

COMMERCIALLY VIABLE LOCAL TELEVISION IN THE UK

**A Review by Nicholas Shott for The Secretary of State for
Culture, Olympics, Media and Sport**

■ **IMPORTANT NOTICE**

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1 EXECUTIVE SUMMARY

This Final Report builds on the Interim Report produced in September. Many of the findings from the Interim Report have remained in this Final Report. However, further consideration has specifically been given to the business model and to potential ownership models. The conditions identified within the report are those which would help facilitate local TV distributed by DTT in the short to medium term.

The report provides a background to the issues considered, and outlines how local TV distributed by DTT during a transitional phase could be possible. This executive summary highlights key findings and the Steering Group's recommendations related to conditions required for facilitating a viable local TV sector. Work toward establishing some of these conditions has started. If it is the case that not all of these conditions can be met, it is possible that alternatives that go toward achieving similar purposes may be found.

Long-term

It was clear at the time of the Interim Report and is clear now that in the long-term, local TV will be well placed to exist through distribution to television sets and other devices through IPTV. This is likely to be less expensive, provide broad distribution potential, is non-linear, and could cover the whole country whilst simultaneously providing a greater degree of localisation than most current distribution methods. However, there is a coherent argument that local TV can be developed on DTT first, where it can build a brand identity, develop a sustainable model and pave the way for transition to IPTV.

In the long-term, local TV looks set to be delivered through IPTV technology; therefore, any steps the Government takes through new regulatory interventions to facilitate local TV should have regard for this

Locations

The definition of 'local' is subjective and varies in different parts of the country and across the nations. It is clear that there is no one standard definition of 'local', but it is agreed that the current regional news provision on national television is not 'local' enough for many viewers. There is also a clear demand for more local content on TV.

As stated in the Interim Report, local TV will not be financially viable distributed by DTT in sparsely populated rural areas. It may, however, be possible to sustain 10 to 12 local TV services around major conurbations subject to the conditions detailed below. This would fit with the transitional nature of local TV, in advance of IPTV when smaller and more rural areas will have the opportunity to develop a local TV proposition.

The Steering Group suggests that the locations be selected based on robust and sustainable business plans submitted by potential operators in any licensing process. Following meetings in Wales, Northern Ireland and Scotland, it is important to note that each nation has its own media heritage and needs, which are elaborated upon within the report and should be taken into account within the licensing process.

Local services may initially be focused in and around 10 to 12 conurbations; determining these areas should be based substantially on the quality and sustainability of business plans together with transmission considerations

Programming and content

Ofcom research has shown an appetite for local TV from audiences, mostly around local news and informational content. There is less evidence of demand for other types of programming. In order to be differentiated from current regional news offerings that carry national brands, the content that is provided should be truly localised and made specifically for the local audience. Further, the content needs to be of high quality and impartial, in order to compete with alternative multi-channel offerings. The Steering Group welcomes the content acquisition agreement with the BBC as it is likely that it will help set a minimum quality threshold.

It is clear that local operators may only be able to supply local news and informational content for part of the day. There is no belief that local content could be provided to fill an entire channel schedule. Similarly, the cost involved in acquiring content to fill a schedule of sufficient quality to maintain an audience is likely to be out of reach for a stand-alone local TV station. The Steering Group therefore refers not to local TV ‘stations’, but instead to ‘local services’. A shared national backbone whose primary purpose is to serve local services should therefore be tasked with acquiring content to fill the schedule and manage the programming around the core local TV offering.

Local services in these conurbations should seek to produce a core of, on average, of at least two hours reasonably low cost but high quality content a day; a national backbone should be tasked with the role of filling the schedule to help attract audiences and ensure a coherent offering

Generating Audiences

Local services need to be able to generate sufficient audience levels, which is a challenge in a market with a number of high quality national channels that cater to large audiences. EPG prominence for local TV would offer an opportunity to compete, attracting more viewers who might otherwise not find their local TV offer.

Carriage on satellite and cable platforms, whilst desirable, is not necessary for the success of local TV. According to recent Ofcom estimates, 73% of households utilise DTT technology on either primary or secondary TV sets, despite the fact that satellite and cable penetration means that only 39% of households utilise DTT technology on their primary TV sets.

Promotion of local TV by channels with large existing viewing shares could boost audience numbers. This cross-promotion could involve piggybacking, or insertion, or be a pop-up on an existing channel (as described later in this report). Recent BBC research has shown that red button technology is less effective than originally anticipated. Piggybacking or insertion methods are more effective, but may face technical difficulties. Furthermore, it could be difficult to persuade a PSB (Public Service Broadcaster) to provide a host channel. Some method of cross

promotion is worth pursuing in the short-term, particularly as a means of introducing consumers to local TV services during an initial establishment phase.

Government should seek to secure EPG prominence across as many platforms as possible – where applicable this prominence may be a single common EPG position across the UK; the prominence might be derived from cross-promotion from an existing highly placed channel

Advertising and Other Revenues

Advertising – both local and national – is a vital way for commercially driven local TV to generate revenue.

The absence of audience measurement at a local level means that local TV lacks a familiar 'currency' for originating local revenues. In addition, local TV advertising markets in many parts of the UK will need to be developed against a structural trend of high street consolidation and substitution of local with national advertising spend.

The Steering Group believes that local media and local enterprise ownership of local services would promote local advertising as a revenue source, but that local advertising in isolation is unlikely to be sufficient to ensure long-term viability. Other revenue sources will be needed, particularly during a establishment phase during which the local services will need to build both an audience and local advertiser following.

Based on illustrative profit and loss models, using inputs from various industry sources, a network of 10 local TV services, including the national backbone, is likely to have a combined cost base of c.£25m per annum.

The Steering Group believes that the best way to cover a large portion of these costs will be to place an underwritten national advertising sales contract with a third party that already has a significant TV advertising inventory. This would guarantee minimum advertising sales revenue for at least 3 years. If a third party cannot be persuaded to take on the advertising sales, it will fall to the national backbone to do so.

Based on conservative assumptions around target audience sizes, audience shares, and pricing, as well as conversations with national advertising agencies, the Steering Group believes that an illustrative network of 10 local TV services could command an underwritten level of £15m per annum in national advertising, which would serve to underpin the viability of the network, particularly in the start-up phase while local advertising revenues are growing.

This would leave a funding gap of £10 million. The BBC's commitment (subject to certain regulatory requirements) to acquire locally generated news content for up to £5m per annum for three years clearly makes a material contribution to closing this gap, and should help ensure a minimum quality threshold. The remainder may be covered by the local advertising sales efforts of the individual local TV services. The Steering Group has some confidence that local advertising revenues could exceed £5m per annum, especially if local services were helped in this endeavour by the involvement of local media operators. In time, this could eliminate the loss and potentially lead to acceptable levels of profit

Local TV is unlikely to be viable if it is dependent on local advertising revenues alone. The agreement already in place with the BBC will be helpful in both providing an additional source of revenue and ensuring an adequate level of quality. In addition, the Government may need to help facilitate access to national advertising revenue through an existing agency that has a significant existing inventory – for example a national PSB. An underwritten national advertising contract of £15m per annum for at least the first three years will be required to have confidence in commercial viability

Technical Distribution

There are a number of technical options for the distribution of local TV by DTT and spectrum award is a policy matter for Government to determine. Geographic Interleaved (GI) spectrum, which will be fully available after digital switchover, carries with it the lowest opportunity cost, greatest technical ability for localisation, and the ability to transmit multiple services or channels over a single multiplex. However, its coverage is patchy, and over 80 individual transmitters would currently be needed to cover 50% of the UK population; although one contributor did suggest that with some significant engineering this might be enhanced to cover closer to 80%.

