

Chair
Cabinet Policy Committee

FREE-TO-AIR DIGITAL TELEVISION: PLATFORM FUNDING AND SPECTRUM LICENSING

Purpose

1. This paper responds to Cabinet's invitation that the Minister of Broadcasting report back to Cabinet Policy Committee with any necessary changes to appropriations to give effect to Cabinet's in-principle decision of May 2006 to fund the FreeView free-to-air digital television platform up to \$5 million per annum for five years (POL Min (06) 8/7). It also recommends an extension of current licence renewal and valuation principles and policies in relation to Digital Terrestrial Television (DTT) licence rights at analogue switch-off (ASO).

Executive Summary

2. In order to support the establishment of free-to-air digital television in New Zealand, Cabinet agreed in-principle to fund FreeView up to \$5 million per annum for five years. This was to be met from the Budget 2006 general contingency, subject to Cabinet confirmation, provided that several conditions were met. Conditional offers of access to DTT spectrum without resource charge to TVNZ, CanWest and BCL, and to SKY in respect of its free-to-air service Prime, were also agreed. The conditions subject to which Cabinet agreed in principle to fund FreeView have now been met, and Heads of Agreement negotiated with:

- FreeView to ensure that it is established with a constitution, governance arrangements and operational protocols that appropriately reflect government's and the public's wider interests in free-to-air digital television, subject to Cabinet confirmation of its in-principle funding decision; and
- TVNZ, CanWest and BCL on licence allocation, subject to Cabinet agreement to provide greater certainty on DTT spectrum renewals and pricing at ASO, and to resolution of one or two minor issues, in order to support their investment in DTT transmission.

It is therefore recommended that the Committee confirm the in-principle offer of funding for FreeView of up to \$5 million per annum for five years. It is also recommended that the Committee agree an extension of current licence renewal and valuation principles and policies in relation to DTT licence rights at ASO, so that all agreements can be finalised.

3. The paper also notes issues which have arisen over recent months concerning compression standards and transmission capacity. It recommends that the due date for a report back to the Minister of Broadcasting and the Minister of Communications on options for criteria and a process for ASO be extended from November 2006 until three months after the finalisation of funding and licence allocation contracts, so that sufficient time can be allowed for industry consultation.

Background

4. In May 2006, Cabinet took a series of decisions to support the development of free-to-air digital television in New Zealand. The decisions were taken in response to a proposal from the FreeView group of broadcasters for the establishment of a hybrid satellite and terrestrial television platform, and in consideration of an independent cost-benefit report which estimated the (base case) net national benefit to New Zealand of making a full transition to free-to-air digital television at \$230 million if (in the case of TVNZ and CanWest) ASO occurs at 2015. Principally, Cabinet agreed:

- To fund FreeView up to \$5 million per annum for five years, to be met from the Budget 2006 general contingency, subject to Cabinet confirmation, conditional upon its establishment with a constitution, governance arrangements and operational protocols that appropriately reflect government's and the public's wider interests in free-to-air digital television; and
- To make conditional offers of access to DTT spectrum (to give coverage of up to 75 per cent of the population) without resource charge until ASO to TVNZ, CanWest, BCL, and to SKY in respect of its free-to-air service Prime. Cabinet decisions confirmed that existing government policies with respect to expiry of rights will apply, subject to further consultation with broadcasters on a process and criteria for ASO.

Platform Funding

5. Cabinet's in-principle decision to fund FreeView was subject to FreeView's establishment with a constitution, governance arrangements and operational protocols, ensuring that FreeView will:

- Operate in a fully open and transparent manner (including dispute resolution procedures);
- Provide access to other free-to-air services on fair and equitable terms;
- Operate a hybrid platform with an agreed roll-out plan and launch date for simulcast and new digital services, and agreed performance targets for platform take-up by viewers;
- Undertake targeted market research (such as consumer willingness to pay); and
- Implement agreed technical and equipment standards.

