and licence fees for digital sound programme service licences;
- application and licence fees for digital additional sound services licences;
- application and licence fees for radio licensable content service licences;
- application and licence fees for additional services licences;
- application fees for renewal of local and national licences; and amendment fees for short-term restricted service licences.

5.25 Application and licence fees for long-term restricted service licences may be subject to some structural increase to reflect costs more accurately. The fees for all licence classes are subject to detailed review before the start of 2005/6 as part of the annual process of determining Ofcom's tariffs.

5.26 The decision not to make any major change to the structure of the digital tariffs reflects Ofcom's view that it remains appropriate to charge fees that are less than full cost recovery for DAB licences, given that the sector's commercial revenue remains very low. Ofcom considers that it would also be inappropriate to increase fees for AM applications given that this sector too tends to be characterised by low margins.

5.27 Application and licence fees for community radio will be set out in Ofcom's forthcoming Statement on Licensing Community Radio.

**Question 15:** Do you agree with Ofcom's intention to rebalance radio licence application fees and radio sector licence fees towards Ofcom's underlying activity costs?

**Question 16:** Do you agree with the proposal to introduce a modestly progressive tariff for local commercial analogue radio?

## Effect of Ofcom proposals

5.28 Ofcom's proposals can affect licensees in two ways :

- the administrative effect covers the time and resources required to comply with the tariff setting information requirements; and
- the financial effect on individual licensees. This requires analysing the financial cost of the tariffs, in the context of the financial performance of the radio sector, to ensure that Ofcom's actions are not particularly onerous or unmanageable for certain licensees.

### Administrative effect

5.29 The administrative effect has been minimised by taking the following steps:

- basing tariffs upon revenue, which should be readily available; and
- not allowing deductions for Additional Payments or any other operating costs (it is allowable to deduct sales related costs).

5.30 Ofcom welcomes any comments on how the process of receiving information from and invoicing licensees can be improved.

### Financial effect

5.31 This section analyses the broad financial effect across the radio sector, which contains some sizable businesses and some very small businesses. Financial performance varies considerably across the sector, as illustrated in the table below.

**Table 10 Average financial performance of radio companies**

2002/3	Lower	Median	Upper
Turnover (£000s)	714	2,343	4,750
Pre-tax profit (£000s)	-304	50	915
Pre-tax profit margin (%)	-8.5	8.7	25.2
Turnover / employee	59,933	89,500	167,625
Average remuneration (£)	17,426	23,316	30,268
Working capital / turnover (%)	30.96	8.14	-19.84
Turnover / fixed assets (%)	5.2	10.0	19.7
Total debt /net worth (%)	122.1	40.9	0
Current ratio (%)	0.5	1.2	1.9

5.32 Table 10 shows how smaller radio companies have considerably poorer financial performance than larger radio companies, negative profit margins, lower scale economies and much higher gearing levels. These figures alone suggest that smaller radio companies do not have much scope for high licence fees and that tariff increases for larger companies would appear affordable, as a consequence of the average 25.2% pre-tax profit margin. However it is worth noting that:

- Ofcom does not set tariffs solely on the basis of affordability;
- The 2004/5 straight-line tariff for a radio licence with a Relevant Turnover of £714,000 is £4,768. This represents just under 1.5% of the average pre-tax loss. Ofcom's tariffs do add costs to loss-making small radio companies, but are not a key driver of their poor profitability;
- This is a snap-shot in time when advertising revenues have been suppressed. However, it is generally perceived that the profitability of small radio stations is poor.

5.33 Table 10 supports the introduction of progressive tariffs on the grounds that the financial impact (as a percentage of profits) of radio sector tariffs is greater for smaller radio stations, with low levels of profitability.

### Tariff effect

5.34 This section analyses the financial impact of the proposed tariff structure on a licence by licence basis. The main class of licences to gain from the illustrative Ofcom tariffs are the existing national analogue stations. This is because the population measure resulted in relatively high licence fees for national stations and lower proportionate fees for local FM stations and the cap in place for 2004/5 only involved a partial movement away from the original population measure. Table 11 below illustrates the movement in licence payments moving from the 2004/5 tariffs to the illustrative 2005/6 tariffs above.

5.35 Table 11 illustrates that three radio licences would face an increase in licence fees of between £50,000 and £250,000 (without transitional relief). It also shows that the percentage swings can be quite significant, where more than 24 licences would experience a increase of fees of more than 500% with the proposed tariff. The issue of transitional relief to mitigate these substantial swings is discussed in the next section.

**Table 11 Effect of illustrative tariffs**

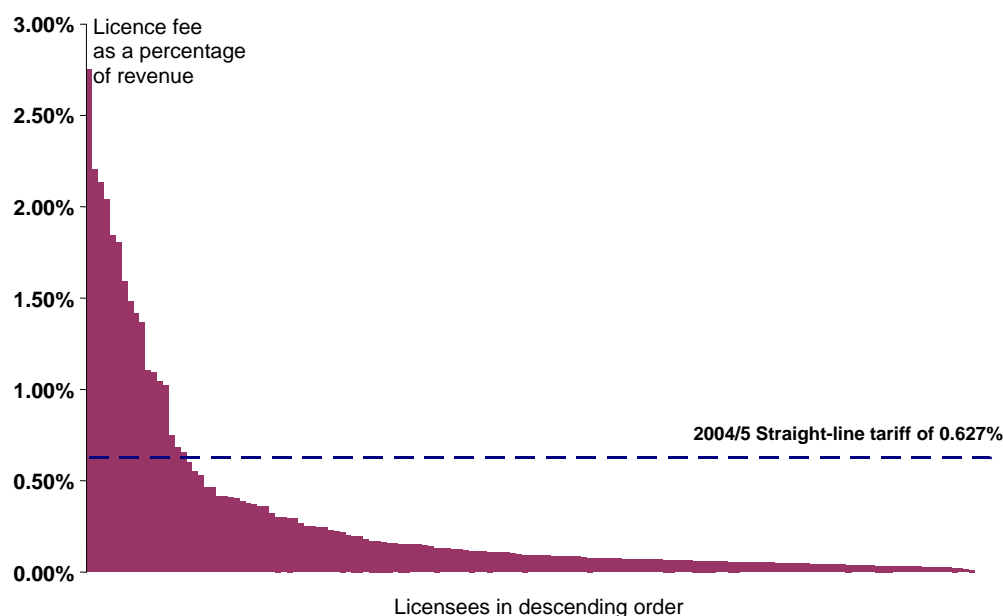
Absolute change (£)	Number of licences	Percentage change (%)	Number of licences
From -500,000 to -250,000	2	-100%	10
From -250,000 to -50,000	7	From -100% to -50%	38
From -50,000 to -25,000	4	From -50% to -25%	25
From -25,000 to -5,000	25	From -25% to -10%	11
From -5,000 to -2,500	9	From -10% to 0%	6
From -2,500 to -500	27	From 0% to 10%	3
From -500 to 0	17	From 10% to 25%	7
From 0 to 500	35	From 25% to 50%	11