National spectrum, which by its nature has the greatest coverage – 98.5% in the case of the PSB multiplexes – has a greater degree of opportunity cost. Localisation potential is less than GI, but certain multiplexes – specifically MUX 1 (owned by BBC) and MUX 2 (owned by ITV and Channel 4) have the capability of transmitting regional variations from multiplexing centres in London and Leeds. Both multiplexes could have availability through optimising or clearing certain services (such as potentially Teletext in the case of MUX 2).

The optimal selection of spectrum may in part be driven by progress in determining the revenue model. National capacity, because of its greater coverage of the UK population, will likely help facilitate access to national advertising. Otherwise, the additional bandwidth and number of channels afforded by GI spectrum would help facilitate local revenue opportunities. It should be noted that the use of national capacity for the core local TV offering would not preclude the use of GI spectrum for additional local services or supplementary commercial services. In fact, maintaining the availability of GI multiplexes for additional local TV offerings, including coverage of smaller conurbations through additional local services potentially as a platform for community TV transmissions, would be desirable.

The Steering Group recommends the Secretary of State discusses technical options with Ofcom. The final decision on technical delivery options should take into account cost, ability to localise, and total population coverage achieved

Ownership

The model for local TV ownership is expected to bear significant influence over the level of interest from existing media companies and potential TV operators, and the longer term prospects for the sector. A number of potential models have been identified and considered by the Steering Group.

As indicated, vital to the success of local TV will be the existence of a national backbone, supporting the local services, providing a hub for shared services, generating national advertising sales (or facilitating the efforts of an external advertising agent) and procuring network content. The backbone provides coherence for the generic concept of local TV. However, the Steering Group believes that the need for a national backbone should not obscure the fact that local services should be at the helm of the local TV sector.

The Steering Group considered, for instance, the possibility of a single national backbone licensee that has significant control over a national network of local TV services, but found this unattractive as it opens up the possibility that the national channel will, overtime, gravitate away from providing local TV to improve the economic prospects of the network and may lead to less interest in participating from existing local media groups.

The involvement of existing local media operators in local services would be beneficial, because of their established news gathering capabilities, their market knowledge and audience relationships and because of opportunities for cross-promotion. Alignment of existing local media operators is likely to help reduce costs through shared resources (for example journalists) and facilitate access to local revenue sources. Full engagement of local media groups is likely to require an ownership of more than 50% in each respective local service, with the remainder of the ownership with local enterprises and the national backbone.

In order to align the interests of all parties and allow the local services to maintain control over the network, the Steering Group believes at least 51% of the national backbone should be owned by the local TV service operators collectively. In turn, the national backbone's minority interest in each local service will facilitate an element of shared interests.

A desirable structure of ownership would recognise that the local TV network should be driven by local services rather than a national backbone. The participation of local media groups and local enterprise should be encouraged through providing sufficient control in local services

Licensing

DCMS and Ofcom have indicated that a licensing process will be needed for local TV. The Steering Group strongly believes that licences should not be allocated on an auction basis. Indeed, if a licence is auctioned, it is unlikely to generate significant revenue and is more likely to lead to financial risk-taking on the part of the participants. Therefore, it would be preferable to award a licence as much as possible on the basis of the quality and sustainability of the local operator's business plan. This is a matter for Government and any option will have implications in terms of opportunity costs and regulatory restrictions.

It is recommended that licences be awarded on the basis of a 'beauty contest' rather than an auction; this should encourage innovation, quality and enhanced level of service rather than financial risk taking

2 INTRODUCTION

The Government's coalition agreement¹ set out a vision of decentralisation, coupled with promotion of a "strong and diverse local media industry". In June 2010, the Secretary of State for Culture, Olympics, Media and Sport stated that "the Government believes in localism and the enormous benefits of fostering local cultural, economic and political identities"². As part of this, the Government is looking to develop a local TV proposition for the UK.

2.1 SCOPE OF THIS STUDY

Nicholas Shott was appointed by the Secretary of State for Culture, Olympics, Media and Sport in June 2010 to undertake an independent study into local TV in the UK. The remit for Nicholas Shott's work was set out in a letter³ that asked him to consider the following:

- What are the conditions necessary in which local television can be commercially viable;
- The scope of revenue opportunities from advertising or other sources;
- Which barriers should be reformed/removed to nurture a new generation of profitable local media companies; and
- How existing industry players might help achieve this.

One of Nicholas Shott's first actions was to appoint a Steering Committee to support his review and provide expert advice as he formulated his findings and recommendations.

The Government believes that there is a void in the media market combined with regulatory failure that has hindered the development of viable local television in the UK. This review was conducted within the wider market context and potential future shape of local media in the UK.

The Government's objectives are that local TV is distributed as widely as possible by Digital Terrestrial Television (DTT) at a minimum and free to the end-user; offering a core local news proposition (i.e. not regional); provided on a commercially sustainable basis; and with relatively light touch regulation (though there will need to be minimum thresholds of quality and content requirements).

Nicholas Shott has considered further key areas including: (1) is local TV technically possible on the DTT platform; (2) can it be done at a low/reasonable cost; and (3) can it generate sustaining revenues? Nicholas Shott and his Steering Committee have striven to address these points in the production of this report. It is clear that each of these questions can be answered in the affirmative in isolation. However, the aim is to identify a construct which affirmatively answers all questions simultaneously in a coherent model.

¹ The Coalition: Our Programme for Government http://www.cabinetoffice.gov.uk/media/409088/pfg_coalition.pdf

² http://www.culture.gov.uk/news/ministers_speeches/7132.aspx

³ REF – Annex 1 Shott Review Remit

2.2 PROCESS AND STRUCTURE

The Steering Committee that supported Nicholas Shott consisted of four individuals with significant experience in media. They were: Claire Enders; Richard Eyre; Baroness Kingsmill; and Brian Linden⁴. The Steering Group (all of the above including Nicholas Shott) was supported by a small secretariat from DCMS.

From June to October 2010, the Steering Group met over 100 individuals, from a variety of backgrounds and sectors, including advertisers, broadcasters, existing and aspirant local media operators, national media, and regulators. These meetings were wide ranging and explored a range of topics which included:

- The TV and media sector context;
- Nature of potential local TV audience demand;
- Potential for attracting commercial sales;
- Distribution, both over DTT and supplementary platforms;
- Experiences of local TV operators and interest groups;
- Perspectives of national TV broadcasters;
- Perspectives of other media groups such as radio and newspapers;
- Perspectives of potential local TV operators.

In addition, the Steering Group reviewed extensive information and data from contributors, some published and some submitted to the group on a commercially confidential basis⁵.

(i) Interim findings

Nicholas Shott wrote to the Secretary of State on 24 September 2010 setting out his interim findings⁶. The Interim Report summarised what the Steering Group had learned through the meetings with interested parties and after examining various data and information that was shared with the group. The findings were also underpinned by the Steering Group's own analysis and scrutiny of the key issues in trying to identify what conditions are necessary for commercially viable local TV to emerge in the UK.

The interim findings suggested that local TV could be viable and sustainable on the following basis:

- Local TV stands a better chance of success in highly populated urban areas;
- Local TV should explore all sources of revenues;

⁴ REF – Annex 2 Steering Committee Biographies

⁵ REF – Annex 3 List of Individuals Met During Course of the Study

⁶ REF – Annex 4 Shott Review Interim Report

- Low production costs should be taken advantage of but not at the expense of quality; indeed high quality programming is essential for local TV longevity;
- News will be the main content driver; and
- Local TV should sit within a wider network structure to improve the national advertising proposition; support a lower overall cost base and deliver sustaining network content.