6. FreeView has now agreed its constitution (conditional on Cabinet confirmation of its offer of funding) as a joint venture company with TVNZ, CanWest, Māori Television, and Radio New Zealand as shareholders. The NZ Racing Board (NZRB), which had participated (in respect of its free-to-air service, Trackside) in the development and presentation to Government of the FreeView proposal, has subsequently withdrawn from participation as a shareholder. The NZRB advises that this is primarily because [Text withheld under OIA section 9(2)(b)(ii)]

It is possible that the NZRB may join FreeView later, either as a shareholder, or a general service provider. FreeView has also been discussing Prime's possible participation as a general service provider with SKY.

7. The FreeView joint venture documentation was examined by officials and submitted for independent legal advice. In particular, a Queen's Counsel's opinion was sought in relation to any potential competition law issues. The Queen's Counsel's opinion identified two possible concerns that the proposed arrangements might lead to the opportunity for conduct contrary to the Commerce Act, but considered that neither of these was of a type that would warrant the Joint Venture partners seeking an authorisation from the Commerce Commission.

[Text withheld under OIA section 9(2)(h)]

These have been taken on board by FreeView in the eligibility criteria and funding allocation plan it established with the final form of its Joint Venture agreement.

8. On this basis, officials have concluded Heads of Agreement with the FreeView shareholders concerning the provision of funding, subject to Cabinet's approval, and are satisfied that the conditions of Cabinet's offer of funding to FreeView have been met. It is therefore recommended that the Committee confirm Cabinet's in-principle decision to fund FreeView up to \$5 million per annum for five years from the 2006/07 Budget contingency, and an appropriation is sought accordingly.

9. Subject to agreement on the above recommendation, the agreement will be finalised with FreeView so that funding can be distributed once the following conditions precedent have been met:

- FreeView has been formally and fully constituted, and a funding allocation plan approved;

- The final spectrum licensing implementation plan has been agreed;
- DTT spectrum licence agreements are completed;
- BCL transmission agreements have been reached with TVNZ and CanWest respectively; and
- Relevant technical and equipment standards have been agreed by industry.

It is proposed that an expectation be communicated to parties that these conditions will have been fulfilled by 30 November 2006, or else the Minister of Broadcasting will review the offer of funding and report back to Cabinet if he considers progress has been insufficient.

Spectrum Licences

Cabinet Decisions

10. The Cabinet decisions on DTV taken in May included offers of spectrum for DTT, capable of providing service from ten main sites, plus some infill stations, to give coverage of up to 75 per cent of the population. Specifically, Cabinet agreed to:

- Reserve and offer to TVNZ and to CanWest up to one new nationwide set of digital licences each, without resource charge until ASO;
- Reserve and offer to BCL up to one set of digital licences, without resource charge until ASO and to the extent that these are used for free-to-air digital simulcast of existing nationwide free-to-air services at cost (rather than on a commercial basis);
- Subject to the above and, should SKY not enter into contracts for simulcast carriage of Prime on the set of licences proposed for BCL, to reserve and offer SKY up to one set of digital licences without resource charge until ASO conditional upon SKY agreeing:
 - not to renew comparable existing UHF licences in 2010 and to transfer such licences to the Crown at an earlier date should SKY cease any of its existing analogue UHF services (consistent with the requirement for TVNZ to relinquish licences in Row 6); and
 - to cancel protection licences in the management right owned by MTS by 2010.

11. These offers were subject to a number of conditions designed to ensure their use for the digital transmission of free-to-air services, to be made available for inclusion in a jointly operated, open EPG. Other conditions aimed to ensure the implementation of the planned DTT roll-out, to maximise capacity utilisation within the licences by requiring new services to be launched, to require the industry to agree and implement technical standards, and to secure a commitment to ASO. The Cabinet decisions also confirmed that existing government policies with respect to expiry of rights will apply, subject to further consultation with broadcasters on a process and criteria for ASO (POL Min (06) 8/8).

