

Qualifying Revenue and Multiplex Revenue:

**Statement of Principles
And Administrative Arrangements under the Broadcasting Act 1990,
the Broadcasting Act 1996 and the Communications Act 2003**

(Fifth Edition)

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Forward

- S.1 Ofcom is required under Part 1 of Schedule 7 to the Broadcasting Act 1990, as amended (the “1990 Act”), to draw up a Statement of Principles of Qualifying Revenue. There is a similar requirement under Part 1 of Schedule 1 to the Broadcasting Act 1996, as amended (the “1996 Act”), to draw up a Statement of Principles of Multiplex Revenue.
- S.2 In February 1993 Ofcom’s predecessor, the Independent Television Commission (the “ITC”) laid before Parliament the First Edition of the Statement of Principles and Administrative Arrangements for Qualifying Revenue defined by the 1990 Act. In January 1995 a Second Edition of the document was published, incorporating provisions regarding local delivery service licensees and some minor modifications to the First Edition. In December 1998 the Independent Television Commission laid before Parliament the Third Edition of the document, covering both Qualifying and Multiplex Revenue. In October 2001 the Fourth Edition was published, incorporating modifications to simplify the administrative procedures for the collection of Additional Payments and the removal of procedures relevant to the Channel Four Support Scheme, which ceased in 1998. The Fifth Edition is published by Ofcom in order to be consistent with the issue of digital replacement licences to Channels 3 and 5 and Public Teletext and the need to clarify the interpretation of Qualifying Revenue. It also sets out more clearly the administrative arrangements in Section 4, as well as making necessary consequential amendments as a result of the Communications Act 2003 (the “Communications Act”).
- S.3 For the avoidance of doubt the relevant sections of the 1990 Act, 1996 Act and Communications Act will take precedence.
- S.4 The Department for Culture, Media and Sport and the Treasury have been consulted by Ofcom on this Statement. The statement may be revised from time to time, after consultation with the Department for Culture, Media and Sport and the Treasury.

Outline of the statement

- S.5 Section 1 provides the background to this statement, including an outline of the relevant statutory requirements, definitions of qualifying revenue and multiplex revenue, along with the relevance of qualifying and multiplex revenue to television broadcasting.
- S.6 Section 2 sets out Ofcom’s principles for assessing qualifying revenue and multiplex revenue.
- S.7 Section 3 offers guidance on the use that may be made of qualifying and multiplex revenue once these have been assessed.
- S.8 Section 4 explains the administrative arrangements that are in place for the payment of qualifying and multiplex revenue.

Section 1

Introduction

Statutory requirements

- 1.1 Under the terms of the 1990 Act, Ofcom is required to draw up, and from time to time review, a statement setting out the principles to be followed in ascertaining the 'qualifying revenue' of certain of its licensees for the purposes of any provision of Part I or Part II of the 1990 Act¹.
- 1.2 The 1996 Act extends this requirement to 'multiplex revenue'. Specifically, Ofcom must draw up a statement setting out the principles to be followed in ascertaining the multiplex revenue in relation to a licence holder for the purposes of section 14 of the 1996 Act, and the share of multiplex revenue attributable to a person in relation to any multiplex service for the purposes of any provision of Part I of 1996 Act².
- 1.3 The Third Edition of the Statement of Principles was a combined statement to meet both these statutory requirements and the Fourth Edition simplified the administrative procedures for the collection of additional payments from licensees and removed procedures in respect of the Channel 4 Support Scheme, which ceased in 1998. The Fifth Edition clarifies the interpretation of Qualifying Revenue, as defined in the 1990 Act, as it applies to the Digital Replacement Licences, sets out more clearly relevant administrative arrangements and makes various consequential amendments following enactment of the Communications Act.
- 1.4 The Statement, and any revision of it, has to be drawn up after consultation with the Secretary of State for Culture, Media and Sport and the Treasury. It must then be published, with a copy being laid by the Secretary of State before each House of Parliament.

Definitions of 'Qualifying Revenue' and 'Multiplex Revenue'

- 1.5 The 1990 Act provides that certain financial processes and payments should be based on qualifying revenue. The 1996 Act makes similar provisions in respect of multiplex revenue.
- 1.6 The statutory provisions contained in the 1990 Act and the 1996 Act are, in some cases, drawn in broad terms. References to the principal definitions used in the Acts can be found at Annex A. The following is a brief summary of these definitions, provided for convenience only, and should not be regarded as a substitute for the definitions in the Acts. Where terms are used whose definitions are summarised in this statement, they are shown in *italic* type. Unless the context requires otherwise, "licensee" in this part means a regional Channel 3 or national Channel 3, Channel 4, Channel 5, additional services, television licensable content service, restricted television service,

¹ Broadcasting Act 1990, Schedule 7, paragraph 1

² Broadcasting Act 1996, Schedule 1, paragraph 1

television multiplex service, digital television programme service and digital television additional service licensee, as the case may be.

- 1.7 Because qualifying revenue is defined by reference to the 'licensed service', it is relevant to consider which services are covered by the licences in order to assess qualifying revenue.
- 1.8 Section 215 of the Communications Act requires Ofcom to offer to replace the current analogue broadcasting licences for Channel 3 and Channel 5 with digital broadcasting licences ('digital replacement licences') to take effect from 29 December 2004. A digital replacement licence is, primarily, a licence to provide a service on a digital terrestrial multiplex with an added requirement to simulcast the service in analogue, as Ofcom considers appropriate.
- 1.9 Section 214(2) of the Communications Act 2003 sets out that the digital licence must (a) be a licence to provide the licensed service with a view to it being broadcast in digital form; and (b) contain such condition (if any) requiring the provider of the service to ensure that the whole or a part of the service is also provided for broadcasting in analogue form as Ofcom consider appropriate.
- 1.10 Therefore, the service provided on both analogue and digital terrestrial will constitute the licensed service and revenues from provision of the service on both platforms will comprise qualifying revenue. Revenue from the provision of a service on cable and satellite will continue to fall outside the definition of qualifying revenue.