Absolute change (£)	Number of licences	Percentage change (%)	Number of licences
From 500 to 2,500	82	From 50% to 100%	25
From 2,500 to 5,000	21	From 100% to 250%	55
From 5,000 to 25,000	22	From 250% to 500%	45
From 25,000 to 50,000	8	From 500% to 1000%	20
From 50,000 to 250,000	3	More than 1000%	4

Source: Ofcom calculations

5.36 An additional aspect of considering the financial effect of changes is for individual licences that were paying a small proportion of revenue, and now face considerably higher tariffs. Because the relationship between revenue and population is weak, some radio licences paid significantly more than others in proportion to their revenue. In 2003, 17 radio licensees with revenues below £1m were paying tariffs above 0.627% of revenue, with a considerable number above 1%. This suggests that radio licensees have had the capacity for higher tariffs in the past, and therefore suggests that the illustrative radio tariffs are affordable. This analysis is presented in the Chart 3 below:

**Chart 3 Distribution of radio tariffs as a percent of revenue 2003**



## Transitional arrangements

5.37 The complete change of tariff setting basis from population to revenue causes significant variation to licence fee payments made by licensees<sup>5</sup>. This will be to the benefit of some licensees and to the detriment of others. In the February consultation there was a mixed response as to whether transitional arrangements should be put in place, which usually reflected whether the outcome was in the interest of the licensee.

<sup>5</sup> The transitional arrangements in 2004 tariffs meant that only a partial movement to revenue based tariffs has so far been achieved

- 5.38 For those licences where the movement from a population measure to a revenue measure results in significant movements, no transitional arrangements (percentage caps) can prevent a significant increase in licence fees at some point in time. Transitional arrangements merely delay this increase.
- 5.39 There are arguments that transitional relief mechanisms may not be required. In particular:
- a progressive banding scale limits the percentage increases for some of the smaller licences and in overall terms the smaller radio licences face smaller increases in licence fees;
  - transitional relief mechanisms introduce an undesirable level of complexity;
  - financial assessment shows that licence fees are affordable and do not introduce structural problems to the industry (ie by altering entry/exit conditions); and
  - Ofcom is keen to move quickly by carrying out necessary changes and then restoring stability and certainty to its tariff setting process.
- 5.40 However, the financial assessment has shown that a considerable number of licensees face tariff increases above 500%, significantly above Ofcom's 50% general guideline, and it is therefore Ofcom's view that a transitional relief scheme should be implemented. In practice, the transitional relief would end after the repayment of the DTI loan in 2007/8, when tariffs (across the board) are expected to fall.

**Question 17:** *Do you agree that transitional arrangements should be used to migrate radio sector tariffs on to the new basis?*



## Section 6

# Networks and Services

6.1 Networks and services tariffs are set on the basis of Relevant Turnover which means the turnover made from carrying on any Relevant Activity. The scope of Relevant Activity was addressed by Oftel in 2003<sup>6</sup>. Following the first consultation on the Statement of Charging Principles, there was no change in the method of calculating Ofcom's administrative charges, as Ofcom elected to follow the regime set by its predecessor, Oftel.

6.2 The key tariff issues for this consultation are:

- the definition of revenue for tariff setting use, in particular whether to allow deduction of wholesale costs from calculation of Relevant Turnover;
- whether to alter the structure of tariffs, onto a more comparable basis to Television and radio; and
- whether Ofcom should publish a list of persons required to pay administrative changes on the basis of information known to Ofcom.

## Definition of revenue

6.3 Revenue for the purpose of tariff setting in 2004/5 is defined as "Relevant Turnover". "Relevant Turnover" is Turnover made by any Relevant Person in the 12 calendar months to 31 December in the previous year. The full definition of these terms is given in Annex 4.

6.4 The definition of Relevant Turnover involves the use of total turnover. Many of the responses received as part of the February consultation commented on this and argued for a net turnover basis, excluding the cost of wholesale regulated telecommunications inputs. This exclusion is mainly proposed by resellers who argue that they effectively pay for the costs of regulation more than once, through the amounts they pay other operators, who may charge on a cost-plus basis, and may therefore contain an element of the Ofcom annual charge.

6.5 The net turnover approach has been suggested by respondents as an alternative to overcome the following disadvantages of the existing total turnover approach:

- a "double-counting" of turnover for fee-setting as wholesale services are passed up the chain of service providers to, for example, resellers and service providers, whose cost base is largely composed of wholesale services provided by other communications providers;
- it arguably discriminates against new entrants to the telecoms market who by definition have to use the communications infrastructure of other service providers, and could thus be seen as a barrier to entry; and
- at the same time, established infrastructure providers have a double benefit of lower overall fees due to the "double-counting" of turnover plus a means to pass on their administrative fee costs to other service providers using their infrastructure.

6.6 An alternative approach to using total turnover is that vertically integrated telecommunications providers separate their wholesale and retail revenues and pay

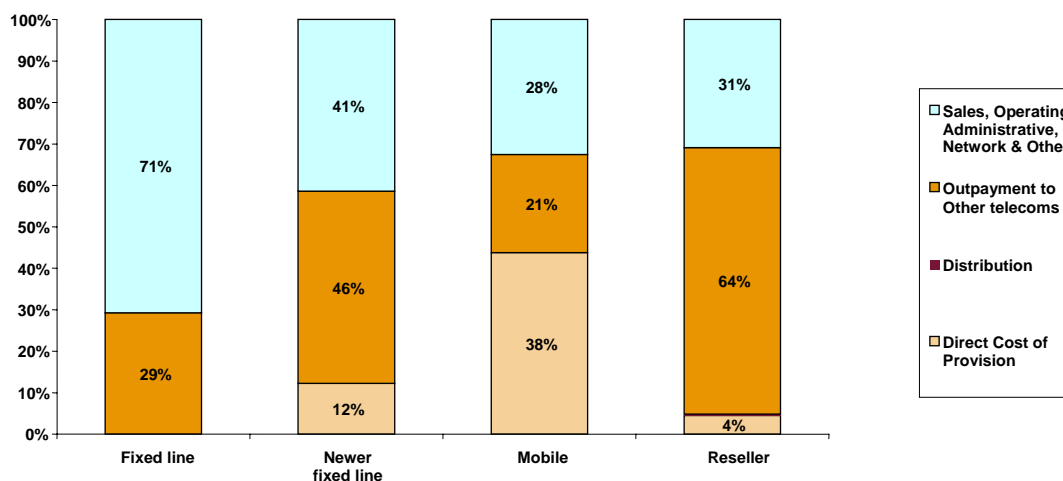
<sup>6</sup> The definition of 'relevant activity' for the purpose of administrative charging. Guidelines issued by the Director General of Telecommunications, 29 July 2003

fees on their wholesale revenue in the same way as a pure network operator and pay fees on their retail revenue in the same way as other retail operators. In general terms, this would arguably treat integrated telecommunications providers in a fairer way compared to non-integrated telecommunications providers. This would result in a higher total revenue figure for integrated telecommunications providers as notional separation of wholesale and retail activity would result in including the underlying wholesale revenues associated with their own retail activities.