Response from Parties

12. SKY's Chief Executive informed officials

[Text withheld under OIA sections 9(2)(b)(ii) and 9(2)(ba)(i)]

In order to allow sufficient time for SKY to resolve its position, it is recommended that SKY be invited to respond finally by 30 November 2006, by which time it is expected (as noted in paragraph 9) that all other parties will have finalised their own arrangements. If by that time SKY has not decided that it wishes to take up the offer of spectrum, it is proposed that the licences instead be held in reserve to meet any future demand following further Cabinet consideration. Should Sky decline the present offer, this alone would not preclude them from any future allocation.

13. TVNZ, CanWest and BCL have confirmed the conditions are broadly acceptable, but have raised questions about the government policies to apply to licence renewals and the basis for setting resource charges once the transitional arrangements terminate at ASO. They have argued that certainty about the future of licensing, including likely costs beyond ASO, is essential for their financial forecasting and final board approval for their digital launch plans, and that these issues require resolution before licence agreements can be finalised. Specifically, the following has been requested:

- Certainty of renewal of DTT licences up to and after ASO;
- Understandings on the pricing formula and related policies that would apply for the renewal of DTT licences at ASO, and (in the case of TVNZ and CanWest) for any necessary renewal of analogue licences in 2015; and
- Clarity about what would happen to licences currently used for analogue transmissions once ASO occurs.

14. There are risks in meeting the free-to-air broadcasters' position, as it represents a further advantage to these licensees at the expense of consistency with overall policies of competitive allocation, estimated market pricing, and expiry of rights. Further, decisions on pricing principles incorporating the possibility of concessionary discounts are being requested now, before confirming a potential analogue switch-off of 2015 or later, in what is seen to be a relatively fast-moving environment. Most countries have struggled to meet initial expectations of analogue switch-off dates. Quite small changes to the present paradigm, such as television and other content being provided by broadband or increasing satellite usage, are capable of making the proposed pricing approach seem inappropriate nearer to their time of applicability. The effect of the policy decisions and long-term commitments to broadcasters may become inappropriate as the broadcasting model in New Zealand evolves.

[Text withheld under OIA section 9(2)(g)(i)]

15. However, there are sound reasons to consider the specific licensing policies to apply to the transition to ASO:

- The move to digital is a special circumstance where a major transition of technology and public investment implies duplication of costs to the broadcasters during a lengthy transition;
- Recognising that ASO is in the national interest, the government has taken a number of decisions to facilitate the transition to DTV. Licence renewal policies can create incentives to achieve ASO; and
- The ASO objective makes the standard policy of negotiating to agree on licence renewals five years in advance of their expiry inappropriate. It would be more logical to determine final renewal arrangements and resource charges at the time an ASO was set, even though this may not be exactly five years in advance of the licence expiry.

Principles

16. It is proposed to extend, in respect of the transition to ASO, the current policy principles that renewals and pricing should optimise incentives to invest, minimise potential for supply discontinuity and the possibility of stranded investment, provide for a fair return to the Crown, ensure right-holders do not pay more than market value, and include the possibility of a case-by-case review providing for charges to be scaled/discounted. Having adopted ASO as a government objective (POL Min (06) 8/8), it is appropriate that renewals and pricing policies should also promote the achievement of ASO. Additional factors could therefore be applied in any case-by-case review for scaling/discounting purposes, including:

- Expected life of relevant services – for example, analogue services until expected ASO date;
- Population penetration – for example, the extent of digital conversion;
- Investment that has been made in new digital services by broadcasters.

Options

17. Non-contestability: The application of a contestable process for DTT licences post-ASO would place infrastructure investment at significant risk. Non-contestability also conforms to the existing policy on licence renewals in the broadcasting bands. It is therefore recommended that Cabinet confirm the non-contestable renewal of DTT licence renewals upon expiry, and of analogue licences until ASO, subject to the relevant licences being in use.