At the same time, the Interim Report suggested that DTT as a broadcast medium, is currently the best way to reach the majority of the population; however DTT is based on an infrastructure that was not designed for localised content distribution. The Interim Report stated that the Steering Group regards DTT as an interim distribution technology that is likely to give way to new distribution methods, in particular, internet protocol television (IPTV). The prospects for IPTV have since improved, with YouView due to launch in 2011 and the Government's announced plans to roll out super-fast broadband to every community in the UK by 2015.

(ii) Final Report

This Final Report outlines the key issues examined by Nicholas Shott and the Steering Committee in their meetings with interested parties. The key issues expand on those discussed in the Interim Report, including a model of local TV, transmission, revenues and potential PSB involvement. The final chapter sets out the conclusions of the Steering Group, including the necessary conditions for commercially viable local TV; a recommendation for a trial of local TV; and questions the Government will need to consider before local TV can be deemed sustainable.

Whilst the Steering Group is confident that the data and conclusions within this report are as reliable as could be expected, it is clear that this is hypothetical modelling and a change in factors could influence a change in the viability of a local TV model.

2.3 MARKET CONTEXT⁷

Before exploring the viability of local TV, it is necessary to understand the context within which local TV currently operates and could operate in the UK. What is local TV and how does it fit into the wider media landscape?

(i) What is local TV?

Localness is not a function of area size. Ofcom research⁸ shows that the term 'local' is used very differently by people in different parts of the country, and regional identity tends to become more significant the further one travels from London.

Indeed in the nations, for example Wales, 'local' may be taken to mean 'Welsh'. However anecdotal evidence would suggest that residents of West London have little concern with what happens in East London. For others, local may be defined at regional or county level. BBC1 and ITV1 news programmes currently serve this level. The Steering Group was told that local

⁷ REF – Annex 5 Market Context Data

⁸ Local and regional media in the UK (2009), p.19

radio evidence suggests that North Cornwall residents do not find stories about Western Cornwall of interest. As one commentator told the Steering Group ‘English people don’t care what’s happening in the town next door; Scots care about Scotland’. This pattern is evidenced by the preference for ITV regional news services, which achieve audience shares of around 40% in Northern Ireland but a UK average of nearer 20%, with London viewers representing the lowest shares⁹. The reasons for these differences are far from clear, but seem to depend at least partly on differing notions of community and belonging. In the nations of the UK, there is far greater distinct sense of nationhood than in England.

Incumbent news and TV operators therefore suggested that in Scotland for example ‘local’ news should not replace national i.e. Scottish news. STV told the Steering Group that it provides a different service in comparison to the ITV English regions. There does however appear to be scope to improve the distribution of reporting across the nations, as residents are appreciably interested in what is happening both across their nation as a whole and in their neighbouring localities.

It is clear that the definition of ‘localness’ is open to interpretation, and also that regional news is not generally considered to be local. For the purposes of this review, the Steering Group regards ‘local’ to be at city-level or a major conurbation. However, it also regards local as possibly county-level where smaller conurbations collectively form the notion of ‘localness’. This report is principally concerned with commercial viability and therefore the extent of ‘localness’ has to be supported by the extent of commercial sustainability.

(ii) TV and media markets in the UK

The UK’s broadcasting sector has evolved quickly, from what was once a PSB-led BBC/ITV free-to-air duopoly to a multi-channel sector transmitted across multiple platforms. This evolution is expected to continue with digital switchover, continued pay-TV platform growth, and increased usage of non-linear and mobile/internet TV. The proliferation of TV channels over the last 20 years has eroded the share of audience of BBC1 and ITV1. However, the top five viewing shares remain concentrated. These contain a high quality programming schedule, with significant original content that has a mass audience appeal. Supporting this is a fully integrated broadcaster business model, with content production, programming, broadcasting/distribution and (for non-BBC channels) advertising sales teams.

The mass market channels are followed by a long tail of channels with approximately a 1% share each that typically rebroadcast archive content or appeal to a niche interest group. Niche channels have adapted their models for significantly smaller market shares, with targeted programming, and are often affiliated with larger broadcasters. This pattern is demonstrated both on DTT (through Freeview) and satellite and cable platforms (both paid-for). Recent Ofcom data¹⁰ shows that take-up of digital television in UK households is over 92%. Just over 36% of homes receive pay-satellite TV services and 13% receive cable TV. 73% of households utilise DTT (commonly referred to as ‘Freeview’) on primary or secondary sets, while 39% of

⁹ Local and Regional Media in the UK, Ofcom (2009) p.27

¹⁰ <http://stakeholders.ofcom.org.uk/market-data-research/tv-research/dtv/dtu-q2-2010/>

households utilise DTT on their primary sets. The penetration on secondary sets means that DTT is the most broadly used digital platform¹¹.

Newspapers, radio and online media all provide national, regional and local coverage. The Steering Group was advised to take care to understand the ways in which the contemporary media environment is changing. Ofcom noted that national media suppliers are increasingly seeking to move away from local provision, but the local TV initiative could halt that trend. Ofcom research¹² has further noted a trend for media ‘multi-tasking’, whereby individuals carry out more than one media activity at the same time, e.g. watching the television and surfing the web. However, the report emphasises that traditional media such as television is thriving and plays a key role in people’s lives today. This age of multimedia and cross-media usage should be borne in mind when considering the platforms and future of local TV.

(iii) Current provision

Current provision of local (depending on audience definition) TV is mainly through *regional*, rather than *local*, opt-outs whereby viewers are automatically re-directed to regional content at certain times of day. The regional breakdown of BBC is to 18 regions/nations and that of ITV1 is to 13 regions/nations. BBC1 and Channel 3 regional news is also available in the Crown Dependencies (including the Channel Islands and Isle of Man). The opt-outs allow regional variations in the form of short news opt-outs and also the occasional regional-interest programme.

Local media services exist across the UK, already providing local newspapers and local radio stations (see table below), with more limited local TV services. Existing providers could play an important role in delivering a new local TV proposition.

MEDIA¹³ QUANTITY

Print	Around 1,300 regional and local newspapers across the UK.
Radio	325 local commercial radio stations 150+ community radio stations 40 local BBC radio stations in England; 2 national services in Wales; 2 Scottish National Services; and 2 Northern Ireland Services
Television	12 RTSL (restricted television service licence) in force. Includes Northern Visions in Belfast and Midlands Asian TV in Leicester England: BBC1 and ITV1 Wales: BBC1, ITV1 and S4C Scotland: BBC1, STV and Alba Northern Ireland: BBC1, UTV Channel Islands: BBC1 and Channel TV

There have previously been examples of local TV in the UK. Ofcom reported in 2009¹⁴ that some two dozen restricted service licences (RSLs) had been issued for local terrestrial TV

¹¹ <http://stakeholders.ofcom.org.uk/market-data-research/tv-research/dtv/dtu-q2-2010/>

¹² <http://stakeholders.ofcom.org.uk/market-data-research/market-data/communications-market-reports/cmr10/>

¹³ Local and Regional Media in the UK, Ofcom (2009) p.21

services in the UK since 1996, but with limited success. During the 1990s, Channel One was launched as a 24-hour cable news channel for London, involving young journalists reporting local stories. It did not survive, with low audience numbers and few advertisers. Northern Visions NvTv in Belfast is an example of a not-for-profit community TV station which provides a free-to-air, terrestrial community television service in the Belfast area. It also runs a media centre, offering opportunities for people to gain skills, project support and advice and resources for film and television production. NvTv receives funding from various sources, including the Department of Culture, Arts and Leisure as well as the Local Authority. They see local TV as very much an opportunity to promote active citizenship; encourage community participation and promote diversity. Another example of community interest television is that of Channel 7 TV, which is aimed at those living in North and North East Lincolnshire. It is part-funded by the lottery as well as receiving advertising revenues.

