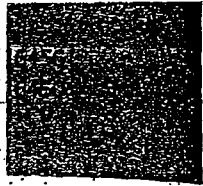
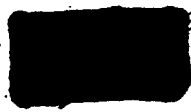


BPD3/02/1.1/1



Diana



I have enlightened
the additions -
Nothing new in [redacted] column
just the fact that Sky
should be deprived
from their money!

To 1. Secretary of State cc. copy list

2. Dr Kim Howells

From: [redacted]

Date 8 February 2002

Opportunity and Implications of requiring distributors of broadcasting services by satellite to carry public service channels (PSB).

Issue

1. How to ensure that the public service channels continue to be available free to all viewers after switchover.

Background

2. In a meeting held on 11th December, you asked for further work on must carry and must offer.

Recommendations

3. That the must offer rule, which the White Paper said would be imposed on Public Service Broadcasters (PSBs), is complemented by a double requirement for
 - satellite service "distributors"¹ to provide the public service channels free to their subscribers, and offer their Conditional Access System (CAS) on Fair Reasonable and non Discriminatory (FRND) terms to broadcasters, and
 - at switchover, the public service broadcasters collectively to bear the cost of the "solus card"² (smart card needed by people who do not take any subscription) for people who rely on satellite for receiving television.

¹ Satellite distributor : operator which sells access to a package of channels available through satellite

² "solus card"² : smart card needed by people who do not take any subscription, who go "alone" on satellite.

4. Item (i) is the option canvassed in Diana Kahn and [REDACTED]'s submission of 26 June 2001. You were concerned that this would cost Sky a great deal to benefit PSBs.
5. Item (ii) is a new proposition for addressing an issue which has arisen when drafting Instructions: who should pay for the smart-cards needed by viewers who buy satellite equipment but only to view free-to-air channels and do not subscribe to Sky: currently the BBC does this as part of its contract with Sky, but they may not continue to do so after expiry of their current contract in 2003 and could not afford to do so after switchover if, as suggested, we rely on satellite to provide say 5 to 10% of the national coverage.
6. We believe that taking these two propositions together would achieve a "rough justice" of costs and benefits.
7. However, you could prefer to choose not to provide in the Bill for a detailed regime, but to have general powers empowering the Secretary of State and OFCOM to implement any regime appropriate and proportionate to ensure universal and free availability of PSBs.

Discussion

8. There is a strong commitment in the White Paper to ensure that public service broadcasters are available on all the main platforms, both before and after switchover. There is also a commitment that they should continue to be available to all who receive them at present. This is likely to mean that some viewers may need to use satellite in those areas to which terrestrial digital coverage cannot cost-effectively extend, perhaps 10% of households (c. 2.6 million).
9. This commitment implies that public service channels should have a right and a duty to be carried on all the main platforms, and that viewers have no cost to bear on top of the equipment and of the licence fee. The issue is addressed on the terrestrial and cable platforms through allocation of spectrum and "must carry" rules respectively, but the satellite platform is more tricky. The policy in the White Paper proposed that there be a "must offer" obligation on PSBs in relation to all main platforms, notably satellite. They would then secure carriage because:
 - they can buy transponder space, allowing them to be broadcast by satellite (there is a competitive and open market for transponders, without any shortage of capacity); and
 - they have the right under European Directives to access conditional access systems (CAS) used on the satellite platforms on Fair, Reasonable and Non-discriminatory terms (FRND).
10. Therefore, no further action is essential to ensure that the PSBs are carried on all platforms including satellite.
11. However, ensuring free-to-air universal access does not only imply that PSB are carried on all main platforms, but also that they are available, free at the point of reception, for all, from at least one platform.

On terrestrial : once people have bought their equipment, they have nothing more than

the licence fee to pay for. But, after switchover, not everybody will be able to get terrestrial television.

On cable : people have a subscription to pay. However, in exchange for this fee, they get the installation (no aerial to pay, digital set-top box and modem) and a phone line. We do not propose to change this.

On satellite : people will have to pay for their dish and digital equipment, but this does not guarantee accessibility because the channels transmitted on satellite need to be encrypted (satellite transmission spills over the borders and will make these channels receivable in countries for which the broadcasters have not bought the rights). Therefore, they need a smart-card containing the relevant data and software enabling their equipment to decrypt the signals. This smart card contains the only CAS used in the UK today on satellite, which is Sky's. More information is attached in annex A.

12. It is also worth remembering that Sky has increased the price of the sale and installation of a dish and set-top box from £100 to 315 pounds (£215 for the box only) for people who do not take a subscription to their services, making the "satellite free to-air" option more expensive.
13. All these issues must be solved before switchover, as it is likely that some people will lose their terrestrial reception and will only be able to get television by satellite. Unlike cable viewers, those seeking free-to-air channels only would have already paid for the equipment at a high price (£315) but someone would also need to bear each year the additional cost of the conditional access system (c. £12 a year per household): this could in theory be the PSBs, the customer, Sky or HMG.
14. A solution could be to impose new obligations

On the main packagers and retailers of satellite channels (in effect only Sky today) to provide the PSBs to all their subscribers at no additional cost. This would be an equal an opposite obligation to the "must offer" obligation proposed to be imposed on PSBs themselves,

and

On the PSBs to provide a "solus card" to all those non-satellite subscribers who rely on satellite, because terrestrial coverage is inadequate, to get the digital PSBs, enabling their digital equipment (which they would have to buy themselves) to decrypt the signals,

and

It would be for the broadcasters and Sky, as at present, but subject to the outcome of Oftel actions at paragraph [15] below, to make financial arrangements (cost of access to the CAS and cost of the solus card), under regulatory control (FRND). We do not suggest that the PSBs should not pay to Sky the FRND price for the CAS.