18. Fair Return: Non-contestability requires a method of establishing a fair return, using estimation or other mechanisms to determine price points for setting resource charges. Licence prices (i.e. resource charges), based on some market data and a formula for value increase, have already been agreed in respect of UHF analogue licences through to 2020. It is not clear, however, if there will be any market price points for DTT licences between now and ASO, as new market entrants and the evolution and particularly the timing of take-up by consumers of DTV are unknown. No further contestable allocations of DTT licences are envisaged, unless Cabinet determines otherwise. Furthermore, the VHF spectrum is full and licences were initially allocated without a market price point. No directly comparable market data can thus guide charging if renewals are required in 2015.

19. Recent valuations have used a formula developed by Covec Ltd. While the Covec formula could be used to determine values at the desired time, it requires input data. In the possible absence of fresh market data, options are to:

- Take the estimated values of spectrum sales post-ASO from the cost–benefit report, or data from a specific study, to estimate post-ASO values of spectrum suitable for television broadcasting purposes; and/or
- Adopt analogue price values (for example using those established for the 2010 UHF analogue renewal process); and/or
- Apply other non-market criteria, such as calculating a percentage of revenue, identified in the Radiocommunications Act.

20. Pricing: Licensees should in principle pay for only one set of licences (either analogue or DTT) during the transition, and one set (DTT) after ASO. Options to give effect to this principle include:

- Creating a price for DTT licences at 2015, irrespective of the ASO date, and in return not charging an analogue price extension when VHF licences expire;
- Charging for analogue licences after 2015, with prices potentially discounted in proportion to viewer take-up of DTV, as an incentive to achieve ASO. DTT resource charges to take effect at ASO (POL Min (06) 8/7, 8/8); or
- Not charging for VHF analogue licences after 2015 if the ASO date is known and imminent (in recognition of the achievement of high viewer take-up to support ASO).

21. Timing: There is no certainty of ASO timing but, while it is assumed to be around 2015, it could be as early as 2010 or as late as 2020. Some information suggests that FreeView members will need to either replace or de-commission elements of the ageing analogue infrastructure before 2015. This uncertainty suggests that pricing should be set when an ASO date is agreed. Alternatively, “decisions in principle” could be taken earlier and reviewed when ASO timing is confirmed.

Recommended approach

22. Officials were authorised by the Ministers of Broadcasting and Communications to negotiate Heads of Agreement with the broadcasters offered licences and BCL on the basis of the above options, subject to Cabinet agreement. This has now been done, and Cabinet confirmation of the following approach to renewals at ASO of DTT licences granted without resource charge, which would give a significant period of certainty for the transition, is sought:

- (a) Licences to replace “in use” licences granted without resource charge during the transition to ASO be granted:
- on a non-contestable basis;
 - for a term of 20 years;
 - providing equivalent coverage to that available from the expiring or cancelled Licences; and
 - configured with frequencies and other technical parameters that recognise the need to efficiently utilise the available spectrum.

- (b) When the timing of ASO is determined:
 - licence-holders to be consulted on the development of a band plan for DTT spectrum that will accommodate existing and future Channels or services and provide for the efficient and effective allocation of the spectrum available for DTT and other potential uses; and
 - the amount of the resource charges for the replacement DTT licences to be granted after ASO will be determined by applying the Covec Formula and relevant input data.
- (c) The relevant input data for the purpose of applying the Covec Formula will include:
 - data from a specific study to estimate post-ASO values of spectrum suitable for television broadcasting purposes; and/or
 - analogue price values, such as those established for the 2010 UHF analogue renewal process; and/or
 - any market data available on other DTT licences that might have been granted on a contestable basis before ASO; and
 - any discount factors relevant to setting the resource charges for the new licences that may be determined to apply, such as the extent of viewer take-up of all DTV options and the extent of the broadcaster's investment in new DTV services.
- (d) When the resource charges for the replacement DTT licences to be granted at ASO are determined, the following principles will apply:
 - the resource charges should provide for a fair return to the Crown;
 - the licence-holder should not pay more for the licences than their market value;
 - incentives to invest should be optimised;
 - the potential for supply discontinuity should be minimised; and
 - the possibility of stranded investment should be minimised.
- (e) If ASO occurs before 2015, then DTT licences would be priced from 2015, recognising that resource charges for analogue licences have been paid until that date.
- (f) If UHF spectrum auctions in the period between the agreement of DTT renewal charges and ASO provide actual market price data which is lower than the values established for renewal, then the renewal price would be reduced accordingly.
- (g) Licence-holders may request the auction of the replacement licences to be granted on ASO if they reject the resource charges determined.
- (h) Analogue licences used to simulcast free-to-air services being carried on the DTT platform will be cancelled, without recompense, at ASO.