Channel M is possibly the best known example of an ambitious local station, which broadcast programming of high quality. It provided news (in conjunction with the Manchester Evening News); and magazine-style shows and entertainment. There was difficulty in attracting national advertising – due in part to the absence of a suitable audience measurement system, and consequently the majority of Channel M’s advertising was local. Channel M was loss-making, but is re-launching in May 2011 adopting a new business model.

The local press – both newspapers and radio – plays an important role in providing local news and information. Whilst local press is facing its own structural challenges, there is no doubt that it performs a service appreciated by many. Ofcom research¹⁵ indicates that people value the role of local and regional news provision, with almost four-fifths of adults believing that local news makes them feel in touch with their local community. The lack of local TV, and its associated additional source of local information, is therefore seen by some as a void in the current local media market – though some contributors preferred to see this as ‘an opportunity’.

(iv) International comparisons

The Steering Group wanted to understand how the local TV markets operate in other countries. Ofcom has produced snapshots containing a range of data on local provision in other countries¹⁶. The comparative table¹⁷ shows that the UK has a very different system to other countries technically as the history of broadcasting in the UK is quite different to that of other countries. In Europe, Government subsidies play a big role. In North America, television is primarily delivered through cable networks, which allows a different and low cost technical solution to that available in the UK. Geographically, the large size of the USA and Canada has a large influence on television viewing and the advertising markets. Larger distances mean that people tend to buy and transact in their local areas. These large urban markets provide significant local advertising potential and this is a key feature that is not consistent with the UK’s

¹⁴ Local and Regional Media in the UK (2009)

¹⁵ Local and Regional Media in the UK (2009) p.74

¹⁶ Case studies on local and regional media outside the UK <http://stakeholders.ofcom.org.uk/binaries/research/tv-research/international.pdf>

¹⁷ Annex 6 Comparisons to Other Countries

TV advertising market¹⁸. Further, carriers' licences in North America require carriage of local TV stations as a public service.

Many other European countries have a similar DTT structure to the UK for the provision of regional TV. However, in the example of France, this is a highly subsidised system with significant public and private funding. There appear to be clear market-based and infrastructure elements that have been key to enabling local TV in other countries which are not prevalent in the UK. It is perhaps for these reasons why Ofcom noted¹⁹ that local television in the UK simply does not have the historic prominence it has in other countries. Indeed, Ofcom states that local TV has "barely taken off" in the UK.

(v) What is the demand for local TV?

Ofcom research²⁰ indicates that nine out of 10 UK adults regularly consume some form of local news, information or other content through television, radio, newspapers or the internet. Consumers and citizens value the role local and regional content plays in their lives. Further, Ofcom notes that local and regional news in particular helps to inform people about what is going on in their local community, whilst news and other types of local content can contribute towards reflecting UK cultural identity and representing diversity and alternative viewpoints. The research explains that local TV services are seen as important by audiences, with 79% of people rating local news stories and 74% rating local weather as 'important' types of media. Further, 41% of those asked chose local TV in their top two options of possible new uses for spectrum, ahead of HD services, improved mobile phone coverage and mobile broadband.

Ofcom research shows that television remains the main source of news about what is going on in the local area²¹, even though the news they are receiving is principally regional. Additional research shows that more people feel attached to their city/town/village (75%) than they do to their region (56%)²². The same research also suggests that the majority of the population would be interested in watching TV programmes reflecting their cities/towns/villages over any other geographic area coverage²³.

Fundamentally, individuals are interested in their local areas. However, a note of caution would suggest that just because people have identified this in a survey, it does not necessarily translate that local TV will prove more attractive for them than the large range of choice available from existing – or other new – TV channels. Prudence is needed in assuming that there will be a ready audience for local TV in the UK. This is further discussed in the 'Content and programming' section (3.1).

(vi) Expected shift to the Internet

Incumbent and prospective TV and news operators were keen to note that the advent of IPTV will provide a significant boost for the prospects for local TV. The new technology will allow for localisation of content, easier audience measurement, and a stronger local advertising model.

¹⁸ Local and Regional Media in the UK (2009) p.104

¹⁹ Local and regional media in the UK (2009) p.104

²⁰ Local and regional media in the UK (2009) p.3

²¹ Ofcom Communication Survey, 2007

²² Ofcom: Digital Local: Options for the future of local video content and interactive services, page 20

²³ Ofcom: Digital Local: Options for the future of local video content and interactive services, page 21

It will also offer significantly reduced costs for operators as transmission costs diminish. Indeed, there are already a number of web-based community services, a number of which are created by local newspaper businesses chasing their readers online. For example, the Johnston Press website links to over 1,000 individual sites, active with local interest. Some contributors were of the view that launching local TV on DTT would not be sensible, given the expected growth of IPTV, where in time, local services could focus on smaller localities and be delivered at a lower cost.

However, a number of those met by the Steering Group did note that local TV could succeed on DTT when viewed as a *transitional* platform. Immediate distribution by DTT would give time to establish a brand confidence in local content, in advance of its eventual transfer to IPTV, once it becomes the primary distribution platform. This brand, though, could only be built if there are high quality standards underpinning the production of local TV and the content was professional, compelling, immediate and relevant. It was also noted that IPTV may take a number of years to fully develop within the UK, and the typical local news market demographic – typically older – is less likely to have access to, and slower uptake of, new (internet) technology. Distribution by DTT is therefore even more necessary and relevant. But, this does not mean that local TV can be developed in isolation without consideration of an online presence or of its future on IPTV. Local TV distributed by DTT could help to pave the way to IPTV, by establishing what works and building a viable and sustainable model.

(vii) [UK media advertising market context](#)

UK advertising spend available for commercially funded local media has diminished due to the rise of the internet, consolidation of the high street on the national level, and heightened competition. Local advertisers have declined in number and overall spend and the wider UK media market suffered from early cycle impact of the recession. There has been a clear shift of advertising to the internet, with online advertising developing as an alternative to traditional media. This trend – and the impact of local TV revenues – is further considered in the ‘Revenue: advertising and sponsorship’ section (3.6).

3 KEY THEMES

This chapter outlines the key areas that the Steering Group explored during its meetings with interested parties as part of the review process.

3.1 CONTENT AND PROGRAMMING

The Steering Group heard that local TV may provide public service content and as a consequence have some form of PSB (public service broadcaster) status, in order to acquire the associated benefits such as spectrum allocation and EPG prominence. However, contributors were clear that local TV could not – and should not – attempt to compete directly with the BBC and ITV. While local services would have potentially greater relevance to local populations, the sheer scale and ability to invest in mass market content of the major PSBs is unlikely to be replicated at a local level. However, local TV could offer a unique product which is not offered by the BBC and ITV. Local TV stands a good chance of capitalising on this individuality, but to do so, must place quality programming at its heart.

(i) The audience

In order to understand the programming and content needs of local TV, it is important to understand the audience. There is already information available on those who currently watch regional TV. Ofcom research²⁴ indicates that regular viewers of regional TV news tend to be older than the population as a whole. Further, in ITV's experience, regional news viewers tend to be of a lower socio economic group. It is reasonable to assume that a similar demographic would be attracted to local TV, though it would not be unacceptable to suggest that local TV could aim to reach a wider audience.