### Practical implications of using net turnover

- 6.7 Ofcom has estimated the potential impact of moving to a net turnover basis.
- 6.8 Accounting cost information of telecommunications operators is difficult to compare across different types of operators, due to problems of data availability and categorisation. The analysis in Chart 4 is based on inspection of a sample of the publicly available financial accounts of telecommunications operators, using estimates where data is unavailable. It provides estimated breakdown of the operating costs for incumbent fixed line businesses, newer fixed line operators, mobile network operators, and resellers and Internet Service Providers (ISPs). It shows that the share of telecommunications wholesale inputs for resellers and ISPs (at 64%) is much higher than for the incumbent fixed line operators (at 29%).

**Chart 4 Share of wholesale costs in the cost base of telecommunications operators**



(note: examples of Newer Fixed line operators are Energis and Colt)

- 6.9 One suggested method would be to allow the deduction of UK regulated telecommunications wholesale inputs from the calculation of Relevant Turnover. The effect of doing this will be that the overall revenue base from which to collect regulatory fees will go down, and therefore the percentage tariff on Relevant Turnover will rise to compensate. Ofcom has modelled this effect for illustrative purposes, using the assumptions of the share of wholesale cost inputs from Chart 4. The illustrative tariff based upon net turnover is shown below:

**Table 12 Illustrative tariff based upon net turnover**

	2004/5 tariff	Illustrative tariff based upon net turnover
% Revenue above £5m, using revenue bands	0.0683%	0.0925%

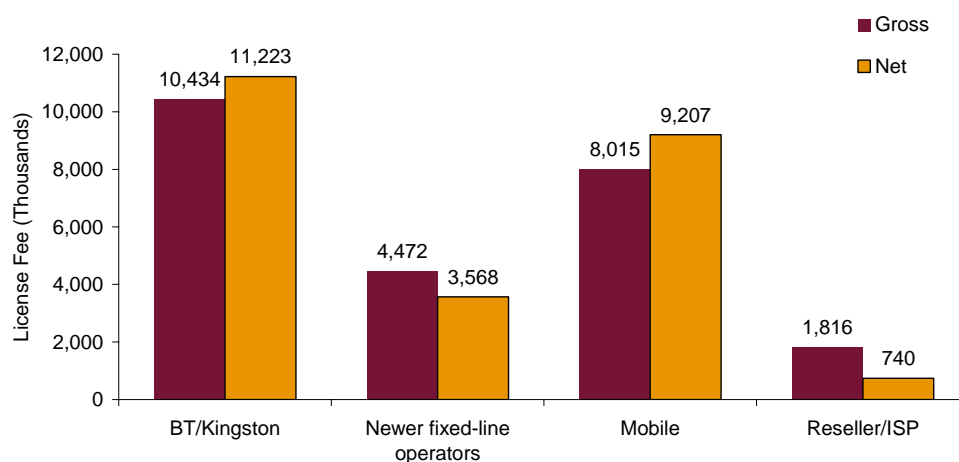
Source: Ofcom calculations

6.10 In overall terms resellers and small telecommunications providers stand to gain from this approach and the incumbent fixed-line providers and mobile operators would face higher fees. The indicative difference in annual administrative charges for each group is presented below.

**Table 13 Estimated impact of tariff based upon net turnover**

	2004/5 tariff Total sector (£)	Illustrative tariff based upon net turnover Total sector (£)	%Change
Fixed incumbent	10,434,235	11,222,680	8%
Newer fixed-line	4,471,966	3,567,745	-20%
Mobile	8,014,516	9,206,507	15%
Reseller/ISPs	1,816,283	740,067	-59%

Source: Ofcom calculations

**Chart 5 Comparison of administrative charges based upon gross revenue and net revenue approaches**

6.11 The impact of the reductions for newer fixed line operators and resellers would be more pronounced because a number of the smaller operators fall below the £5m turnover threshold as a result of the deduction of wholesale input costs and therefore would not be required to pay any administrative charges.

6.12 While this approach may have some merits in principle, Ofcom does not believe it is desirable in practice and is not currently minded to use a net turnover approach. This is because of:

- the complexity of precisely defining what constitutes a regulated wholesale input. For example, international termination payments represent a wholesale telecommunications cost input, but not one that has attracted UK administrative charges, and hence would not be deductible, like other UK interconnection payments;
- the additional regulatory burden of compiling and monitoring net revenue data for operators and Ofcom;
- the additional difficulties in ensuring that operators have calculated and declared Relevant Turnover consistently and fairly;
- the unfairness perceived by resellers is mitigated by the fact that the bulk of the resellers for whom this may be an issue have revenues less than £5m so administrative charges are not payable; and
- the tariff as a percentage of revenue is smaller than the television and radio sectors.

Overall, Ofcom believes the drawbacks of moving to a net turnover basis of setting tariffs for networks and services outweigh the benefits.

**Question 18:** *Do you agree with Ofcom that a gross revenue basis should be used for setting networks and services tariffs?*

## Structure of network and services tariffs

6.13 The structure of networks and services tariffs is different to proposed TV and radio tariffs. In particular:

- the tariffs rely upon 15 bands for Relevant Turnover, whereas television and radio use fewer bands;
- the application of the tariff table rounds down Relevant Turnover to the lowest point within the Relevant Turnover band, whereas there is no rounding down for television and radio tariffs; and
- all relevant persons with a Relevant Turnover lower than £5m do not pay administrative charges. This is a far higher threshold than for television and radio tariffs.

6.14 However, the overall effect of networks and services tariffs is mildly progressive on account of the £5m floor and the rounding down of turnover figures, and Ofcom sees little benefit in changing the structure to make it more like the television and radio tariffs and therefore proposes to keep the existing networks and services tariff structure.

**Question 19:** *Do you agree that Ofcom should retain the structure of networks and services tariffs?*

## Publishing a list of Designated Persons

- 6.15 It has been suggested to Ofcom that it should publish a list of those operators who are required to pay administrative charges to Ofcom. The benefit of publishing this list would be that it would enable Ofcom to ensure that its records are kept more up to date, as circumstances change, for example, electronic communications companies exiting the market or increasing their Relevant Turnover beyond the £5m threshold. As individual licensing of networks and services providers is no longer required under the Communications Act 2003, Ofcom has fewer formal links with many smaller participants in the networks and services industry and would therefore welcome the assistance of the sector in keeping the list up to date.