Qualifying Revenue

- 1.11 The following provides a brief summary of qualifying revenue, as defined by the Acts.

Channel 3, Channel 4 and Channel 5, Television Licensable Content Service, and Restricted Television Services Licences

- 1.12 For Channel 3, Channel 4 and Channel 5, Television Licensable Content Service and Restricted Television Services Licences, qualifying revenue means all payments, received or to be received, by the licensee, as well as by any *connected person* :
 - a) in consideration of the inclusion in the licensed service in that period of advertisements or other programmes;
 - b) in respect of charges made by him in that period for the reception of programmes included in the licensed service;
 - c) in connection with the inclusion of any advertisement or other programme in the licensed service in order to meet any additional payments, other than the cash bid;
 - d) by way of 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 the costs incurred or to be incurred in connection with any programme included in the licensed service.

Public Teletext

- 1.13 For Public Teletext, qualifying revenue consists of the aggregate of all amounts received or to be received by the licensee or any person connected to him:
- a) in consideration of the inclusion in the licensed service in that period of advertisements or other items; and
 - b) all amounts received or to be received by the licensee, or any person connected to him, in respect of the provision of the service from anyone authorised by the licensee to provide the licensed service, in whole or in part or from any person connected to someone so authorised.

Television Licensable Content Service

- 1.14 Qualifying revenue for Television Licensable Content Service licensees includes income derived from the broadcasting of the service in the United Kingdom and overseas. Where qualifying revenue is earned in one or more foreign currencies and is not accounted for in sterling in the licensee's audited accounts, the revenue will be converted into sterling at the average of the spot rates on the opening and closing dates of the accounting period as published in the Financial Times for those dates. Where the Financial Times is not published on one or both of those dates, Ofcom will use the spot rate published in the next available Financial Times. Where Ofcom is required to estimate qualifying revenue for the purposes of imposing a financial penalty and where it is necessary to express qualifying revenue in sterling, the appropriate exchange rate will be the one published in the Financial Times on the date on which Ofcom decides to impose the penalty.

Additional Services

- 1.15 Qualifying revenue for Additional Services means all amounts received or to be received which refer to the right to use, or to authorise any other person to use, the spare capacity allocated under the licence.

Multiplex Revenue

- 1.16 The 1996 Act sets out definitions for multiplex revenue, which concern both Multiplex Licensees and third parties providing services carried on the multiplex (for example, programme providers). The following summarises the definitions in the 1996 Act.
- 1.17 For Multiplex Licence Holders, multiplex revenue includes all payments or other financial benefit received, or to be received by him or any person connected to him, in consideration of the inclusion in the services carried on the multiplex of advertisements or other programmes, or from charges for the reception of programmes included in those services. It also includes all payments received by the television multiplex licensee, or any connected person, in respect of the broadcasting of any qualifying service by means of the television multiplex licence or payments made to enable the television multiplex licence holder to meet its additional payments.
- 1.18 If a programme provider or additional services provider derives any financial benefit (whether direct or indirect) from payments made by any person, other

than the television multiplex licence holder, by way of sponsorship for the purpose of defraying or contributing towards the cost of programmes, the amount of financial benefit shall constitute multiplex revenue

- 1.19 All payments referred to in paragraphs 1.17 and 1.18 above will comprise multiplex revenue if received by:
- a) the television multiplex licensee, or any person connected with him, from a person other than a programme or additional services provider;
 - b) any programme provider, or any person connected with him, from a person other than the television multiplex licence holder, an additional services provider or another programme provider;
 - c) any additional services provider, or any person connected with him, from a person other than the television multiplex licence holder, a programme provider or another additional services provider.

Use of Qualifying Revenue and Multiplex Revenue by Ofcom

- 1.20 As noted above, this statement sets out the principles to be followed in ascertaining qualifying revenue and multiplex revenue for the purposes of any provision of Part I or Part II of the 1990 Act (in the case of qualifying revenue), and for sections 14 and 56, and Part I or Part II of the 1996 Act (in the case of multiplex revenue). These purposes include the setting of certain payments by licensees to the Treasury ('additional payments'), as well as in the enforcement of licences by means of financial penalties. These are described briefly below.

Additional payments

Qualifying Revenue

- 1.21 Qualifying revenue is used when determining payments made by licensees to the Treasury, both when licences are awarded by competitive tender, and thereafter where the licence holders apply for a review of their financial terms.
- 1.22 The 1990 Act requires that certain kinds of licences be awarded by Ofcom after a process of competitive tender. These include licences for Channels 3 and 5, the Public Teletext licence and additional services licences. These licensees are required to make additional payments, to be collected by Ofcom, consisting of amounts expressed as percentages of qualifying revenue and a cash bid. The cash bid is a fixed sum, adjusted annually in line with movements in the Retail Prices Index, and is unrelated to qualifying revenue. The percentage of qualifying revenue (PQR) applicable to a licence is determined by Ofcom and is included in the advertisement for the licence.
- 1.23 Section 225 of the Communications Act allows for Channel 3, Channel 5 and Public Teletext licensees to apply for reviews of their financial terms for payments to the Treasury. Under section 227 of the Communications Act, following an application for a review, Ofcom must determine the fixed annual cash amount to be paid for the licence and PQR payable for each year of the licence period.

Multiplex Revenue

1.24 The 1996 Act requires that licences to provide a multiplex service are awarded after a competitive process. The ITC invited applications for the granting of multiplex licences, with a zero percentage of multiplex revenue payable by the licensee set for the initial period. No cash bid has to be made by the licensee.

Financial Penalties

1.25 Financial penalties may be imposed by Ofcom, where a licensee fails to comply with a condition of the licence or any direction issued by Ofcom. If a penalty is imposed before the first accounting period has ended, Ofcom is required to estimate qualifying or multiplex revenue for that accounting period. The level of financial penalty can vary, guidance on which is set out in Section 4.

Section 2

Principles for assessing Qualifying Revenue and Multiplex Revenue

- 2.1 Ofcom applies specified principles in assessing a licensee's qualifying revenue or multiplex revenue. These include treatment of both the various payments received by a licensee, and of revenues derived from transactions with certain third parties ('connected persons'). These principles are set out in this section.
- 2.2 Once Ofcom has assessed qualifying revenue or multiplex revenue, it can be used to determine additional payments and financial penalties. This is discussed further in Section 3.