Distributors explained to the Steering Group that local TV is likely to have relatively low viewing figures (compared to very large broadcasters). This is because local TV is by virtue targeted to smaller populations than a nationwide broadcast service and unlikely to have the big programming budgets of other channels which drive the content and therefore the viewership.

However, other contributors told the Steering Group that niche content and content that has particular relevance to a particular locality would have extensive appeal. For example, the Steering Group heard that of its 1.2m addressable audience, Channel M reached 300,000 viewers per week, with peak viewing for the local news which is a considerable achievement given its position in the EPG.

²⁴ Local and regional media in the UK (2009) p.50

(ii) Content

If local TV is to succeed, the Steering Group believes that it will need to provide a compelling offer for its viewers. Ofcom research²⁵ indicates that the aspects of local TV most sought by viewers are local news, weather and local sport. Viewers think it is important that local news providers are ‘on the front foot’ covering breaking news and a range of stories. Other elements such as weather, travel and event listings are also important, though already available from a range of sources, including the internet.

A number of TV distributors told the Steering Group that it was important for local content to extend beyond local news and that local TV should offer a community service, covering local events, sports, and webcams. The local TV channel will also have to offer enough new material so that the audience will come back for more; although this must be balanced with the costs of producing original content.

One media strategist suggested that local TV content should be *adapted on a case by case basis to provide something that is distinct and fulfils unfilled demand*. Existing television providers told the Steering Group that viewers in different parts of the country have different appetites for content, with the emphasis on ‘hard news’ for example as being particularly attractive to a London audience. This need for different types of service should be at the heart of local provision, allowing differentiation of content by locality.

Quality of content, whether it is for a local or a national audience, was identified by many who met the Steering Group as one of the most significant factors for commercially viable television. TV distributors in particular noted that any new local TV content would need to be of quality for commercial as well as public interest reasons. On DTT, local TV services must stand alongside very high production values, expensively collected news and high investment in presenters. It was further noted that user-generated content is useful only occasionally to support news stories and other small pieces; it is not good enough to rely on regularly. There remains a perception among many existing media players that local TV equates to poor quality content and a ‘home video feel’. It is not to say that such content does not have a place, but the Steering Group believes that any viable local TV proposition will require high production standards in order to compete in a multi-channel world.

It was suggested by some that the requirement for impartiality of TV news provision is an impediment to local news providers. The impartiality threshold exists to uphold the standards of news reporting on television as the most trusted medium for news in the UK. However, impartiality requires very careful compliance measures. This kind of compliance is not necessary in non-broadcast media and there is an argument that a more relaxed compliance regime for local news could free up scope and coverage of stories and investigations and as a result contribute to local TV’s bottom line and uniqueness of output. Whilst removal or relaxation of the impartiality rules may make life easier for local TV producers, the Steering Group did not hear a convincing argument that the requirement for impartiality adds significantly to the cost of supply.

²⁵ Local and Regional Media in the UK, Ofcom (2009) p.74

Incumbent local TV and news operators told the Steering Group about the importance of understanding viewing habits and how these relate to TV schedules. Breakfast television tends to run from 6am to approximately 9.25am, with audiences slipping from 8.30am, when drive time radio peaks (i.e. when many people are travelling to work or school). The Steering Group heard that engagement with television in the morning is significantly different to evening viewing. Morning viewing is very fragmented with people only seeing parts of shows and adverts, whereas evening and prime time viewing can be an appointment to watch with viewers watching for longer periods and wanting to be entertained. Daytime TV tends to have a much smaller audience and consequently is harder to monetise. The TV peak viewing slot is from 6pm – 10:30pm. This would suggest that local TV should seek to broadcast at the times of highest audience viewing. It was further noted, however, that local TV shown at peak time on any platform / channel would be in direct competition with the general prime time entertainment offerings on the multitude of other channels. As a result it is likely that local TV would have a small share of the possible audience. Consideration will be needed of how to balance these factors, perhaps showing repeats of key local news broadcasts throughout the day to capture the largest possible total audience.

(iii) Programming

Unless local content is looped on a 24 hour repeat, local TV operators and Ofcom suggested that local content was unlikely to make up the whole of the channel schedule as there would simply not be enough available material. The schedule could therefore be split into local and non-local parts. It was suggested that the non-local airtime could be sold to the highest bidder, or filled with network content provided in another way, for example through partnership with an existing network provider. The Steering Group was warned that a local TV channel should not be too broad, as it will then not fully reflect its local remit or be sufficiently distinguishable from other network channels. One suggestion was that other public service material which is disappearing from competitive programme schedules could be corralled into the local TV service, such as arts, religion, education, and minority sports. However, while this may not initially appear to be a particularly viable channel offer, it would make the channel of particular interest to different groups at different times of day.

In the Interim Report, the Steering Group suggested that local TV businesses should be thought more as local TV ‘services’ than local TV ‘channels’. Rather than being expected to produce a full schedule of programming, local service operations could feed into a shared national schedule of programming referred to as a national backbone.

(iv) Nations

During the course of the review, the Steering Group met a number of individuals from the UK’s nations. With members of his Steering Committee, Nicholas Shott undertook visits to Scotland, Wales and Northern Ireland to speak to individuals representing the regulatory, media and political institutions in those nations.

A number of issues were raised. The most consistent theme was that the nations are distinct from the rest of the UK. Each nation has a slightly different media heritage and nations-based

regional and local media differs considerably. However, a common theme was that there was insufficient content about the nation or specifically for the nation reflected on-screen.

Scotland is well served by the local and national press. In contrast, Wales has a very limited local press and the UK's national newspapers do not provide a Welsh edition unlike in Scotland. In Northern Ireland, the Steering Group heard about the importance of news to citizens where the Troubles have contributed to a huge appetite for news and information. UTV consequently has the highest audience share among the Channel 3 licences.

Equally, devolution brings with it its own specific democratic processes and it is widely seen that an effective local press that can hold the political institutions to account is an essential part of this process. Many of the interested parties the Steering Group spoke to emphasised that a solution for local TV in the nations may well encompass a whole-nation approach as opposed to trying to create a number of individual local services within a single nation.

Members of the Steering Group were told about the Scottish elections happening in 2011 which will be covered through televised regional news and information programmes. The Steering Group heard that a significant part of the population in southern Scotland will not receive the same coverage as those living elsewhere in the nation because the area's main commercial regional news is provided by ITV in the Borders Tyne Tees region.

Nicholas Shott met Fiona Hyslop MSP, the Scottish Minister for Culture and External Affairs. The Scottish Government had asked Blair Jenkins to lead an independent panel of experts which will investigate options for establishing and funding a new Scottish Digital Network (SDN) providing public service broadcasting.

Separately, the Steering Group heard from community television representatives including ULTV and the Institute of Local Television. Arguments were put forward that a new seventh multiplex could be created in Scotland using interleaved spectrum given the relative abundance of spectrum available. Other arguments supported the delivery of community based local television or a so called 'local national' proposition that is very much a bottom up approach to creating local TV services within small communities and working with local authorities, universities and other education institutions and other civic and community groups.

In Northern Ireland, the Steering Group review team visited NvTv to see how a community television station functioned. This was largely supported through volunteers and public subsidy to produce content about communities in Northern Ireland addressing a very wide range of issues and subject material. In Wales, the Steering Group heard from several individuals who explained that Welsh news was fundamentally important to the people of Wales. It was emphasised that any local TV proposition should not undermine the reach of TV news for the whole of Wales. One comment was that Wales is very 'local' but it is also a nation that could be better served as a whole.

While the Steering Group believes that local TV will only be commercially viable in larger conurbations, the Steering Group recognises that the nations have far smaller conurbations than in many other parts of the UK. At the same time, the nations see themselves with a certain

degree of autonomy politically and geographically. Any award process for local TV will need to take these considerations into account.