**Question 20:** *Do you agree that a list of those operators who are required to pay administrative charges to Ofcom under Section 44 of the Communications Act should be published?*

## Section 38 Designations

- 6.16 Under Section 38(2) of the Act, Ofcom can only charge those providers of electronic communication networks, services or associated facilities of a description that have been designated.
- 6.17 In accordance with good administrative practice, Ofcom intends to publish a fresh designation which will relate to the charging year 2005/06 and will cover charging years subsequent to that (the "Designation"). Ofcom proposes that the Designation reflects the nature of the designation originally published by the Director General of Telecommunications in 2003 and relied upon by Ofcom in the Statement of Charging Principles in March 2004.
- 6.18 Ofcom therefore proposes that the Designation will designate those providers who have a total turnover from relevant activities of £5 million or more in their financial year ending in the charging year immediately prior to the charging year in question. For example, a provider with a total turnover from relevant activities of £5 million in their financial year ending in June 2003 will be designated for the purpose of setting tariffs for Ofcom's charging year of April 2004 to March 2005.
- 6.19 Ofcom proposes to consult on the wording of the Designation in the Draft Statement of Charging Principles that it expects to publish in November 2004, and with the Secretary of State in accordance with section 33 of the Act.

## Electronic Communications Code

- 6.20 Electronic Communication Code fees, (s.106 Communications Act 2003), are related to the costs of dealing with applications for the Code and ongoing administration costs including enforcement of the restrictions and conditions which apply to Code operators.
- 6.21 Ofcom proposes to maintain the application fee of £10,000 per person granted Code powers. Ofcom also intends to maintain the current system of having the same level of yearly charge for each Code operator for the costs of administration of the Code. This will be calculated by taking those estimated costs and dividing it by the number of Code operators at the time that the charge is calculated.

**Question 21:** *Do you agree with maintaining the current Electronic Communications Code tariff?*

## Section 7

# Key Proposals and Assessment

7.1 This section sets out Ofcom's key proposals within each regulatory sector and the regulatory impact of our proposals.

### General issues

7.2 Ofcom proposes that tariffs should have a small degree of progression, so that larger licensees and regulated operators pay a higher proportion than smaller licensees and regulated operators.

7.3 Ofcom intends to keep radio and television as separate regulatory sectors.

### Television sector

7.4 In the television sector, Ofcom proposes to:

- change the definition of Relevant Turnover from one based on Qualifying Revenue, as defined in the 1990 Broadcasting Act, to a new definition;
- define Relevant Turnover to include all sources of revenue obtained through providing a licensed service; this includes revenues from advertising, sponsorship, premium rate telephone income, and retail revenue from goods and services. Relevant Turnover will exclude retail revenue earned from platforms;
- use Relevant Turnover to replace Qualifying Revenue as a component of the assessment of obligations under the Code on Television Access Services;
- introduce a simple tariff table, that removes the distortions caused by the caps that have been placed on licence fees in the past;
- change the tariffs for licence fees so that they are applied in a way that reflects the cost of PSB and non-PSB regulation;
- reduce the maximum revenue threshold from £400m to £300m, beyond which the tariff is set to zero and reduce the degree of progression in the tariff structure;
- introduce a new category of tariff for digital terrestrial multiplex licences;
- allow transitional relief for the migration of television licence fees onto the new tariff basis in cases where the new tariff structure results in licence fee increases of more than 50%.

### Radio Sector

7.5 In the radio sector, Ofcom proposes to:

- rebalance fees, so that in general, application fees are increased and licence fees reduced;
- change the definition of Relevant Turnover from one based on Qualifying Revenue, as defined in the 1990 Broadcasting Act, to a new definition;
- define Relevant Turnover in a broadly similar way to the definition for the television sector;

- introduce a more progressive tariff so that larger licensees pay a higher proportion than smaller licensees and set licence fees to zero if they would be lower than £100; and
- allow a period of transitional relief for the migration of 2004/5 tariffs onto new tariffs.

## Networks and services sector

7.6 In the networks and services sector, Ofcom proposes:

- no alteration to the structure of existing tariffs;
- no alterations to the existing definition of Relevant Turnover; and
- to publish a list of Designated Persons for the purpose of administrative charging.

## Assessment of Regulatory Impact

7.7 An assessment of the financial impact of the proposals on different types of stakeholders is included in Sections 4, 5 and 6. This section provides comparison of the proposals against the criteria set out in Section 3 (and repeated below) and the effect of the proposals on regulatory compliance costs.

7.8 The criteria for the regulatory impact assessment are:

- **Fairness.** The tariff structure should raise Ofcom's required funding across the regulated sectors in a manner that is equitable;
- **Cost-reflectiveness.** Charges should broadly reflect the underlying cost of regulating each category of stakeholder;
- **Reliability.** The tariff base needs to be stable over time, and not prone to erratic movements. Charges should not move substantially in any one year;
- **Simplicity.** The calculation of charges should be as simple as possible, wherever practicable using data that stakeholders would anyway gather for their own management purposes; and be relatively simple to administer for Ofcom;
- **Be easily verified.** Information required for the setting of charges should be easily verifiable to ensure industry-wide compliance;
- **Adaptable.** Tariff principles and structures should be able to adapt to a changing market environment and be consistent with wider policy; and
- **Relevance.** Charges should cover in full an operator's activities that flow from the licence or authorisation, but only those activities.

7.9 This assessment is in Table 14 over the page. Ofcom would welcome stakeholders' views on this assessment.



**Table 14 Regulatory Impact Assessment**

			<b>Fair</b>	<b>Cost reflective</b>	<b>Reliable</b>	<b>Simple</b>	<b>Easily verified</b>
TV	A	Change from statutory revenue definition	n/a	n/a	Yes	Yes	n/a
	B	Revenue definition	Yes	Broadly	Yes	Less simple	Yes
	C	Tariff table with no caps	Yes, removes historical distortion	Broadly	Yes	Yes	n/a
	D	Categorisation	Yes	Broadly	Yes	Yes	n/a
	E	Tariff structure	Yes	Broadly	Yes	Yes	n/a
	F	Transitional relief	Postpones impact of new tariff	n/a	Yes	No	n/a
Radio	G	Tariff rebalancing	Yes	Yes	Yes	Yes	n/a
	H	Change from statutory revenue definition	n/a	n/a	Yes	Yes	n/a
	I	Revenue definition	Yes	Broadly	Yes	Less simple	Yes
	J	Progressive tariff & no fees <£100	Yes	Broadly	Yes	No	Yes
	K	Transitional relief	Postpones impact of new tariff	n/a	Yes	No	n/a
N&S	L	Use of existing tariffs	Yes	Broadly	Yes	Yes	Yes
	M	Existing definition of Relevant Turnover	Yes	Broadly	Yes	Yes	Yes
	N	Publishing a list of Designated Persons	Yes	n/a	n/a	Yes	Publishing should improve list accuracy

7.10 Ofcom has paid particular attention to the effect of those proposals on compliance costs (for both Ofcom and stakeholders). It is inevitable that any system for collecting fees and charges will generate administrative costs, but it is desirable to keep these to a minimum.