15. This solution is not what the PSBs requested, which was to benefit from a better deal (discriminatory in their favour) for using SKY's conditional access system than the other

broadcasters. They believed that instead of the full price, which takes into account the investments in the set-top boxes and in the constitution of the platform and of its subscriber base, they should have to pay only the marginal costs for Sky to give access to the CAS. This is the point that we understand Ed Richards wanted to pursue, but under the European Directives, OfTel have to determine independently what FRND terms are. Our proposal goes some way to depress the charges to PSBs, but in a way which is compatible with European law

16. There are two other current possibilities for improving the terms for PSBs:

OfTel is consulting on whether their current principle for determining a fair price for access to the satellite platform should be changed to offer more benefit to PSBs, particularly non-profit PSBs. They appear to be more sympathetic to treating non-profit PSBs, particularly the BBC, favourably than the commercial PSBs of Channel 3.

ITV has complained to OfTel about the terms extracted by BSkyB for putting ITV on satellite. The outcome of this complaint could also affect the way that FRND terms are set in future

16. The solution that we propose in para 13 seems less interventionist, more equitable and has the merit of dealing with the issue of free-to-air viewers, as well as with satellite subscribers. It still requires a commercial negotiation between Sky and the PSBs, on the financial conditions of the use of their CAS, under OfTel's control. Therefore, we would not appear as interfering in a regulated matter. And because we do not fix a price, but let the FRND mechanism in place, we do not impose any major loss of revenue to Sky.

17. This is a solution which has presentational - and may be only presentational - advantages since it rectifies the current alleged negotiating imbalance between satellite packager and broadcasters. From informal soundings, we believe that ITV, Channel 4 and the BBC would welcome this, though they will say that it does not go far enough.

Impact on the Bill

18. Imposing an obligation on "satellite channels distributors" would require the creation of a new regime (at least a general authorisation regime), implying the acceptance of a new "must distribute" obligation. It will be an entirely new regime, though very limited in its scope. The "packagers" will be authorised/granted a licence, with one obligation: distributing free (at no cost for the viewer, and at a regulated cost (existing rules on FRND) for the broadcaster) the public service channels. (*"must distribute" to their subscribers*). OFCOM will have a power to exempt some smaller or inappropriate packagers of this requirement (for instance, a bunch of porn channels; or a bouquet of channels in foreign language).

19. Imposing an obligation on PSBs (including the BBC) would require to give OFCOM the duty to determine how costs of the "solus card" will be shared between the BBC and the other PSBs and which viewers should benefit from the free card.

Impact on the industry

20. Requiring the "packagers" to distribute these channels free to their subscribers will :

- ▶ benefit public service broadcasters, and ensure their carriage on satellite, whatever their market-share position after switchover is. (Whilst Sky shares an interest today in being able to offer BBC and ITV to its consumers, this incentive could become less if the multi-channel environment decreased the PSBs' audience.
- ▶ Ensure a level-playing field between satellite and cable. You have received letters from ITV, the BBC and Channel 4, all asking for a "must carry" provision to be set. Greg Dyke claims that "such a must carry provision is essential for the satellite platform. The current Ofcom regime does not provide this. It regulates a negotiating process, by providing for fair, reasonable and non-discriminatory treatment in negotiations for conditional access, rather than, guaranteeing an outcome, namely the availability of public service channels to all satellite viewers? You cannot have a must offer obligation without a reciprocal must carry commitment - otherwise the broadcaster has no position at all from which to strike reasonable carriage agreements with the satellite platform operator."
- ▶ Impose a new regulatory burden on Sky. The direct marginal cost for Sky will be minimal, but if ITV Digital are right when they say that Sky benefited from their assumed weaker negotiating position, Sky would lose some of the money they got from the broadcasters (£4 m for the BBC, (but the deal was made much earlier, and is likely to be renegotiated on more expensive terms) and £17m for ITV only). As a matter of comparison, it seems that, when they began their negotiations, ITV were willing to pay 6 to 7 m only.
- ▶ If it was decided to go further, and to say that the PSBs should benefit from a "free" or a "marginal cost" access to the conditional access system, the impact would be much higher, and very difficult to legitimate : Sky would be deprived of part of the income they get as return from their huge investments, and would have to throw back this loss either on the other channels they carry, or on their subscribers. Maybe these downsides could be accepted for the BBC, but certainly not for a commercial company.