23. It has also been agreed with TVNZ and BCL[Note: should be CanWest] that there is an intention to make commercial offers for the renewal of expiring analogue licences beyond 2015 if ASO has not occurred by that time, so that the broadcasters can continue to broadcast their existing analogue services until ASO and, subject to Cabinet's approval, that this will be recorded in a separate exchange of letters on the following basis:

- An analogue licence extension value from 2015, synthesised from UHF renewal values to be developed at the earlier of either 2010 or the time an ASO date is set, and with the scaling/discount factors identified below then applied in a case-by-case review;
- The following factors could be applied in any case-by-case review for discount/scaling purposes:
 - expected life of the services to be carried on the licence – i.e. through to the expected date for ASO;
 - population penetration – i.e. the extent of digital conversion through viewer take-up of DTV options;
 - investment that has been made in new services by broadcasters.
- If UHF spectrum auctions in the period between the agreement of analogue licence extension charges and 2015 provide actual market price data which is lower than the values established, then the analogue extension price would be reduced accordingly. Conversely a higher market price data would suggest a lower degree of discounting was appropriate.

Other Issues

Compression Standards

24. The FreeView business case and the independent cost-benefit report assumed that the MPEG2 compression standard for standard definition digital television would be employed. Cabinet's decisions of May 2006 require FreeView and those taking up the offer of free DTT licences to agree an industry-wide approach, but do not mandate one or other standard. FreeView and BCL commissioned an independent report on the likely market availability and cost of MPEG4 set-top boxes during the launch phase of free-to-air DTT in order to determine the best choice of technology.

[Text withheld under OIA sections 9(2)(b)(ii) and 9(2)(g)(i)]

There are two types of MPEG4 box: MPEG4 standard definition set-top boxes are likely to be similar at launch to the projected price for MPEG2 boxes (estimated at around \$200), but MPEG4 high definition set-top boxes are likely to be significantly more expensive for several years. Using MPEG4 increases the number of standard definition services which can be carried in the existing spectrum and enables the introduction of high definition services without requiring a future upgrade of compression technology.

[Text withheld under OIA sections 9(2)(b)(ii) and 9(2)(g)(i)]

(SKY has already indicated its intention to transmit Prime as a high definition service which implies use of the MPEG-4 standard).

DTH and DTT Capacity and Service Access Issues

25. A FreeView decision to launch DTT using MPEG4 technology for standard definition services would allow more services to be carried on DTT than on the currently available DTH capacity, which will continue to operate with MPEG2. While further DTH capacity may become available, it is likely to be some time before this is a commercial option for broadcasters. In addition, regional and non-commercial broadcasters contracting for access to BCL's DTT licences may not be able to acquire or afford access to the existing satellite capacity. A transition to high definition services, however, will reduce the number of channels that can be carried in the existing DTT spectrum, and possibly create pressure for the release of additional DTT capacity to maintain services.