7.11 Ofcom's assessment is that these proposals should not lead to any significant increase in the administrative costs of the system, and may lead to some modest reduction over time due to greater clarity and transparency. The principal positive administrative effects are:

- introduction of a consistent revenue measure across the three regulatory sectors;
- the removal of caps in the television sector
- minimum fee of £100 in the radio sector; and
- no changes in the networks and services sector.

7.12 The less positive administrative effects are:

- slightly more complex calculation of Relevant Turnover stemming from the broader definition of revenue for television, and potentially radio (although the radio sector does not have the same extent of additional revenue sources as television);
- inclusion of transitional relief in the radio and television sectors; and
- introduction of slightly progressive tariffs may introduce some additional complexity, but the tariff calculations are reasonably simple for a basic spreadsheet.

7.13 Ofcom's overall assessment is that the proposals outlined in this document are more fair and consistent across the sectors, more cost reflective and improve reliability, verifiability, adaptability and relevance. Whilst the proposals contain some aspects that are not simplifying, Ofcom's view is that the benefits of the proposals outweigh the drawback of these more complicating factors.

**Question 22:** *Do you have any comments on Ofcom's assessment of the impact of its proposals, either the financial effects by type of stakeholder, or in terms of the administrative costs of the system?*

## Section 8

# Responding to this consultation

### How to respond

- 8.1 Ofcom invites written views and comments on the issues raised in this document, to be made by **5pm on 30 September 2004**.
- 8.2 Ofcom strongly prefers to receive responses as e-mail attachments, in Microsoft Word format, as this helps us to process the responses quickly and efficiently. We would also be grateful if you could assist us by completing a response cover sheet (see Annex 2), among other things to indicate whether or not there are confidentiality issues. The cover sheet can be downloaded from the 'Consultations' section of our website.
- 8.3 Please can you send your response to [externalfinance@ofcom.org.uk](mailto:externalfinance@ofcom.org.uk).
- 8.4 Responses may alternatively be posted or faxed to the address below, marked with the title of the consultation.

Rex Warner  
Head of External Finance  
Ofcom  
Riverside House  
2a Southwark Bridge Road  
London SE1 9HA  
E-mail: [rex.warner@ofcom.org.uk](mailto:rex.warner@ofcom.org.uk)  
Tel: 020 7981 3483  
Fax: 020 7981 3630

- 8.5 Please note that we do not need a hard copy in addition to an electronic version. Also please note that Ofcom will not routinely acknowledge receipt of responses.
- 8.6 It would be helpful if your response could include direct answers to the questions asked in this document, which are listed at Annex 6. It would also help if you can explain why you hold your views, and how Ofcom's proposals would impact on you.

### Further information

- 8.7 If you have any questions about the issues raised in this consultation, or need advice on the appropriate form of response, please contact us using the details above.

### Confidentiality

- 8.8 Ofcom thinks it is important for everyone interested in an issue to see the views expressed by consultation respondents. We will therefore usually publish all responses on our website, [www.ofcom.org.uk](http://www.ofcom.org.uk), ideally on receipt (when respondents confirm on their response cover sheet that this is acceptable).
- 8.9 All comments will be treated as non-confidential unless respondents specify that part or all of the response is confidential and should not be disclosed. Please place any confidential parts of a response in a separate annex, so that non-confidential parts may be published along with the respondent's identity.

- 8.10 Ofcom reserves its power to disclose certain confidential information where this is necessary to fulfil its functions, although in practice it would do so only in limited circumstances.
- 8.11 Please also note that copyright and all other intellectual property in responses will be assumed to be assigned to Ofcom unless specifically retained.

### Next steps

- 8.12 Following the end of the consultation period, Ofcom intends to publish a draft Statement of Charging Principles in November 2004.
- 8.13 Please note that you can register to get automatic notifications of when Ofcom documents are published, at [http://www.ofcom.org.uk/static/subscribe/select\\_list.htm](http://www.ofcom.org.uk/static/subscribe/select_list.htm).

### Consultation principles

- 8.14 Ofcom is keen to make responding to consultations easy, and has published some consultation principles (see Annex 1) which it seeks to follow, including on the length of consultations.
- 8.15 If you have any comments or suggestions on how Ofcom conducts its consultations, please call our consultation helpdesk on 020 7981 3003 or email us at [consult@ofcom.org.uk](mailto:consult@ofcom.org.uk). We would particularly welcome thoughts on how Ofcom could more effectively seek the views of those groups or individuals, such as small businesses or particular types of residential consumers, whose views are less likely to be obtained in a formal consultation.
- 8.16 If you would like to discuss these issues more generally, or Ofcom's consultation processes more generally, you can alternatively contact Philip Rutnam, Partner, Competition and Strategic Resources, who is Ofcom's consultation champion:

Philip Rutnam  
Ofcom  
Riverside House  
2A Southwark Bridge Road  
London SE1 9HA  
Tel: 020 7981 3585  
Fax: 020 7981 3333  
E-mail: [philip.rutnam@ofcom.org.uk](mailto:philip.rutnam@ofcom.org.uk)

## Annex 1

# Ofcom's consultation principles

There are seven principles which we will follow for each written consultation.

### Before the consultation

A1.1 A. Where possible, we will hold informal talks with people and organisations before announcing a big consultation to find out whether we are thinking in the right direction. If we do not have enough time to do this, we will hold an open meeting to explain our proposals shortly after announcing the consultation.

### During the consultation

A1.2 We will be clear about who we are consulting, why, on what questions and for how long.

A1.3 We will make the consultation document as short and simple as possible with a summary of no more than two pages. We will try to make it as easy as possible to give us a written response. If the consultation is complicated, we may provide a shortened version for smaller organisations or individuals who would otherwise not be able to spare the time to share their views.

A1.4 We will normally allow 10 weeks for responses.

A1.5 There will be a person within Ofcom who will be in charge of making sure we follow our own guidelines and reach out to the largest number of people and organisations interested in the outcome of our decisions. This individual (who we call the consultation champion) will also be the main person to contact with views on the way we run our consultations.

A1.6 If we are not able to follow one of these principles, we will explain why. This may be because a particular issue is urgent. If we need to reduce the amount of time we have set aside for a consultation, we will let those concerned know beforehand that this is a 'red flag consultation' which needs their urgent attention.

### After the consultation

A1.7 We will look at each response carefully and with an open mind. We will give reasons for our decisions and will give an account of how the views of those concerned helped shape those decisions.