21. Requiring PSBs to provide free cards to those people who rely on satellite for digital :

- ▶ will have a cost for them (£12 per viewer per year - up to say £30million).
- ▶ However, this could be a much cheaper solution to meet their universal coverage requirement than having to pay for the extra transmitters to go from 90 or 95 to 99.4 % terrestrial coverage.
- ▶ To avoid any State-aid and cross-subsidy issues, we believe that all the PSBs would

have to share the costs, and that we could not require the BBC to pay for all.

Impact on the viewers

22. It would be very unpopular to ask people unable, for technical reasons, to get digital terrestrial to have to pay, on top of their licence fee a further £12 or so a year to receive PSBs.

23. The suggested solution deals with that concern. The BBC and the other public service broadcasters would not be obliged to extend the delivery of free cards to any licence fee payer requiring it, if they have access to digital terrestrial. They might well, if the numbers were small, find it less expensive to send the cards without further enquiry than checking everybody's entitlement case by case.

Alternative solution

24. An alternative solution would be not to impose must offer in the Bill, now that ITV is on satellite, and benefits from it, because of the digital dividend. However, we do not know whether, after switchover, some people will rely on satellite to get their public service channels: will the DTT coverage reach 99.4% or will it stop when the marginal cost of extending it is too high for a commercial channel such as ITV? At this point, it might well be essential to have a leverage on commercial PSBs to force them to be on satellite.

Recommendations

25. That you choose between two solutions:

A/ You agree with the proposals that:

- ▶ satellite packagers such as Sky are submitted to the requirement that they make available free to their subscribers the public service channels
- ▶ that for people whose only means of receiving digital television is satellite, the cost of the "solus card" is paid by the public service broadcasters
- ▶ that people wishing to receive free-to-air satellite television, but capable of receiving digital television by another free-to-view means (ie terrestrial as today cable reception is linked to a subscription), have to pay themselves for the cost of the solus card, unless the broadcasters choose to.
- ▶ it is made clear that the cost of the solus card can be regulated by Ofcom, as well as the cost of CAS. Ofcom will also have a power to determine, in case of a dispute, how the costs of the solus card are shared between PSBs.
- ▶ instructions are prepared on this policy and introduced in the draft Bill.

OR

B/ The Bill just provides for

- ▶ a general duty on OFCOM to ensure that after switchover, as many people as practicable can receive the PSBs channels on at least one platform, free-to-view.
- ▶ a power for the Secretary of State, after consultation, to impose, by order any conditions on satellite packagers and on PSBs **appropriate and proportionate** to ensure that after switchover, as many people as practicable can receive the PSBs channels on at least one platform.

28. "Sunrise" provisions (creating the regime but not implementing it until necessary), can combine all the political downsides, Sky the PSBs and may be the viewers being unsatisfied. However, in this case, we decrease the risk : because we are not today in a situation where we can foresee what will happen at switchover, or how the DTT coverage will evolve, it could be sensible not to create now a regime which might be useful after switchover, but is now superfluous.



Annex A : The "solus card", and how to ensure that people can get PSBS channels via satellite without having to subscribe to Sky.

- ▶ With satellite, buying a dish and the relevant digital equipment does not allow the viewers to access to free-to-air channels.
- ▶ This is because the channels transmitted on satellite need to be encrypted (satellite transmission spills over the borders and will make these channels receivable in countries for which the broadcasters have not bought the rights).
- ▶ Therefore, the viewers need a smart-card containing the relevant data and software enabling their equipment to decrypt the signals. This smart card contains the only CAS used today on satellite, which is Sky's.
- ▶ Today, the BBC bears the costs of these cards.
- ▶ Today, because this is a marginal issue the BBC has been sending for free these cards to the licence fee payers who asked for it. The cost for the BBC is £12 a year, price which has been negotiated with Sky, in a contract ending in 2003. Two factors make it difficult for the BBC to keep on paying for these cards. First, the possibility that Sky increase their price. Secondly, the fact that more and more people will need such a card : all the free-to-view satellite viewers, attracted by the new BBC digital services and all Sky "churners", once Sky decide to change their cards and send new ones to their subscribers and only to them, which is a pending threat for BBC's finances. In effect, to avoid piracy, Sky might well change all their cards by the end of the year : the BBC would therefore have to pay for the 350,000 people who have stopped subscribing to Sky since they launched, and have kept their equipment.
- ▶ **Who should pay in the future for these cards ?**
 - ▶ Option 1 : Sky, which will throw back the cost on their own subscribers. There does not seem to have any justification for this.
 - ▶ Option 2 : *The public service broadcasters, each for its part.*
 - ▶ Option 3 : The BBC alone : asking the BBC to pay instead of commercial companies will create a dangerous precedent, raise some complex aid and cross-subsidies issues.
 - ▶ Option 4 : The consumers.

We recommend option 2

- ▶ **Who should receive free cards ?**
 - ▶ Option 1 : everybody wishing to receive digital television via satellite
 - ▶ Option 2 : only people unable to receive digital television via another free platform.

We recommend option 2, but with the possibility for PSBS to choose option 1, on a voluntary basis.