26. FreeView DTH services will use technology compatible with SKY's satellite service.

[Text withheld under OIA sections 9(2)(b)(ii) and 9(2)(g)(i)]

27. The licence allocation Heads of Agreement negotiated with TVNZ, CanWest, and BCL, and the funding Heads of Agreement negotiated with FreeView, seek to mitigate these risks by tying the DTH and DTT elements of the FreeView platform together as closely as possible. Requirements for additional DTT capacity may be able to be met in the first instance via the set of licences offered to SKY (if this is not taken up by 30 November), and subsequently via capacity that may be released at 2010 with the return of a number of unused analogue UHF licences, and that will certainly be released at ASO.

[Text withheld under OIA section 9(2)(f)(iv)]

ASO Criteria and Process

27. Given that the negotiations with TVNZ, CanWest and BCL have taken longer than expected, and require Cabinet decisions prior to being finalised, it is recommended that the due date for a report back to the Minister of Broadcasting and the Minister of Communications with preliminary recommendations on criteria and a process to trigger ASO be amended from November 2006 (POL Min (06) 8/8), to three months after the finalisation of funding and licence allocation contracts.

Consultation

28. This paper has been prepared by the Ministry for Culture and Heritage, in consultation with the Ministry of Economic Development, CCMAU, the Treasury and Te Puni Kōkiri. The Department of the Prime Minister and Cabinet was also informed.

Fiscal Implications

29. This paper recommends confirmation of Cabinet's in-principle decision to fund FreeView up to \$5 million per annum for five years from the 2006/07 Budget contingency. The approach to spectrum renewal and valuation recommended in this paper provides a basis for estimating the possible pricing of DTT licences at ASO based on a fair return. It is not possible to quantify with any certainty the actual return a contestable allocation of the licences by auction would realise. The extent of any discount offered and the potential for mis-estimation of fair market values will determine the opportunity cost to the Crown, but it is impracticable to quantify these at the present time. As noted by Cabinet in May (POL Min (06) 8/7), TVNZ's business case for participating in FreeView [*Text withheld under OIA section 9(2)(b)(ii)*], while it was estimated that BCL [*Text withheld under OIA section 9(2)(b)(ii)*]

Human Rights and Legislative Implications

30. None.

Treaty of Waitangi Implications

31. The establishment of a free-to-air digital television platform, which the recommendations in this paper support, would provide for the promotion and protection of Māori language and culture through the participation of Māori Television, TVNZ and Radio New Zealand.

Regulatory Impact and Compliance Cost Statement

32. Not required.

Publicity

33. It is proposed that the Minister of Broadcasting advise FreeView and other parties of relevant aspects of Cabinet's decisions, and that he be authorised to make wider announcements in due course as appropriate.

Recommendations

34. It is recommended that the Committee:

Background

1. **note** that in May 2006 Cabinet agreed in principle to fund FreeView up to \$5 million per annum for five years, to be met from the Budget 2006 general contingency, subject to Cabinet confirmation conditional upon its establishment with a constitution, governance arrangements and operational protocols that appropriately reflect government's and the public's wider interests in free-to-air digital television (POL Min (06) 8/7);
2. **note** that Cabinet agreed to make conditional offers of access to DTT spectrum (to give coverage in the first instance of approximately 75 per cent of the population) without resource charge until ASO to TVNZ, CanWest, BCL, and to SKY in respect of its free-to-air service Prime, subject to either licence conditions or separate contracts (which may be terminated on non-compliance) consistent with the government's objectives in granting the licences (POL Min (06) 8/7);
3. **note** that Cabinet's decisions (POL Min (06) 8/8) confirmed that existing government policies with respect to expiry of rights will apply, subject to further consultation with broadcasters on a process and criteria for ASO;
4. **note** that officials from the Ministry for Culture and Heritage and the Ministry of Economic Development were directed to negotiate with FreeView and other relevant parties within the parameters set out above, and that the Minister of Broadcasting was invited to report back to Cabinet, upon satisfactory conclusion of the negotiations in relation to platform funding, with any necessary changes to appropriations to give effect to the Cabinet's decisions (POL Min (06) 8/7);