## Annex 2

# Consultation response cover sheet

- A2.1 In the interests of transparency, we will publish all consultation responses in full on our website, [www.ofcom.org.uk](http://www.ofcom.org.uk), unless a respondent specifies that all or part of their response is confidential. We will also refer to the contents of a response when explaining our decision, without disclosing the specific information that you wish to remain confidential.
- A2.2 We have produced a cover sheet for responses (see below) and would be very grateful if you could send one with your response. This will speed up our processing of responses, and help to maintain confidentiality by allowing you to state very clearly what you don't want to be published. We will keep your completed cover sheets confidential.
- A2.3 We strongly prefer to receive responses in the form of a Microsoft Word attachment to an email. Our website therefore includes an electronic copy of this cover sheet, which you can download from the 'Consultations' section of our website.
- A2.4 Please put any confidential parts of your response in a separate annex to your response, so that they are clearly identified. This can include information such as your personal background and experience. If you want your name, address, other contact details, or job title to remain confidential, please provide them in your cover sheet only so that we don't have to edit your response.

## Cover sheet for response to an Ofcom consultation

### BASIC DETAILS

Consultation title:

To (Ofcom contact):

Name of respondent:

Representing (self or organisation/s):

Address (if not received by email):

### CONFIDENTIALITY

What do you want Ofcom to keep confidential?

Nothing

☐

Name/contact details/job title

☐

Whole response

☐

Organisation

☐

Part of the response

☐

If there is no separate annex, which parts?

If you want part of your response, your name or your organisation to be confidential, can Ofcom still publish a reference to the contents of your response (including, for any confidential parts, a general summary that does not disclose the specific information or enable you to be identified)?

### DECLARATION

I confirm that the correspondence supplied with this cover sheet is a formal consultation response. It can be published in full on Ofcom's website, unless otherwise specified on this cover sheet, and I authorise Ofcom to make use of the information in this response to meet its legal requirements. If I have sent my response by email, Ofcom can disregard any standard e-mail text about not disclosing email contents and attachments.

Ofcom seeks to publish responses on receipt. If your response is non-confidential (in whole or in part), and you would prefer us to publish your response only once the consultation has ended, please tick here.

☐

Name

Signed (if hard copy)

## Annex 3

## Ofcom 2004/5 tariffs

## Key Television tariffs

Table 15 Television Licence Fees

		Tariff for 2004/5	
Qualifying Revenue		Category A	Category B
Bands			
£0m -	£10m	0.1408%	0.0429%
£10m -	£35m	0.7843%	0.3120%
£35m -	£75m	1.3904%	0.6500%
£75m -	£400m	2.8520%	1.0000%
Over	£400m	0.0000%	0.0000%

Notes:

- i. Minimum Fee = £575
- ii. Rates are expressed cumulatively. That is, for Category A licensees, 0.1408% is charged on the first £10m of qualifying revenue: 0.7843% on the next £25m, 1.3904% on the next £40m and 2.8520% on the next £325m.
- iii. The percentage increase for a licence with a annual fee in the 12 months to 31 March 2004 of greater than £575 will be capped at 32 per cent.

A3.1 These tariffs were inherited from the ITC. If the tariffs were applied without the cap, Ofcom would raise an amount substantially in excess of Ofcom's funding needs from the television sector. However, to ensure increases for all licensees are proportionally equal, a capped increase of 32% has been applied. In future years it is the intention that the tariff table should generate the required level of revenue without the need for such a cap.

A3.2 The main source of income for the above licensees is advertising revenue and subscription revenue derived from the broadcasting of content. However, services such as shopping channels, interactive betting or gaming services, advertising supported services, and those supported by premium rate telephone charges are providing additional income for the licensees as an indirect source of revenue. This group of licences also includes services targeted at specific overseas markets, including Scandinavia and the Middle East.

## Key radio tariffs

Table 16 Analogue radio licences

	Tariff for 2004/5 % of Qualifying Revenue
Local licenses	0.627%
National licenses	0.627%



A3.3 The tariff for local and national analogue radio stations was moved from a banded population basis to a revenue basis in 2004/5

A3.4 Transitional arrangements are in place for 2004/5, because the change in the basis of calculating licence fees would have otherwise led to substantial swings in licence fee payments. These arrangements mean that the increase for any licence fee payable from 2003/4 to 2004/5 is capped at 45%, and any reduction arising from the change in tariff is capped at 0%.

### Key networks and services tariffs

A3.5 The level of tariffs (as a percentage of revenue) in the networks and services sector is significantly lower than the percentage charged within the broadcasting sectors. This is due to the size of Ofcom's costs in relation to the turnover in the sector (£35bn) compared with the TV (£6bn) and radio (£0.6bn) sectors.

A3.6 The range of administrative charges for networks and services is provided below:

**Table 17 Networks and services administrative charges**

	2004/5 % of Relevant Turnover
Administrative charge	0.0683%

A3.7 The administrative charge for networks and services is applied on a banding basis, whereby the first band representing £0 to £5m does not pay any administration charges. A further 14 revenue bands are used to apply the 0.0683% administrative charge. The bands serve to define the lower points to which revenue figures are rounded down.

**Table 18 Administrative charges for the Electronic Communications Code**

	Tariff for 2004/5 £
Annual Administrative charge	£3,000

A3.8 Persons who have been granted the electronic communications code in a particular Charging Year must pay a one-off charge in respect of the estimated costs of dealing with their applications for the code.

**Table 19 Electronic Communications Code Application Charge**

	Tariff for 2004/5 £
Application charge	£10,000

## Annex 4

# Existing definitions of Qualifying Revenue and Relevant Turnover

## Television

**Table 20 Definition of Qualifying Revenue for television licences**

Source	Definition
Broadcasting Act 1990 Sections 19(2),	<p>Qualifying Revenue for any accounting period of the licence holder shall (subject to subsection (6)) consist of all payments received or to be received by the licensee or by any connected person:</p> <p>in consideration of the inclusion in the licensed service in that period of advertisements or other programmes, or</p> <p>in respect of charges made by him in that period for the reception of programmes included in that service;</p>
Broadcasting Act 1990 Section 19(3)	<p>If, in connection with the inclusion of any advertisements or other programmes whose inclusion is paid for by payments falling with subsection (2)(a), any payments are made to the licence holder or any connected person to meet any payments payable by the licence holder by virtue of subsection (1)(c), those payments shall be regarded as made in consideration of the inclusion of the programmes in question.</p>
Broadcasting Act 1990 Section 19(4)	<p>In the case of an advertisement included under arrangements made between:</p> <p>a) the licence holder or any connected person, and</p> <p>b) a person acting as an advertising agent,</p> <p>the amount of any receipt by the licence holder or any connected person that represents a payment by the advertiser from which the advertising agent has deducted any amount by way of commission shall, except in a case falling within subsection (5), be the amount of the payment by the advertiser after the deduction of the commission.</p>
Broadcasting Act 1990 Section 19(5)	<p>If the amount deducted by way of commission as mentioned in subsection (4) exceeds 15 per cent of the payment by the advertiser, the amount of the receipt in question shall be taken to be the amount of the payment less 15 per cent.</p>
Broadcasting Act 1990 Section 19(6)	<p>If, in any accounting period of the licence holder, the licence holder or any connected person derives, in relation to any programme to be included in the licensed service, any financial benefit (whether direct or indirect) from payments made by any person, by way of sponsorship, for the purpose of defraying or contributing towards costs incurred or to be incurred in connection with that programme, the qualifying revenue for that accounting</p>