3.2 DTT TRANSMISSION

A critical component of the viability of local TV is the transmission and technical feasibility that underpins the local services. The Steering Group had extensive discussions with Ofcom and others during the review to understand the different options that are available for the carriage and transmission of local TV services.

The Secretary of State's focus has been on local TV distributed by DTT in order to be available to the majority of homes on a free-to-air basis. The Steering Group has also considered carriage on pay platforms and the various technical means and costs associated with all the technical options as far as this information has been made available. Ofcom has provided extremely valuable data and information during the review which provided extensive information for the Steering Group.

Ofcom's research document on the technical options for delivering Local TV²⁶ has provided a sound basis to assess the pros and cons associated with each option. DTT is undoubtedly a good way to reach large audiences (Freeview has a penetration of 73% of households on the basis of primary and secondary sets and transmission coverage of up to 98.5%). However, terrestrial transmitters built over 50 years ago pose inherent constraints and were not designed to broadcast to specific communities or localities. Indeed, some conurbations adjacent to each other in the North of England are covered by the same transmitter. For example Manchester and Liverpool share the Winter Hill transmitter. The two cities are clearly distinct from the other and therefore a solution to this transmitter problem would need to be considered for any local TV offering in these conurbations. Even if two distinct channels are transmitted over the same multiplex, they would compete for each other for the EPG slot that would ideally be designated nationally for local TV. Ofcom explained to the Steering Group that one option could be to timeshare the signal. Essentially, this means that each city sharing a transmitter receives the same local programming but at different times of the day.

DTT does not, therefore, naturally lend itself to local TV purposes. Technically, DTT will require further engineering solutions (with potentially expensive capital and investment costs) to produce even a reasonable patchwork of local TV coverage. Because different distribution methods have different costs and audience capabilities, the ultimate decision on which distribution option to use will affect the scale of audience and the shape of local services across the country.

A consequence of digital switchover (DSO) is the release of spectrum. The move to DTT will free up this 'digital dividend', some of which could be used for the broadcast of local TV. These technical options were explored in Ofcom's technical paper²⁷. The Steering Group is not

²⁶ http://stakeholders.ofcom.org.uk/binaries/broadcast/tv-ops/Local_TV_FINAL.pdf

²⁷ Technical delivery options for local television services in the UK (2010)

http://stakeholders.ofcom.org.uk/binaries/broadcast/tv-ops/Local_TV_FINAL.pdf

recommending a particular technical option as it does not feel able to fully determine the merits of one option over another or the availability of certain components of spectrum. There are many considerations for the Government on which option it may choose and these arguments have been articulated in Ofcom's analysis. For the sake of completeness, the options are reiterated here and some comments the Steering Group heard through its review are included.

Spectrum options therefore include:

- Geographic Interleaved (GI) spectrum with up to 50% reach; or
- New network using 600MHz band on DTT reaching around 90% coverage.

And there are possibilities for local TV to be carried on the existing TV multiplexes via:

- Using an existing PSB channel which would involve localised variations; or
- A new DTT stream on a PSB or Commercial Multiplex.

(i) Geographic Interleaved Spectrum

A number of prospective TV operators suggested that GI spectrum could be a solution to the need to broadcast at a local scale. New transmitters could be installed at existing transmitter sites serving the target locations, each broadcasting on a local GI multiplex using any suitable interleaved frequency available at that transmitting station. An advantage of GI spectrum is that it can be targeted towards specific areas. Additionally, a local GI multiplex has the bandwidth to carry a number of services (multiple TV channels as well as radio or data), which could present the local multiplex operator with the opportunity to either transmit multiple channels aimed at different population conurbations covered by a particular transmitter, or to share transmission costs by leasing multiplex capacity to other service providers. However, additional bandwidth can come at the expense of coverage.

Some GI spectrum is available now and the costs to transmit via GI are relatively low in comparison to other options. The Steering Group understands that the costs associated with the build and operation of new multiplexes is the lowest of the technical options.

However, there are some issues associated with the use of GI spectrum. Local services from individual transmitter sites will not fully match the reach of the existing DTT services at any particular site, and may be very limited in some areas. GI spectrum therefore has some significant transmission blackspots, for example Bristol and Leeds²⁸. Further, although GI coverage is usually given as 50%, the Steering Group was told by one contributor that this could be increased to nearer 80% using compression technology and engineering. This could make for a significantly more attractive proposition in terms of coverage and therefore national advertising, but remains subject to understanding more of what this compression technology involves.

Ofcom also explained that some GI transmissions originating in the South of England could be receivable in parts of continental Europe. Therefore, to ensure that interference within the UK

²⁸ Ofcom noted that Bristol and Leeds were not suited to GI based on work previously carried out. However, these areas may be able to be served by GI if this was the specific aim of local TV. This would require further examination and reconsideration of GI coverage.

is avoided, the availability of GI spectrum is more limited in the south than other parts of the UK and this spectrum is subject to negotiations at European-level to settle the boundaries as analogue switch-off across Europe occurs. The more limited GI coverage is, the more it likely means lower audience reach with consequent diminution of advertising revenues.

(ii) 600 MHz Band

Channels 31 to 37 will be cleared across the UK as a result of switchover; these are referred to as the 600MHz band. These could provide two to three new UK-wide DTT networks whose coverage would be similar to that achieved by the three existing commercial multiplexes. One or more slots within the multiplex could then be used to carry local television services.

Given the scope of carriage using this spectrum, the Steering Group understands that this is a valuable commodity for use beyond local TV purposes. Reserving any of this spectrum for local TV would carry significant - and in the Steering Group's view disproportionately high - opportunity costs for the Government, as it is likely that a number of buyers would be interested in acquiring the spectrum for other uses (such as using it to provide HD services). This would raise a significant bid price that the Exchequer would receive. An open auction of the 600MHz band is likely to mean that prospective local TV operators are unlikely to be able to effectively compete on the open market. While the Steering Group sees that this spectrum would be suitable for local TV purposes, the Government has had to balance its priorities for maximising exchequer revenues and delivering local TV. The Steering Group agrees with the Government's decision that the opportunity costs are too high for this to be a viable proposal.

(iii) [Public service broadcaster multiplex](#)

The PSB multiplexes offer an extensive network, covering some 98.5% of UK households which would allow the best opportunity for national advertising sales. A capacity slot secured by local TV services could be broadcast from transmitters in the areas of interest. This would be straightforward if the pattern of local services matches the regionality of the host multiplex (i.e. covers the same areas as the BBC or ITV services) otherwise engineering work is required to further 'regionalise' the multiplex. An alternative approach - which is likely to incur lower costs - is the 'add/drop' technique, whereby local programming is inserted directly at individual transmitter sites, using dedicated equipment. Either method will require complicated moderation of technical arrangements of the PSB multiplex, requiring significant capital investment.

It seems possible that ITV/Channel 4's multiplex (known as MUX 2 or D3/4) has room for another channel. Currently, ITV has 48.5% of the capacity, Channel 4 has 48.5% and 3% is being used by Teletext which no longer provides services and is likely to be phased out (subject to decisions to be taken on its future). Potentially using the capacity allocated to Teletext, along with some optimisation to the whole multiplex, it seems possible that enough space could be created for another channel (a 'ninth video stream'). Similarly, the BBC's multiplex (known as MUX 1) may have room for an additional channel using similar compression technology.