Payments considered in assessing qualifying or multiplex revenue

- 2.3 As set out in Section 1, qualifying revenue is defined by reference to amounts received in connection with the licensed service. Revenues from licensed services may include advertising revenue, sponsorship income and income received in respect of charges for the reception of programmes ("subscription income"). The bases for ascertaining these amounts are set out in this section.
- 2.4 Following the issuance of digital replacement licences for Channel 3, 5 and the Public Teletext licensees, the service provided on both analogue and digital terrestrial will constitute the licensed service. Qualifying revenue for these licensees will therefore include revenues from provision of the service on both platforms. Revenue from the provision of a service on cable and satellite falls outside the definition of qualifying revenue.
- 2.5 Ofcom is aware that in the case of advertising and sponsorship revenues licensees often do not earn revenues separately for broadcasting on analogue, digital terrestrial cable and satellite.
- 2.6 Where advertising and sponsorship revenue is derived from the inclusion of advertisements or sponsorship on more than one of the analogue and digital services of Channels 3, 5 and the Public Teletext licensee, and the advertiser or sponsor is not invoiced for the analogue and digital services separately, it will be necessary to apportion the revenue between the licensed service (ie the analogue and the digital terrestrial services) and the other digital services that fall outside the definition of the licensed services.
- 2.7 Qualifying revenue will therefore be calculated by reference to the proportion of homes that do not receive digital satellite, analogue cable or digital cable services. Where households receive services via the digital satellite, analogue cable or digital cable platforms, these households will not be included in the calculation for qualifying revenue.

Advertising revenue

- 2.8 Advertising revenue represents the net advertising revenue (ie net of commission paid to advertising agents) derived from analogue and digital

programme and digital additional services as recorded in the profit and loss account for the accounting period computed on a normal accruals basis. For the purpose of calculating advertising revenue, all revenue which results from the normal trading terms and conditions for the insertion of advertisements into and around the programmes or information on the services will be taken into account. For example, late payment surcharges and cancellation penalties will be included as qualifying or multiplex revenue, and early payment or volume discounts will be deducted from qualifying or multiplex revenue.

- 2.9 Specific provisions for bad debts that are made in relation to advertising revenue in the audited accounts of licensees may be deducted. However, costs related to the selling of airtime are not allowable as a deduction from qualifying or multiplex revenue.
- 2.10 Where airtime is provided to an advertiser, and where all or part of the consideration for an advertisement is received or is receivable other than in cash (for example, by barter or other exchange or contra-deal), the advertising revenue in respect of that advertisement will be deemed to be the amount that Ofcom determines would have been receivable in cash, having regard to the factors that affect the price of analogue or digital television advertising for the licence in question.
- 2.11 Any amount received or receivable by the licensee in respect of an advertisement or other programme to meet his liability for additional payments (excluding the cash bid) will be regarded as advertising revenue.
- 2.12 Apart from commission paid to advertising agents, advertising revenue may not be reduced under arrangements where all or part of the consideration for the advertisement is receivable by any person other than the licensee or his connected person. Commission paid to an advertising agent in excess of 15 per cent of the amount payable by the advertiser will be disregarded when computing advertising revenue.

Sponsorship Income

- 2.13 A programme is sponsored if any payment is made, or if any part of its costs of production or transmission is met, by an organisation or person other than a licensee, with a view to promoting that organisation or person's own or another's name, trademark, image, activities, products, or other direct or indirect commercial interests.
- 2.14 Sponsorship income of a licensee will be calculated on the same basis as advertising revenue in paragraph 2.8 above, so far as applicable. That is, normal trading terms and conditions will be taken into account in determining sponsorship income.
- 2.15 As a general principle, sponsorship income may not be reduced under arrangements where all or part of the consideration for the sponsorship is receivable by any person other than the licensee or his connected person. Similarly, the costs or commission paid to any agent, organisation, or person appointed to sell sponsorship on behalf of the licensee cannot be deducted from qualifying or multiplex revenue.

- 2.16 Where a licensee secures sponsorship income on behalf of one or more licensees in connection with programmes to be transmitted on his own and/or their licensed services, any fee received by that licensee (for example, a finder's fee), will form part of his qualifying or multiplex revenue.
- 2.17 Where all or part of the financial benefit (direct or indirect) for including a programme in a licensed service, by way of sponsorship, is receivable by a licensee, but is receivable other than in cash, the qualifying or multiplex revenue will be the value, as determined by Ofcom, of the financial benefit received by the licensee. For example, where programme material is purchased on behalf of, or provided to a licensee, the qualifying or multiplex revenue of the licensee will be deemed to include the cost of the programme material to the supplier. Where transactions of this sort occur the licensee must endeavour to obtain true and fair records of the cost of the programme to the programme supplier.
- 2.18 However, if sponsorship appears in a programme but the sponsorship was arranged and sold not by the licensee but by an independent programme maker, other organisation, or by the organiser of an event or occasion which features in the programme (such as a sporting fixture, concert or theatrical performance) and the licensee neither received any part of the sponsorship payments nor played any part in determining the commercial terms on which the sponsorship was negotiated or sold, then such sponsorship income will not be qualifying or multiplex revenue. It is important, however, that the terms on which the licensee pays for the programme or programme rights are independent of the terms on which the programme maker, event organiser or other person benefits from the sponsorship.
- 2.19 Off-air and support material, including books, videos, tapes, conferences, exhibitions, helplines and information lines, such as 'special services' [08x or 09x] telephone numbers, may be sponsored. Where the sponsor is given screen credits, the value of this sponsorship will count as qualifying or multiplex revenue.
- 2.20 Any amount received or receivable by the licensee, in respect of the inclusion of a programme in the service, to meet his liability for additional payments (excluding the cash bid) will be regarded as sponsorship income.