	period shall be taken for the purposes of subsection (1) (c) to include the amount of the financial benefit so derived by the licence holder or the connected person, as the case may be.
Broadcasting Act 1990 Schedule 2, Part 1, Paragraph 3 as amended by Broadcasting Act 1996 Schedule 2 Part 1, Paragraph 1(4)	<p>The following persons are to be treated as connected with a particular person:</p> <p>a) a person who controls that person;</p> <p>b) an associate of that person or of a person falling within paragraph (a); and</p> <p>c) a body which is controlled by that person or by an associate of that person [see Broadcasting Act 1990 Schedule 2, Part 1 Paragraphs 1 (1A) and (2) for the statutory definition of 'associates'].</p>

## Radio

**Table 21 Definition of Qualifying Revenue for radio licences**

Source	Definition
Broadcasting Act 1990 Section 102 (2)	<p>Qualifying Revenue for any accounting period of the licence holder shall (subject to subsection (6)) consist of all payments received or to be received by him or by any connected person—</p> <p>(a) in consideration of the inclusion in the licensed service in that period of advertisements or other programmes, or</p> <p>(b) in respect of charges made in that period for the reception of programmes included in that service.</p>
Broadcasting Act 1990 Section 102 (3)	<p>If, in connection with the inclusion of any advertisements or other programmes whose inclusion is paid for by payments falling within subsection (2), any payments are made to the licence holder or any connected person to meet any payments payable by the licence holder by virtue of subsection (1)(c), those payments shall be regarded as made in consideration of the inclusion of the programmes in question.</p>
Broadcasting Act 1990 Section 102 (4)	<p>In the case of an advertisement included under arrangements made between—</p> <p>(a) the licence holder or any connected person, and</p> <p>(b) a person acting as an advertising agent,</p> <p>the amount of any receipt by the licence holder or any connected person that represents a payment by the advertiser from which the advertising agent has deducted any amount by way of commission shall, except in a case falling within subsection (5), be the amount of the payment by the advertiser after the deduction of the commission.</p>
Broadcasting Act 1990 Section 102 (5)	<p>If the amount deducted by way of commission as mentioned in subsection (4) exceeds 15 per cent. of the payment by the advertiser, the amount of the receipt in question shall be taken to be the amount of the payment less 15 per cent.</p>
Section 102 (6)	<p>If, in any accounting period of the licence holder, the licence holder or any connected person derives, in relation to any programme to be included in the licensed service, any financial benefit (whether direct or indirect) from payments made by any person, by way of sponsorship, for the purpose of defraying or</p>

	contributing towards costs incurred or to be incurred in connection with that programme, the Qualifying Revenue for that accounting period shall be taken for the purposes of subsection (1)(c) to include the amount of the financial benefit so derived by the licence holder or the connected person, as the case may be.
Broadcasting Act 1990 Schedule 2, Part 1, Paragraph 3 as amended by Broadcasting Act 1996 Schedule 2 Part 1, Paragraph 1(4)	<p>The following persons are to be treated as connected with a particular person:</p> <p>(a) a person who controls that person;</p> <p>(b) an associate of that person or of a person falling within paragraph (a); and</p> <p>(c) a body which is controlled by that person or by an associate of that person [see Broadcasting Act 1990 Schedule 2, Part 1 Paragraphs 1 (1A) and (2) for the statutory definition of 'associates'].</p>

## Networks and Services

**Table 22 Definition of Relevant Turnover for networks and services**

Source	Definition
	"Relevant Turnover" is Turnover made by any Relevant Person in the 12 calendar months to 31 December in the previous year.
	A "Relevant Person" means a person liable to pay the administrative charge under section 38 of the Communications Act 2003
	"Turnover" means the turnover made from carrying on any Relevant Activity after the deduction of sales rebates, value added tax and other taxes directly related to turnover. Only those relevant persons with a Turnover greater than £5m are liable to pay fees to Ofcom.
	<p>"Relevant Activity" means any of the following:</p> <p>the provision of Public Electronic Communications Services to end-users;</p> <p>the provision of Electronic Communications Networks, Electronic Communications Services and Network Access to Communications Providers; or</p> <p>the making of Associated Facilities to Communications Providers.</p>

## Annex 5

# Proposed definition of Relevant Turnover

This Annex sets out Ofcom's proposed new definition of Relevant Turnover and how it applies to each of the regulated sectors covered in this document.

## Television

"Relevant Turnover" is Turnover received by the licensee or by a person connected to the licensee in the 12 calendar months to 31 December in the previous year.

"Equivalent" revenue includes goods and services received in lieu of cash payment.

References to a person being connected with another person shall be construed in accordance with Part 1 of Schedule 2 to the Broadcasting Act 1990.

"Turnover" means the revenue or equivalent (after deduction of sales rebates, commission, value added tax and other taxes directly related to revenue) earned from the licensed service as follows:

### Advertising revenue

- i. Any amount that is received by the licensee or by a connected person in respect of consideration for the inclusion of advertisements in the licensed service. In the case of advertisements included under an arrangement between the licensee and a person acting as an advertising agent the amount included as Turnover shall be the amount paid over by the advertiser after the deduction of the advertising agent's commission. The maximum amount that may be deducted in respect of the advertising agent's commission shall be 15% of the payment by the advertiser;
- ii. Where the amount paid over by the advertiser includes a payment in respect of any costs incurred by the licensee in producing the advertisements included in the programme service, then this amount shall be included as Turnover;

### Sponsorship revenue

- iii. Any payment received directly or indirectly by the licensee or a connected person in relation to any programme to be included in the licensed service. This includes all income derived from sponsorship and co-funding, together with any financial benefit derived by virtue of any person making payments for the purpose of defraying, or contributing towards the costs incurred, or to be incurred, in connection with the programme. In determining the licensee's Turnover, the amount included in the computation shall be the amount paid over by the sponsor or co-funding organisation, after the deduction of any advertising agent's or other intermediary's commission. The maximum amount that may be deducted in respect of any commission shall be 15% of the payment made by the sponsor or co-funder;

### **Subscription revenue**

- iv. Subscription and pay-per-view revenue paid to the licensee or a connected person directly, or paid to the licensee or a connected person by platform operators who retail the service. Where the licensee or a connected person is also a platform operator who receives subscription or pay-per-view revenue directly, a reduction for the retail element of the gross value of the revenue may be deducted;

### **Fee revenue**

- v. Fees received by the licensee or a connected person from a programme provider for the provision of programmes in the licensee's service;
- vi. Amounts received or to be received by the licensee or a connected person which refer to the right to use, or to authorise any other person to use, the licensed capacity;

### **Other revenues from the licensed activity**

- vii. Payments or other financial benefits which are received by the licensee or a connected person from a programme provider which are derived from programme services. This includes any shares of premium rate telephone service revenues and interactive revenues paid to the licensee or a connected person;
- viii. Revenues from premium rate telephone services or other interactive revenues directly linked to the licensed service or programmes within the licensed service. Services include, but are not restricted to, betting, gaming and interactive services where income is earned by the licensee or a connected person; and

### **Retail revenues**

- ix. The retail sales value of goods and services sold directly using the licensed service. Where the sale of goods and services is carried out as a separate activity and advertised or promoted on the licensed service in the same way that third party activities are, then the cost or value of the advertisement (after deduction of commission and sales related taxes) is to be included in Turnover.