The Steering Group believes that local services carried in a national multiplex could be of significant benefit to a commercially viable local TV proposition due to its improved coverage of

the UK population compared with GI spectrum. This option presents lower opportunity cost in terms of Exchequer revenues to the Government but delivering a local TV proposition on a PSB multiplex will require capital investment and agreement with the multiplex owner. It would also be helpful for the local TV proposition to have some form of PSB status in order to justifiably sit within a PSB multiplex. The timescales of this kind of work are uncertain. If the re-engineering cannot happen before 2012, which is the Government's target to license local services, then alternative technological solutions might need to be found. Further consideration of this will be needed by Government and in discussion with the relevant parties.

(iv) Commercial multiplex (Com Mux)

The commercial multiplexes are broadcast from 80 of the UK's principal transmitters. Post-DSO, the commercial multiplexes will achieve coverage of up to 90% of UK households (less than the 98.5% offered by PSB Mux but still significant). Spare capacity on the existing multiplex is not freely available, but it is understood that some space may be available for one local TV channel. Space on the multiplex is highly valued and sought after and the market value of slots in the Com Mux is high (to the order of several million pounds). A key risk associated therefore with using a Com Mux is that a local service would have to pay a high market rate for its capacity. Further, a UK-wide service may need to be displaced to accommodate the local service. Even if the additional capacity released at switchover could be used for a local service, this would mean the Mux operator would be unable to launch a valuable additional UK-wide service in that capacity. TV distributors noted at meetings that this would have a large opportunity cost for the incumbent channel operator.

The commercial multiplexes also only feature very limited regionality. Additional technical equipment would therefore need to be added to the commercial multiplex networks to permit them to carry local TV services. This could be achieved through add/drop or by providing a few centralised multiplexing centres to assemble the different regional variants. Any method of inserting programmes in the commercial multiplexes is likely to involve a costly upgrade of their existing infrastructure. Add/drops into commercial multiplexes are largely untested.

Prima facie, it seems sensible to rule out the 600Mhz on opportunity cost grounds. Both GI spectrum and carriage on a national multiplex offer possibilities for local TV. However, there are significant issues of a technical nature to consider as well as timescales that are beyond the scope of the report. The Steering Group recommends the Secretary of State discusses technical options with Ofcom. The final decision on technical delivery options should take into account cost, ability to localise, and total population coverage achieved.

3.3 DELIVERY ON ADDITIONAL PLATFORMS

As stipulated by the Secretary of State's brief for this report, the Steering Group has focused on the feasibility and conditions needed for local TV to be viable over DTT. Distribution of local TV by DTT has been viewed as a minimum, but could also be extended to satellite and cable platforms in order to increase audience share. Sky and FreeSat now have penetrated

approximately 11 million households and Virgin Media is in 3 million households. Together these represent over 50% of all UK households. TV Distributors noted the importance of ‘first set’ viewing. A home with satellite or cable television will typically use this platform almost exclusively on the first/main set, although with subsequent sets (e.g. in other rooms in the home), the proportion of DTT viewing does grow sharply. DTT is the primary viewing platform in 39% of all UK households. However, taking into account secondary TV sets, 73% of UK households use DTT equipment²⁹.

Whilst it was understood that carriage on satellite and cable would increase viewing figures, it was also recognised that this could disproportionately increase costs. The operators group suggested that small-scale channels are unlikely to have the option of carriage on satellite due to current high prices associated with EPG positions and required technology. Further, they felt that the penetration of DTT in 2nd and 3rd sets at satellite/cable homes could provide a sufficient business model without satellite use.

Some contributors did question whether satellite and cable operators could be forced to carry local TV through ‘Must Carry’ obligations. However, it was pointed out to the Steering Group that ‘Must Carry’ does not equal ‘Carriage for Free’. Sky TV does carry some channels for free, but this tends to be if those are offered exclusively to Sky.

Whilst having universality and platform neutrality would be the ideal, there are a significant number of reasons as to why this may not be practical. Distribution via DTT should provide enough coverage to make a sustainable local TV proposition, but of course carriage on other platforms would strengthen the commercial viability.

3.4 AUDIENCE PROMOTION

In order for local TV to be commercially viable, it needs to attract a significant audience. Whilst quality of content and appropriate spectrum choice – as described above – will be important, there are some additional methods which could boost audience levels. These types of promotion of viewer numbers will be particularly important during the ‘start-up’ phase as a means of expediting the growth of a local TV audience following.

(i) EPG prominence

Obtaining high Electronic Programme Guide (EPG) prominence for local TV would provide a nationally recognised location for local services. Behind this one high channel number is a range of services, which vary by – and are tailored to – locality. This is the vision as set out previously by the Secretary of State³⁰. Local TV operators backed this view and stated that high EPG positioning would make local TV immediately visible to a much larger number of viewers who tend to view channels higher on the EPG. The Steering Group strongly agrees that a prominent EPG position will be beneficial for local TV and should be considered seriously. It is

²⁹ <http://stakeholders.ofcom.org.uk/market-data-research/tv-research/dtv/dtu-q2-2010/>

³⁰ Speech to Royal Television Society conference http://www.culture.gov.uk/news/ministers_speeches/7447.aspx

understood that this will not be simple to achieve, but could make a noticeable difference to the success of local TV in attracting audiences.

It should be noted that high EPG is not a guarantee of success. Operators stated that viewers will not spend time with a service that does not earn their respect and interest. No matter where it sits on the EPG, a local TV channel will be exposed to tough, existing competition from the mixed schedule of new and proven material provided by comparatively sumptuously funded broadcasters.

While EPG prominence is likely to help commercial viability, the actual value of this is very difficult to quantify. The Steering Group also understands that regulation of the EPG is relatively light-touch and that Government will need to consider how it can best enable such prominence in this context.

Prospective operators also noted that consideration would be needed of EPG positioning once local TV is available via IPTV. TV distributors added that IPTV will have almost limitless capacity and therefore, a potential challenge for local TV will be to achieve prominence and profile on IPTV. This confirms the importance of local TV establishing itself and its 'brand' on DTT, before a move onto IPTV. This will give it the prominence it needs to compete with the myriad other TV stations.

(ii) Piggybacking

Piggybacking is an automatic re-directioning system which takes the viewer from a host national channel straight to their local TV service. The user can refuse to be redirected by using the red button. At a meeting with media strategists, the Steering Group asked whether a local TV service could be inserted into an existing national channel in order to capitalise on an existing audience base. Attendees suggested this was possible, although engineering would be needed in order to make it technically feasible. Such a model is likely to be viable only if local TV is broadcast on a national multiplex (i.e. MUX 1 or MUX 2) in order to avoid viewers being transferred to areas where there was no coverage by the local service transmitter which may result in a blank screen.

(iii) On-screen prompts

An alternative to being directly housed within an existing channel is for viewers to choose to view local TV by using the 'red button' function to transfer from another channel. A pop-up at the end of the national news segment or indeed throughout the day could indicate to viewers that they can access their local news (if applicable) by switching to whichever channel is hosting local TV. The existing channel could also run a short clip from the local news to show what is on offer. However, recent studies by the BBC have suggested that red button usage is far less prevalent than expected, which means that the value of this technique would be limited.

(iv) Insertion

Much like BBC1 and ITV1 regional news, insertion would involve local content being included as a regional variation within a host national channel's schedule. For this to be viable, the host

channel would need to be on a national multiplex with a regional variation capability. Currently, the PSB multiplexes are capable of regional variations.

TV Distributors spoken to by the Steering Group suggested that cross-promotion on other channels / media was vital for local TV. Business providers considered this to be as important as any financial or technical assistance to the success of local TV.