Subscription Income

- 2.21 Subscription income represents the income received by the licensee or a connected person in respect of charges made for the reception of programmes included in his service and which results from the terms and conditions relating to those charges. Late payment surcharges and cancellation penalties will be included, whereas early payment discounts will be deducted. Specific provisions for bad debts that are made in relation to subscription income in the audited accounts may be deducted.
- 2.22 Commissions or fees paid to any agency, organisation, or person appointed to sell subscriptions on behalf of the licensee, or costs incurred by the licensee himself, will not be allowed as a deduction from qualifying or multiplex revenue.
- 2.23 Where subscriptions are provided to subscribers, and where all or part of the consideration for a subscription is receivable other than in cash, Ofcom will

impute a value for the amount that would have been received by reference to the terms and conditions relating to subscriptions.

- 2.24 Where subscription fees include a charge for equipment necessary to receive the service, income from the hire, rent or lease of equipment will not be treated as qualifying or multiplex revenue, provided that such income is calculated on a normal commercial basis. The licensee should establish and maintain accounting arrangements sufficient to enable the separate assessment of qualifying or multiplex revenue.

Analogue Additional Services

- 2.25 Qualifying revenue will consist of all amounts which are received or to be received by a licensee, or by any connected person, and are referable to the right to use, or to authorise any other person to use, the spare capacity allocated by the licence.
- 2.26 Where the licensee authorises another person to use the spare capacity, and that person is not a connected person, payments made to the licensee or his connected person by that person for the right to use all or part of the licensed spare capacity will be qualifying revenue of the licensee. However, the sub-licensee's or sub-contractor's own revenues, arising from the use of the capacity, will not form part of the licensee's qualifying revenue.
- 2.27 If a licensee, or his sub-licensee or sub-contractor, provides other goods, services or facilities in conjunction or association with the use of the licensed spare capacity, income from these other activities will not be qualifying revenue of the licensee. The licensee or any connected person must establish and maintain separate accounts sufficient to enable qualifying revenue to be identified and assessed.
- 2.28 Where all or part of the consideration for the use of the spare capacity is received or is receivable other than in cash (for example, by barter or other exchange or contra deal), the revenue derived from the use of the spare capacity will be deemed to be the amount that Ofcom determines would have been receivable in cash having regard to the factors that affect the price of the use of the spare capacity for the licence in question.

Other Income

- 2.29 Where the price paid for the right to include an advertisement or other programme, or sponsorship on the licensed service also covers other rights, Ofcom reserves the right to apportion the price paid between that part which, in the opinion of Ofcom, relates to qualifying or multiplex revenue of the licensed service, and that part which relates to other rights. Similar provisions apply where the amount is received other than in cash.

Transactions Involving Persons Connected with a Licensee

- 2.30 As mentioned above, revenues from some third parties – connected persons – will also be considered by Ofcom when assessing qualifying or multiplex revenue. For the purposes of computing qualifying or multiplex revenue a connected person is the licensee, its parent company or body which controls the licensee, together with any associates of the licensee or the body which controls the licensee, and any body which is controlled by the licensee or by

any of its associates, are connected with each other. A more detailed description of what qualifies as a connected person is set out in the Acts.

- 2.31 Any qualifying or multiplex revenue of a licensee's connected persons will be taken into account in the calculation of the licensee's qualifying or multiplex revenue. There is no provision for the apportionment of such qualifying or multiplex revenue on the basis of the licensee's interest in the connected person or the connected person's interests in the licensee. Where a company is a connected person of two or more licensees, Ofcom will (in order to avoid double counting), apportion between the licensees the qualifying or multiplex revenue arising from those activities of the connected person. This will be done on the basis of how, in Ofcom's opinion, those activities reflect or discharge the rights of the licensees under their respective licences.
- 2.32 Where the connected person is himself a licensee liable to a payment of a percentage of qualifying or multiplex revenue, it is necessary to avoid a payment being made twice on the same qualifying or multiplex revenue. That is, once in the hands of the licensee and again in the hands of its connected person. In such circumstances the licensee who will be liable for the charge will be the one from whose licensed service the qualifying or multiplex revenue first arises.
- 2.33 Transactions of a licensee's connected person who is not incorporated in the United Kingdom and who has the whole, or substantially the whole, of his business outside the United Kingdom, are treated as outside the scope of qualifying or multiplex revenue provided that Ofcom is satisfied that the connected person is not engaging to any significant degree in activities which are associated with, or incidental to, or arise out of the licensee's rights under his licence.

Accounting period

- 2.34 Accounting Period shall be taken to mean the period for which the licensee makes up a profit and loss account which is laid before the licensee's shareholders in general meeting, or before the Secretary of State in the case of Channel 4, whether that period is a year or not. The accounting period of the holder of a television multiplex licence shall be used as the basis for the determination and attribution of multiplex revenue, regardless of whether this differs from the accounting periods of other licensees or connected persons from which multiplex revenue may arise.

General

- 2.35 These principles include conditions imposed by Ofcom to prevent avoidance of the declaration of qualifying or multiplex revenue, and to ensure, as far as possible, equitable treatment between licensees. Where a licensee receives financial benefit (directly or indirectly) that falls within the definition of qualifying or multiplex revenue, this is counted as qualifying or multiplex revenue even if the activity concerned is in breach of Ofcom or other regulations.
- 2.36 When a licensee receives payment, or other restitution, for example, under an insurance or legal claim, this will be treated as qualifying or multiplex revenue to the extent that it is in respect of activities that would have generated qualifying or multiplex revenue.

Section 3

Application of Qualifying or Multiplex Revenue

- 3.1 Section 1 provides a summary of the definitions of qualifying or multiplex revenue, whilst Section 2 sets out the principles applied by Ofcom in assessing a licensee's qualifying or multiplex revenue. This section provides general guidance on how once assessed, qualifying or multiplex revenue is to be applied by Ofcom in certain circumstances. In particular, this section concerns the treatment of qualifying revenue in response to the issuance of digital replacement licences and its use in calculating additional payments, plus a summary of how financial penalties are calculated in accordance with the 1990 Act, the 1996 Act and the Communications Act.

Calculation of Additional Payments.