Platform Funding

5. **note** that FreeView has now conditionally agreed its constitution as a joint venture company with TVNZ, CanWest, Māori Television, and Radio New Zealand as shareholders in accordance with the conditions of Cabinet's offer of funding, and that officials have concluded Heads of Agreement with the FreeView shareholders concerning the provision of funding, subject to Cabinet's confirmation of its in-principle funding decision;
6. **confirm** Cabinet's in-principle decision to fund FreeView up to \$5 million per annum for five years from the 2006/07 Budget contingency, so that funding can be distributed after the following have been fulfilled:
 - 6.1. FreeView being formally constituted, and a funding allocation plan approved;
 - 6.2. The final spectrum licensing and implementation plan being agreed;
 - 6.3. Licence agreements being completed;
 - 6.4. BCL transmission agreements being reached with TVNZ and CanWest respectively; and
 - 6.5. Relevant technical and equipment standards being agreed by industry.
7. **invite** the Minister of Broadcasting to review the offer of funding if 6.1 to 6.5 have not been fulfilled by 30 November 2006 and to report back to Cabinet Policy Committee if he considers progress on those matters to have been insufficient;
8. **approve** the following changes to appropriations to provide funding from the 2006 Budget contingency of up to \$5 million per annum for five years to facilitate a hybrid DTH/DTT FreeView digital platform, with a corresponding impact on the operating balance:

Vote Arts, Culture and Heritage Minister of Broadcasting	\$m – increase/(decrease)				
	2006/07	2007/08	2008/09	2009/10	2010/11
Non-Departmental Output Expenses Public Broadcasting Services	5.000	5.000	5.000	5.000	5.000

9. **agree** that the changes to appropriations for 2006/07 above be included in the 2006/07 Supplementary Estimates and that, in the interim, these expenses be met from Imprest Supply;

Spectrum Licences

10. **note** that SKY [Text withheld under OIA section 9(2)(b)(ii)]

wishes the offer of licences to be held open;

11. **direct** officials to invite SKY to respond finally to the offer of licences referred to in recommendation 2 by 30 November 2006;
12. **agree** that if SKY has not decided by 30 November 2006 to take up the offer of licences, then these licences will instead be held in reserve to meet any future demand following further Cabinet consideration;
13. **note** that TVNZ, CanWest and BCL have confirmed that Heads of Agreement setting out the conditions of the offer of spectrum licences are acceptable but that, in order to provide the certainty required to support the significant investment involved in a transition to digital television, the parties have requested:
- 13.1. Certainty of renewal of DTT licences up to and after ASO (after which frequency changes and resource charges would apply);
 - 13.2. Understandings around the pricing formula and related policies that would apply for the renewal of DTT licences at ASO, and (in the case of TVNZ and CanWest) for any necessary renewal of analogue licences in 2015;
 - 13.3. Clarity about what would happen to licences currently used for analogue transmissions once ASO occurs;
14. **note** that the matters in recommendation 13 require resolution before licence agreements can be finalised, but that there is also some risk in doing so, including that:
- 14.1. other right-holders might seek to use DTT licence commitments as a precedent
[Text withheld under OIA section 9(2)(g)(i)]
; and
 - 14.2. possible changes to the current paradigm, such as significantly delayed ASO or increased broadband and satellite usage, may make the renewal and pricing approach seem inappropriate nearer to the time of its application
15. **note** that there are nevertheless sound reasons for considering the specific licensing principles and policies to apply to renewals and pricing at ASO, including:
- 15.1. The move to digital is a special circumstance where a major transition of technology implies duplication of costs to the broadcasters during a lengthy transition;
 - 15.2. Licence renewal policies can create incentives to achieve ASO;
 - 15.3. The ASO objective makes the standard policy of offering licence renewals five years in advance of their expiry inappropriate;

16. **agree**, given ASO has been adopted as a government objective (POL Min (06) 8/8), that renewal and pricing policies in the transition to ASO should, in addition to established principles, also promote the achievement of ASO;