## **Radio**

"Relevant Turnover" is Turnover received by the licensee or by a person connected to the licensee in the 12 calendar months to 31 December in the previous year.

"Equivalent" revenue includes goods and services received in lieu of cash payment.

References to a person being connected with another person shall be construed in accordance with Part 1 of Schedule 2 to the Broadcasting Act 1990.

"Turnover" means the revenue or equivalent (after deduction of sales rebates, commission, value added tax and other taxes directly related to revenue) earned from the licensed service as follows:

### **Advertising revenue**

- i. Any amount that is received by the licensee or by a connected person in respect of consideration for the inclusion of advertisements in the licensed service. In the case of advertisements included under an arrangement between the licensee and a person acting as an advertising agent the amount included as Turnover shall be the amount paid over by the advertiser after the deduction of the advertising agent's commission. The maximum amount that may be deducted in respect of the advertising agent's commission shall be 15% of the payment by the advertiser;
- ii. Where the amount paid over by the advertiser includes a payment in respect of any costs incurred by the licensee in producing the advertisements included in the programme service, then this amount shall be included as Turnover;

### **Sponsorship revenue**

- iii. Any payment received directly or indirectly by the licensee or a connected person in relation to any programme to be included in the licensed service. This includes all income derived from sponsorship and co-funding, together with any financial benefit derived by virtue of any person making payments for the purpose of defraying, or contributing towards the costs incurred, or to be incurred, in connection with the programme. In determining the licensee's Turnover, the amount included in the computation shall be the amount paid over by the sponsor or co-funding organisation, after the deduction of any advertising agent's or other intermediary's commission. The maximum amount that may be deducted in respect of any commission shall be 15% of the payment made by the sponsor or co-funder;

### **Subscription revenue**

- iv. Subscription revenue paid to the licensee or a connected person directly, or paid to the licensee or a connected person by platform operators who retail the service;

### **Fee revenue**

- v. Fees received by the licensee or a connected person from a programme provider for the provision of programmes in the licensee's service;
- vi. Amounts received or to be received by the licensee or a connected person which refer to the right to use, or to authorise any other person to use, the licensed capacity;

### **Other revenues from the licensed activity**

- vii. Payments or other financial benefits which are received by the licensee or a connected person from a programme provider which are derived from programme services. This includes any shares of premium rate telephone service revenues and interactive revenues paid to the licensee or a connected person;

- viii. Revenues from premium rate telephone services or other interactive revenues directly linked to the licensed service or programmes within the licensed service; and

#### **Retail revenues**

- ix. The retail sales value of goods and services sold directly using the licensed service. Where the sale of goods and services is carried out as a separate activity and advertised or promoted on the licensed service in the same way that third party activities are, then the cost or value of the advertisement (after deduction of commission and sales related taxes) is to be included in Turnover.

#### **Networks and Services**

Ofcom proposes no change to the Relevant Turnover definition described in Section 6 and Annex 4.



## Annex 6

# Consultation questions

**Question 1:** *Are Ofcom's proposed criteria for designing the tariff structure appropriate?*

**Question 2:** *Do you agree with Ofcom's view that revenue should be the basis of setting tariffs? If not, which alternatives would you prefer and why?*

**Question 3:**

- a) *Do you agree with Ofcom's general approach to tariff structures?*
- b) *If not, are there any other tariff structures which Ofcom has not considered?*
- c) *Do you agree that there should be mild progression within Ofcom's tariffs?*

**Question 4:** *Do you agree with Ofcom's view that television and radio should not be combined into one overall regulatory sector for the purpose of tariff setting?*

**Question 5:** *Do you agree with Ofcom's proposal to allow retail revenues to be deducted when calculating subscription revenues where the licensee is also the retailer of the service?*

**Question 6:** *Do you agree with Ofcom's proposed definition of Relevant Turnover in the television sector?*

**Question 7:** *Do you agree with Ofcom's view that Additional Payments should not be subtracted from Relevant Turnover for the purpose of setting television tariffs?*

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**Question 8:** *Do you agree with Ofcom's proposed structural changes for television tariffs?*

**Question 9:** *Do you agree with Ofcom's view that television multiplex service licences should be moved to a new Category of licence? Is £10,000 an appropriate annual fee?*

**Question 10:** *Do you agree with Ofcom's view that, for the purposes of assessing obligations under the Code on television Access services, qualifying revenue should be replaced by Relevant Turnover?*

**Question 11:** *Do you agree with Ofcom's view that transitional arrangements should be used to migrate television sector tariffs on a new basis? Is 50% a sensible threshold for licence fee increases to judge when transitional arrangements are appropriate?*

**Question 12:** *Do you agree with Ofcom's proposed definition of Relevant Turnover in the radio sector?*

**Question 13:** *Do you agree with Ofcom's view that Additional Payments should not be subtracted from Relevant Turnover for the purpose of setting radio tariffs?*

**Question 14:** *Do you agree that operating costs should not be subtracted from Relevant Turnover for the purpose of setting radio tariffs?*

**Question 15:** *Do you agree with Ofcom's intention to rebalance radio licence application fees and radio sector licence fees towards Ofcom's underlying activity costs?*

**Question 16:** *Do you agree with the proposal to introduce a modestly progressive tariff for local commercial analogue radio?*

**Question 17:** *Do you agree that transitional arrangements should be used to migrate radio sector tariffs on to the new basis?*

**Question 18:** *Do you agree with Ofcom that a gross revenue basis should be used for setting networks and services tariffs?*

**Question 19:** *Do you agree that Ofcom should retain the structure of networks and services tariffs?*

**Question 20:** *Do you agree that a list of those operators who are required to pay administrative charges to Ofcom under Section 44 of the Communications Act should be published?*

**Question 21:** *Do you agree with maintaining the current Electronic Communications Code tariff?*

**Question 22:** *Do you have any comments on Ofcom's assessment of the impact of its proposals, either the financial effects by type of stakeholder, or in terms of the administrative costs of the system?*