- 3.2 As explained in section 2, qualifying revenue is defined by reference to the 'licensed service' and includes advertising and sponsorship revenue to the extent that it is derived directly from, or apportioned to, the inclusion of advertisements or sponsorship on both the analogue and the digital terrestrial services of Channels 3, 5 and the Public Teletext licensee.
- 3.3 Channel 3, Channel 5 and Public Teletext licensees and the additional services licensees are required to make additional payments to the Treasury consisting of amounts based on a pre-determined percentage of qualifying revenue (the PQR) and a cash bid. The cash bid is a fixed sum, adjusted annually in line with movements in the Retail Prices Index, and is unrelated to qualifying revenue.
- 3.4 For the purposes of calculating the Additional Payments under the terms of the digital replacement licences offered by Ofcom in 2004, Ofcom will apply the PQR to qualifying revenue that includes revenues from both the analogue and digital terrestrial services.
- 3.5 Once a licensee's qualifying revenue has been assessed, for reasons that are explained below, it will be necessary to apportion it between the analogue service and the digital terrestrial services, into:
- Analogue qualifying revenue
 - Digital terrestrial qualifying revenue

Also for reasons explained below, Ofcom will assign a weighting to each category.

- 3.6 Analogue qualifying revenue will be calculated by reference to the proportion of homes that do not receive digital services or analogue cable services. Digital terrestrial qualifying revenue will be calculated by reference to the proportion of homes that receive digital services via the digital terrestrial service and no other digital service. Where households receive digital

services via the digital satellite or digital cable platforms, these households will not be included in the calculation for digital terrestrial qualifying revenue.

- 3.7 Where advertising or sponsorship agreements on the digital service(s) are invoiced separately, no apportionment will be required. It is expected that the invoiced amount will represent the value of a separate, arm's length transaction. If, in Ofcom's view, the invoiced amount misstates that value, Ofcom will adjust the amount so that it is equal to a separate arm's length price.
- 3.8 The reasons for apportioning total qualifying revenue into separate analogue and digital terrestrial categories, and for applying a weighting to each category, were explained in the Ofcom statement on the methodology of reviews of financial terms for channels 3, channel 5 and Public Teletext licenses³, and in the previous consultation document⁴. In brief, the purpose of the system of additional payments is to recover a fair share of the value of the Channel 3, Channel 5 and Public Teletext licences for the taxpayer. As explained in this Statement, and in the methodology consultation and statement, Ofcom considers that the correct definition of Qualifying Revenue in relation to these licences includes revenue derived from both the analogue and digital terrestrial platforms. However, it would be inconsistent with the principles of a fair and reasonable valuation to treat analogue and digital qualifying revenue identically for the purpose of collecting additional payments, as the value of the licence is different in the two cases. The analogue broadcasting rights are scarce, and obtainable only via these licences, while the digital terrestrial broadcasting rights can also be obtained in the market.
- 3.9 Furthermore, Ofcom understands that the intention when drafting the Communications Act was that licence holders' total payment amounts should not change as a result of the issuance of digital replacement licences alone.
- 3.10 In order to address the issues identified in paragraphs 3.8 and 3.9, Ofcom will apportion qualifying revenue into two categories as described above, and apply a weighting to each category, in order to calculate the additional payments that are due.
- 3.11 The weighting that will attach to analogue qualifying revenue when the digital replacement licences are issued will be 100%. The weighting that will attach to digital terrestrial qualifying revenue when the digital replacement licences are issued will be zero. The weighted calculation will therefore result in the same total PQR payments when the digital replacement licences are issued as would have been due under the old analogue licence.
- 3.12 The weighting applied to the digital terrestrial qualifying revenue may change however following a review of the financial terms of the licence, if this is determined to be appropriate in that review, in order to recover an appropriate

³ Ofcom statement *Methodology for reviews of financial terms for Channel 3, Channel 5 and public teletext licenses*, 13 October 2004, see in particular paragraphs 33-35 and annex 5

⁴ Ofcom consultation, *Consultation on methodology for reviews of Channel 3 licences*, 29 June 2004, see in particular paragraphs 1.9-1.11

share of value for the taxpayer. In that case licensees will be advised of the appropriate weightings along with the new terms.

- 3.13 Channel 3 licensees may apply to Ofcom for advertising to be sold jointly over more than one Channel 3 regional licence area where the Channel 3 licences are in common ownership. At least three months in advance of the date from which joint selling is to be applied, forecasts of advertising revenue for each licensee for the following three years must be submitted to Ofcom. The forecasts must show the effect of macro regional apportionment of revenue on each regional licensee's advertising revenue and additional payments based on a percentage of qualifying revenue. The apportionment will normally be based on net ITV homes in each regional area or whatever basis Ofcom considers appropriate in the circumstances.

Setting the level of Financial Penalties

- 3.14 Penalties concerning Channel 3, Channel 4, Channel 5, Public Teletext and Additional Services are up to 5 per cent of the licensee's qualifying revenue in his last complete accounting period.
- 3.15 The maximum for penalties concerning Multiplex Licences, Digital Television Programme Services, Digital Television Additional Services, Television Licensable Content Services; and Restricted Services shall not exceed whichever is the greater of £250,000 or 5 per cent of the licensee's qualifying revenue (for Television Licensable Content Services; and Restricted Services) or share of the multiplex revenue (for digital multiplex and digital services licensees) attributable to him in his last accounting period. The relevant accounting period in relation to a digital television programme service or digital television additional services means the accounting period of the holder of the television multiplex licence on whose multiplex the service is carried.
- 3.16 For the avoidance of doubt, more than one penalty may be incurred in connection with a simulcast, in which case penalties may be determined separately for each licensed service.
- 3.17 On the revocation of Channel 3, Channel 5, Public Teletext and the Multiplex Licences, a notice will be served on the licensee to pay a financial penalty which shall not exceed whichever is the greater of £500,000 and 7 per cent of total qualifying revenue (or multiplex revenue for the multiplex operators) for his last complete accounting period.