DTT Licences

17. **agree** to the following policies for renewal at ASO of free-to-air DTT licences referred to in recommendation 2 and granted without resource charge during the transition to ASO:
 - 17.1. Licences to replace those licences actually in use at ASO to be offered:
 - 17.1.1. on a non-contestable basis;
 - 17.1.2. for a term of 20 years;
 - 17.1.3. providing equivalent coverage to that available from the expiring or cancelled licences; and
 - 17.1.4. configured with frequencies and other technical parameters that recognise the need to efficiently utilise the available spectrum;
 - 17.2. When the timing of ASO is determined:
 - 17.2.1. licence-holders will be consulted on the development of a band plan for DTT spectrum that will accommodate existing and future channels or services and provide for the efficient and effective allocation of the spectrum available for DTT and other potential uses; and
 - 17.2.2. the amount of the resource charges for the replacement DTT licences to be granted at ASO will be determined by applying the Covec Formula and relevant input data;
 - 17.3. The relevant input data for the purpose of applying the Covec Formula will include:
 - 17.3.1. data from a specific study to estimate post-ASO values of spectrum suitable for television broadcasting purposes; and/or
 - 17.3.2. analogue price values, such as those established for the 2010 UHF analogue renewal process; and/or
 - 17.3.3. any market data available on other DTT licences that might have been granted on a contestable basis before ASO; and
 - 17.3.4. any discount factors relevant to setting the resource charges for the new licences that may be determined to apply, such as the extent of viewer take-up of all DTV options and the extent of the licence-holder's investment in new DTV services;
 - 17.4. When the resource charges for the replacement licences to be granted at ASO are determined, the following principles will be applied:
 - 17.4.1. the resource charges should provide for a fair return to the Crown;
 - 17.4.2. the licence-holder should not pay more for the licences than their market value;
 - 17.4.3. the incentives to invest should be optimised;
 - 17.4.4. the potential for supply discontinuity should be minimised; and
 - 17.4.5. the possibility of stranded investment should be minimised.
 - 17.5. If ASO occurs before 2015, then DTT licences would be priced from 2015, recognising that resource charges for analogue licences have been paid to that date;
 - 17.6. If UHF spectrum auctions in the period between the agreement of DTT renewal charges and ASO provide actual market price data which is lower than the values established for renewal, then the renewal price would be reduced accordingly;
 - 17.7. Licence-holders may request the auction of the replacement licences to be granted on ASO if they reject the resource charges determined;
 - 17.8. Analogue licences used to simulcast free-to-air services being carried on the DTT licences will be cancelled, without recompense, at ASO;

Analogue Licences

18. **agree** to the following policies for the renewal of analogue licences expiring in and beyond 2015 if ASO has not occurred by that time, and which are in use for simulcast of services carried on the DTT licences referred to in recommendation 2:
 - 18.1. An analogue licence extension value from 2015, synthesised from UHF renewal values to be developed at the earlier of either 2010 or the time an ASO date is set, and with the scaling/discount factors identified below then applied in a case-by-case review;
 - 18.2. The following factors could be applied in any case-by-case review for discount/scaling purposes:
 - 18.2.1. expected life of the services to be carried on the licence – i.e. through to the expected date for ASO;
 - 18.2.2. population penetration – i.e. the extent of digital conversion through viewer take-up of DTV options;
 - 18.2.3. investment that has been made in new services by broadcasters.
 - 18.3. If UHF spectrum auctions in the period between the agreement of analogue licence extension charges and 2015 provide price data which is lower than the values established, then the analogue extension price would be reduced accordingly, whilst any higher price data may make a lower application of discounting appropriate;
19. **direct** officials to consult with industry stakeholders and report back to the Minister of Broadcasting and the Minister of Communications within three months after the finalisation of the funding and licence allocation contracts referred to in recommendation 6 with preliminary recommended criteria and a process to trigger analogue ASO.

Hon Steve Maharey
Minister of Broadcasting

Hon David Cunliffe
Minister of Communications