Financial penalties – attributable multiplex revenue

- 3.18 Where financial penalties are to be imposed on a digital television programme or digital television additional service licensee or television multiplex licensee it will be necessary to attribute multiplex revenue to the relevant licensee. Attributed multiplex revenue means the share of multiplex revenue attributable to the holder of a television multiplex licence, or to a programme provider or additional services provider in relation to a television multiplex service. The relevant attribution of multiplex revenue will be that declared on the audit certificate supplied by the television multiplex licensee (see section 4) in the first instance.

3.19 A definitions of the share of *multiplex revenue* attributed a) a holder of a television multiplex licence, and b) a programme provider or additional services provider are set out in the 1996 Act, references to the appropriate sections of which can be found in Annex A.

Section 4

Administrative Arrangements

- 4.1 Ofcom assesses and forecasts qualifying or multiplex revenue, to monitor returns, review computations and to examine the accounts. In order to do so, it requires access to the accounts and supporting records of a licensee and any *connected persons*. Additionally, the same access is required for the representatives of the Comptroller and Auditor General in order for him to meet his statutory responsibilities for the examination and certification of Additional Payments and Financial Penalties accounts. On being given reasonable notice a licensee may be required to provide a certificate of qualifying or multiplex revenue (as appropriate), audited by the licensee's external auditors, confirming the level of qualifying or multiplex revenue for an accounting period and stating it has been calculated in accordance with the Statement of Principles.
- 4.2 The assessment of qualifying revenue will normally be based upon the statutory accounts, as audited and laid before the company's shareholders in general meeting, or before the Secretary of State in the case of Channel 4. Such accounts, if accompanied by an unqualified report by the company's auditors, provide prima facie evidence that income is correctly recorded.
- 4.3 Until such time as additional payments are due from a television multiplex licensee, the assessment of multiplex revenue for each television multiplex licence holder will normally be based upon receipt of a certificate of multiplex revenue audited by the licensee's external auditors confirming the level of multiplex revenue and stating that it has been calculated in accordance with this Statement of Principles. The multiplex licensee is responsible for the supply of these audit certificates to Ofcom, even if the multiplex revenue is generated by a digital television programme service or digital television additional service licensee or a *connected person*. The certificate must record all payments received or receivable within the accounting period of the television multiplex licence holder. It must identify clearly the payments received by each licensee (and *connected person*) for services carried on the multiplex and whether the payment is in consideration of the inclusion of advertisements or other programmes, sponsorship, charges for the reception of programmes or payments received for the broadcasting of services.
- 4.4 Ofcom has, however, the duty to form its own opinions as to any item or amount included or excluded from:
- a) the audited profit and loss account for the purpose of determining qualifying or multiplex revenue;
 - b) audit certificates of qualifying revenue and computations of qualifying revenue for an accounting period; and
 - c) audit certificates of multiplex revenue for the purpose of determining the multiplex revenue of the television multiplex licensee, digital television programme service licensee or digital television additional services licensee.

- 4.5 Ofcom may also, from time to time and upon giving reasonable notice, carry out its own examinations of accounts, records etc., including at intervals which may not coincide either with the publication of a licensee's audited accounts or with the provision of audited certificates of qualifying or multiplex revenue.
- 4.6 Where a company's audited accounts relate to a business of which the licensed activity is only a part, the licensee must establish and maintain separate accounts for the licensed activity sufficient to enable qualifying revenue or multiplex revenue to be separately identified and assessed.
- 4.7 In the circumstances outlined in paragraph 4.6, and when the licence is not in force throughout an accounting period, Ofcom may require the licensee to procure, and secure that each of its connected persons (other than any which Ofcom agrees may be excluded from this requirement) procures a certificate from its auditors confirming the level of qualifying revenue or multiplex revenue and stating that it has been calculated in accordance with the Statement of Principles.
- 4.8 It is implicit that audited accounts and certificates of qualifying revenue or multiplex revenue are drawn up in accordance with generally accepted accounting practices appropriate to the industry and which conform to the accounting standards and the guidelines promulgated by the professional accountancy bodies. It is equally implied that accounting policies are applied consistently throughout these accounts. Any changes in policy or practice which might have a material effect on a licensee's qualifying revenue or multiplex revenue should be discussed with Ofcom before implementation. Where necessary Ofcom will consult the Department for Culture, Media and Sport and the Treasury.
- 4.9 The following arrangements are designed to ensure that statutory requirements are met. They expand upon conditions incorporated in Ofcom licences where appropriate.

ADDITIONAL PAYMENTS

Qualifying Revenue

- 4.10 Whether incorporated in the United Kingdom or not the licensee, and any connected person, is required to keep true and fair accounts of relevant income and other transactions, together with such information as is necessary to enable accurate computations to be made of his liability for additional payments. Licensees are required to follow a uniform pattern, prescribed by Ofcom, in the reporting of qualifying revenue.

1990 Act sections 19(1) and 52(1)

- 4.11 The 1990 Act provides that, in relation to that part of additional payments which consists of a specified percentage, or percentages, of qualifying revenue, Ofcom may require payments to be made by monthly instalments. Where this is the case, a licensee's additional payments calculated as a percentage of qualifying revenue for a particular month will be based on the preceding month's actual statement of qualifying revenue.

- 4.12 In the case of a new licence which comes into force upon which additional payments are due, calculated as a percentage of qualifying revenue, the first month's additional payment will be based on the first month's forecast of qualifying revenue. Payments in subsequent months will be based on the preceding month's actual statement of qualifying revenue.
- 4.13 Not later than six weeks before the beginning of each accounting period, falling wholly within the period for which the licence is in force, the licensee must send to Ofcom a forecast of qualifying revenue in the form prescribed by Ofcom, for each month in the accounting period. To assist Ofcom, licensees should provide a brief written commentary explaining the basis of the forecast and the assumptions underlying it. Holders of licences for Channels 3, 4 and 5 and Public Teletext should also provide Ofcom with further information supporting forecasts of their own qualifying revenue, including forecasts of total television revenues.
- 4.14 The instalments of additional payments will be payable on the penultimate business day of each calendar month. Payment should be made by electronic transfer to the Paymaster General's Account on the due date.
- 4.15 Not later than two weeks after the end of each successive six month period in each accounting period, the licensee must send to Ofcom a revised estimate of qualifying revenue (and total television revenues, if relevant) together with any supporting written commentary explaining the reasons for any changes, for each of the remaining months in the accounting period.
- 4.16 Where the start of an accounting period is before the date on which the licence comes into force, the licensee must send to Ofcom a forecast of qualifying revenue in the form prescribed by Ofcom for each month or part month within the accounting period for which the licence is in force. The forecast must be submitted not later than six weeks before the licence comes into force. To assist Ofcom, licensees should provide a brief written statement explaining the basis of the forecast and the assumptions underlying it. Licensees should also provide Ofcom with further information supporting forecasts of qualifying revenue, which may include forecasts of total television revenues.
- 4.17 Not later than two weeks after the end of each calendar month the licensee must provide to Ofcom a statement in the form prescribed by Ofcom of his actual qualifying revenue for the month and details of the analysis of the additional payments to be made for the month between the cash bid and the payment based on a percentage of qualifying revenue.
- 4.18 Not later than three weeks after the signing of the report of its auditors on its audited accounts of the licensee or its ultimate holding company for each accounting period, or not later than one week after those accounts have been sent to members of the company, whichever is earlier, the licensee must send to Ofcom a true copy of those accounts and report. With the accounts the licensee must send to Ofcom a draft qualifying revenue computation for the accounting period in the form prescribed by Ofcom that determines a licensee's actual liability to additional payments on the basis of the prescribed percentage of qualifying revenue. To assist in this process, the accounts should disclose qualifying revenue. Where appropriate, Ofcom may also require additional reports or certificates to support this process.

4.19 As soon as it can after the receipt of the audited accounts, and after its own examination and inspection of the accounts, audit certificates, draft computation and records of the licensee, Ofcom will send to the licensee a final computation showing its assessment of qualifying revenue and the additional payments to be made in respect of the accounting period, the instalments paid on account and the amount of any balance due or refundable. Any balance due must be paid within 14 days of the date of the final computation.

1990 Act Schedule 7, Part 1, paragraph 2

4.20 The licensee may dispute any amounts in the final computation within 14 days. Ofcom will consider any objections to the computation, accept them or reject them in whole or in part, and where necessary send a revised computation to the licensee. When finally determined, any balance due from the licensee must be paid within 14 days of receipt of the final statement. In the event of any disagreement between the licensee and Ofcom the amount to be paid will be the sum determined by Ofcom.

4.21 When, for an accounting period, the instalment(s) paid exceed the amount due, or when, for an accounting period, the total instalments paid exceed the liability shown in the licensee's draft computation or Ofcom's final computation, the excess will, at Ofcom's discretion, be:

- a) set off against amount(s) payable for the remainder of, or in other accounting period(s); and/or,
- b) refunded directly to the licensee.

Multiplex Revenue

1996 Act section 13(1).

4.22 Multiplex licensees are required to adopt procedures similar to those outlined above in respect of multiplex revenue in circumstances when licensees become liable for additional payments.

FINANCIAL PENALTIES

Qualifying Revenue Based Financial Penalties

1990 Act sections 18, 41, 42 and 55 (see also Communications Act, Schedule 13, Part 1, paragraphs 2, 3 and 5 respectively); Communications Act, section 237 and Schedule 10, Part 2 paragraphs 9 and 12; 1990 Act section 42(B), 1990 Act schedule 13, paragraph 4

4.23 Unless the first accounting period is not completed or the licence has not come into force, qualifying revenue for the purposes of computing a licensee's liability to a financial penalty will be determined on the basis of the qualifying revenue reported in the latest audited accounts of the licensee and, if appropriate, Ofcom's own inspection of the licensee's accounts and records for that period. The amount of any financial penalty will be determined by Ofcom and will be up to 5 per cent of qualifying revenue for Channel 3, 4, 5 Public Teletext and analogue additional services licences, and in the case of restricted television service and a television licensable content service

licences, the maximum penalty will be whichever is the greater of £250,000 and 5 per cent of qualifying revenue. On revocation of the licence, in relation only to Channel 3, Channel 5 and Public Teletext licences, the maximum penalty will be whichever is the greater of £500,000 and 7 per cent of qualifying revenue. For the other analogue licences, no penalty is payable on revocation of the licence and in the case of Channel 4, there are no provisions for revocation. In each case qualifying revenue will be the amount assessed by Ofcom for the last complete accounting period.

- 4.24 Where the first accounting period is not completed or the licence has not come into force Ofcom will make its own estimate of what the qualifying revenue would have been for that period. The amount of any financial penalty shall be determined by Ofcom on the basis of its estimate of qualifying revenue.

Multiplex Revenue Based Financial Penalties

1996 Act sections 11, 17, 23 and 27 (see also Schedule 13, Part 2, paragraphs 11, 13, 14 and 15)

- 4.25 Ofcom will generally determine the multiplex revenue attributed to the licensee on whom the financial penalty is being imposed on the basis of the revenue reported on the certificate audited by the television multiplex licence holder's external auditor (paragraph 4.3). However, Ofcom may also require the licensee to provide a certificate from statutory auditors confirming the amount of his attributed multiplex revenue. Ofcom also retains the right to carry out its own inspection of each licensee's accounts, records and certificates of multiplex revenue. The amount of any financial penalty will be determined by Ofcom and the maximum penalty will be whichever is the greater of £250,000 and 5 per cent of attributed multiplex revenue. On revocation of the licence, in relation only to the television multiplex licence, the amount will not exceed whichever is the greater of £500,000 and 7 per cent of multiplex revenue.
- 4.26 Where the first accounting period of the television multiplex licensee providing the television multiplex service is not complete, or, in the case of television multiplex licensees, the licence has not come into force, Ofcom will make its own estimate of multiplex revenue and the amount attributable to the television multiplex licensee, the digital television programme or digital television additional services licensee, as appropriate, for the accounting period. The accounting period will be that of the television multiplex licence holder on whose multiplex the service is carried.

GENERAL

Information and Records

- 4.27 To enable Ofcom to discharge its duties under the relevant Act each licensee, and, if any, his connected persons must furnish to Ofcom any information or statements (audited if required to be so) which Ofcom may ask for.
- 4.28 Where a connected person of a licensee ceases to be so connected, the licensee must ensure that the connected person will nevertheless furnish to Ofcom information which relates to the period up to the date upon which it ceased to be a connected person and continue to permit inspection of its

accounts and records in respect of its transactions up to that date. Similar provisions apply to sales houses, sponsorship agencies, subscriber management businesses and other organisations responsible for the selling, invoicing and collection of qualifying revenue or multiplex revenue.

- 4.29 Where a licence is no longer in force, the former licensee must ensure that Ofcom continues to have access to its accounts and records, or those of any connected person, in respect of transactions in the period up to the date on which the licence ceased to be in force for so long as such accounts and records are to be held in line with the relevant legislation.

Receipts of Ofcom

- 4.30 Additional payments and financial penalties, which are received by Ofcom, do not form part of the revenue of Ofcom but are paid into the relevant Consolidated Fund (as detailed in section 400 of the Communications Act) as appropriate. The recipient is determined by Ofcom according to the area to which a service is provided under the terms of the licence. Where more than one area is provided with a service under the same licence Ofcom will arrange payments to the relevant Funds and Treasuries in such proportions as it considers appropriate.
- 4.31 The licensees pay all sums due in respect of additional payments and financial penalties into a non-interest-bearing Paymaster General's account held in Ofcom's name. The amounts are retained in this account for a short period before being transferred to the appropriate Consolidated Fund (as detailed in section 400 of the Communications Act).
- 4.32 Ofcom will prepare an account in respect of each financial year ended 31 March showing the additional payments and financial penalties received from licensees, and the sums paid to Consolidated Funds of the United Kingdom and Northern Ireland, and the Treasuries of the States of Jersey, the States of Guernsey, and the Isle of Man respectively. The account is sent to the Comptroller and Auditor General who examines, certifies and reports on it and lays copies of it, together with his report, before each House of Parliament.

Interest on Late Payments

- 4.33 Interest is payable on any late payments (either instalments or final balances) at the rate of three per cent over the base rate, for the time being of Lloyds TSB Bank plc (or if unavailable then the rate published by another clearing bank as selected by Ofcom), from the date such payment was due until the date of actual payment. Any interest received by Ofcom in respect of additional payments and financial penalties will be paid into the relevant Consolidated Fund (as detailed in section 400 of the Communications Act).

Amounts Determined by Ofcom

1990 Act Schedule 7 Part 1, paragraph 2; 1996 Act Schedule 1, Part 1, paragraph 2

- 4.34 The amount of qualifying or multiplex revenue in relation to any person, or any payment made to Ofcom in respect of qualifying or multiplex revenue, shall in the event of a disagreement between Ofcom and that person, be the amount determined by Ofcom.

Annex A

A.1 The following lists the relevant sections from the 1990 and 1996 Acts and Communications Act with reference to the definitions summarised in this statement.

Accounting Period:

1990 Act sections 19(9) and 52(5); 1996 Act section 14(1); Communications Act, Schedule 10, Part 2, paragraph 7

Additional payments

For Licences Awarded by A Competitive Process without a Cash Bid:

1996 Act sections 7 and 13(1). The Broadcasting (Percentage of Television Multiplex Revenue) Order 1996

For the review of the financial terms of Channel 3, 5 and Public Teletext licences:

1990 Act sections 217(1) and 223(1), 1990 Act section 53(7); and 1996 Act sections 16(4), (5) and 8(a), Communications Act section 225

Advertising revenue:

1990 Act section 19(2) (a) 1996 Act section 14(1)

1990 Act section 19(2) 1996 Act section 14(1)

1990 Act section 19(3) and 1996 Act section 14(2)

1990 Act sections 19(4) and (5) and 1996 Act sections 14(3) and 14(4) Broadcasting Act 1990 Schedule 2, Part 1, paragraph 1(1)

Connected persons:

1990 Act Schedule 2, Part 1, paragraph 3 as amended by 1996 Act Schedule 2 Part 1, paragraph 1(4)

1990 Act Schedule 2, Part 1, paragraph 1(3)

1990 Act Schedule 2 Part 1 paragraph 1(1) 1996 Act

Analogue additional services:

1990 Act section 52(2)

Financial penalties

Channel 3, Channel 4, Channel 5, Public Teletext and Additional Services:

1990 Act sections 41 and 55 (see also Communications Act Schedule 13, Part 1, paragraphs 3 and 5 respectively and Schedule 10, paragraph 10 in respect of public teletext)

For Multiplex Licences, Digital Television Programme Services, Digital Television Additional Services, Television Licensable Content Services; and Restricted Services:

1996 Act sections 17, 23 and 27 (see also Communications Act, Schedule 13, Part 2, paragraphs 13 to 15); Communications Act section 237; and 1990 Act section 42 (see also Communications Act, Schedule 13, Part 1, paragraph 4)

For financial Penalties on Revocation of Licence: Channel 3, Channel 5, Public Teletext and the Multiplex Licences:

1990 Act sections 18(3) to (5) and 42 (see also Communications Act, Schedule 13, Part 1, paragraph 2); Communications Act paragraph 12, Schedule 10; and 1996 Act section 11(5) to 11(7) (see also Communications Act, Schedule 13, Part 2, paragraph 11)

Multiplex Revenue:

1996 Act section 14(1)

1996 Act sections 14(5) and (6)

1996 Act section 15

1996 Act sections 15(2) and (3)

Qualifying revenue:

1990 Act sections 19(2), 29(1), section 42B(3C); and Communications Act section 237(5) and Schedule 10, Part 2, paragraph 7.

1990 Act section 19(3)

1990 Act section 19(6)

1990 Act section 52(2)

Sponsorship income:

1990 Act section 19(6) 1996 Act sections 14(5) and 14(6)

1990 Act section 19(3) 1996 Act section 14(2)

Subscription income:

1990 Act section 19(2)(b) 1996 Act section 14(1)