(v) [Ofcom's initial thoughts on the interaction between a national backbone and local services](#)

Ofcom set out some initial thoughts on how a national backbone and local services might interact, as follows:

- The red button model / piggybacking. A host channel on national spectrum links through to local GI spectrum using a red button. In regions where local services are not present, there is no link-few option for consumers. The local service likely has a low EPG position compared with the host national channel on which it relies for audience inheritance.
- The local prominence model. Simulcast national channel content is carried on local GI spectrum, with local content being inserted during certain parts of the day. Here, a high EPG position for the local channel carried on GI spectrum is more important.
- The insertion (non-GI) model. Local content is inserted into the schedule as a regional variation within a host national channel. This may be accompanied by a separate full schedule of local TV on GI spectrum for each area where there is a local service, enabling more local content. The local services are likely to rely on the host national channel's EPG prominence.
- Local GI only model. Local TV is broadcast over GI spectrum relying on high EPG prominence but no 'promotion' or audience inheritance from a national channel. In regions where no local services are present, there would be no local TV content filling the designated EPG position

The potential audience reach of these four options is highlighted in Annex 7 Ofcom's Initial Thoughts on the Interaction between a National Backbone and Local Services. The Steering Group suggests that facilitating a delivery method that maximises audience reach will be vital to ensuring the viability of local TV. However, the optimal technical option for delivery is likely to depend on aspects highlighted such as the ability to secure EPG prominence, the availability national spectrum on an appropriate multiplex, and the willingness of a suitably strong host channel to participate.

3.5 COSTS FOR LOCAL TV

During conversations with local TV providers and those involved in the wider media world, the Steering Group has gained an understanding of the potential costs of a local TV proposition. It

is not the intention of the Steering Group to provide too much detail here as a significant amount of the information is commercially sensitive. However, a top-line indication is given.

TV stations have significant fixed costs associated with programming, transmission and administration. The cost of producing content of sufficient quality to attract and retain an audience vis-a-vis other well-funded national TV channels further increases this cost. The inhibitive nature of costs mean that it is likely that only the largest population conurbations or major cities have a chance of supporting local TV³¹.

The costs associated with local TV can be separated into direct and indirect:

DIRECT COSTS:	INDIRECT COSTS:
Local content: journalists, presenters and production staff and other costs directly attributable to original content production	Advertising sales: local advertising particularly will require a sales team in-house
Network content: primarily likely to be acquisition of catalogue content to fill schedule	Broadcast support: to provide technical and IT assistance
Transmission: Costs to uplink the content to broadcast	Marketing: for promotional activities to drive audience capture
	Administration: Management, accounting/finance, etc
	Establishment: Rent, utilities, etc
	Depreciation reflecting the amortisation of initial spend on capital items

The Steering Group has calculated that operational (direct and indirect) costs for local TV stand at approximately £25m for an illustrative 10 station network. Broadly, the cost base assumptions have been split into costs that might be incurred at the 'local service' level and separately the 'national backbone' level.

The primary cost incurred by local services is the direct cost of producing local content – which includes salaries of presenters video journalists and production staff, and expenses directly attributable to creating programming. The Steering Group believe that a reasonable level of quality is important, and have therefore assumed direct costs of £1,500 per hour for production costs, incurred for an average of 14 hours per week. This aggregates to £1.1m per year for each local service, and £11m across a network of 10 local TV services. The Steering Group noted novel techniques for creating relevant 'automated content' during meetings with operators. Automated content includes text-based local news and information, imagery, weather and music which can be of relevance to local audiences and may be used to fill less important times within a schedule for limited cost. The level of local content in each conurbation is likely to need to be optimised based on the size of the respective markets, and the roll-out of low cost techniques may eventually make it viable for much smaller conurbations to participate within a local TV network.

Additional 'indirect' local service costs are likely to include local advertising sales, marketing and promotion activities, transmission (which is somewhat dependent on the spectrum selected), and

³¹ Annex 8 Illustrative Candidate Conurbations Identified by Ofcom

establishment costs. For relatively low cost operations these have been estimated to be £0.5m per conurbation, which would bring the full cost of operating an illustrative local service to approximately £1.6m per year, and the fully-loaded cost per hour of original content to £2,200. However, the incremental ‘indirect’ component of costs may be heavily influenced by the degree of involvement of existing local media and local enterprise groups. In conducting an independent assessment of costs, the Steering Group has drawn some comfort from the assumptions related to local services being similar to those used within Roger Parry’s 2009 report recommending the creation of ‘local media companies’.

Under the construct proposed by the Steering Group, a national backbone in place to fill a schedule around local services would be responsible for national content, some aspects of network management, and facilitating national advertising sales. The national use of local content would help balance the overall identity of the local TV offering. National backbone content may include some original content of national relevance created by the local services (which may also form another funding stream into the local services), for example related to local competitions or entertainment that is not currently covered by other national broadcasters and provides the local TV network with a differentiated proposition. National syndicated / re-broadcast content, such as general entertainment, documentaries and films is also assumed to be an important part of the national content mix.

Including network administration, programming and broadcasting costs, the Steering Group has estimated the cost of operating the national backbone as being £9m, the majority of which is related to nationally broadcast content that is shared between the local services. The optimal expenditure on national content is likely to be a function of the size of the addressable audience and geographic coverage (usage of local versus national spectrum).

3.6 REVENUE: ADVERTISING AND SPONSORSHIP

In order to balance the above costs, local TV will need sufficient and sustainable revenues. Incumbent regional TV and media operators suggested that the public would not pay directly for local TV – i.e. through subscription services, and that funding through advertising would be an important part of local TV revenue. Advertising has historically offered the revenues necessary for many commercial television services to be financially viable. Further, current advertisers brought the Steering Group’s attention to the fact that 40-50 channels both commence and cease broadcasting on Sky each year, illustrating that if demand from audiences and advertisers is not present, channels do not survive.

Prospective local TV broadcasters suggested that by broadcasting for 12 or 24 hours per day rather than only at certain times of day, local TV services would be able to bring in more, although still comparatively low, advertising revenues. A discussion with TV Distributors suggested that a model with 2-5 hours of local programming fragmented throughout the day would need a critical addressable audience of 800,000 households per area. The critical mass for advertisers in this scenario would be some 40,000 households, based on challenging viewing

figures of 5%. Similarly, Local TV operators suggested that the minimum viable audience for local TV would be 100,000 viewers. As a part of understanding the potential audience reach, consideration has to be made of both the local and national markets.

(i) Local advertising

The Steering Group was told that a key factor in the demise of the local 'Channel One' in London was that sufficient local advertising could not be attracted. Local advertisers could offer a way for local TV to gain revenue whilst also offering a unique selling point indicating the local remit. Some prospective local TV producers thought that local businesses would be keen to advertise on local TV, including restaurants, pubs and shopping centres.

However, during discussions it became clear that this was a view expressed by the few rather than the many. Local advertisers using the platform are likely to be relatively small companies and consequently will not have large advertising budgets. It was also argued that these local companies are likely to perceive their needs are met already by the internet, or through their habitual subscription to the local Yellow Pages. The recent and continuing shift of classifieds to online is seen as a one-way shift. Volumes of local advertising revenues have been in decline over the last five years³². The internet is a fierce competitor, offering cheaper ways of advertising and an ability to reach a wide range of customers often in a targeted way. During discussions with incumbent local and national TV and news operators, it was noted that these independent local traders (i.e. those which would advertise on local TV) are being replaced on many high streets by national and multi-national chains that run national advertising campaigns. The local butcher and baker have rapidly declined. This shift from independent local traders to national chain businesses means that local display advertising is also disappearing.

This trend away from local display markets makes it appear unlikely that there is some as yet undiscovered, latent local advertising market of sufficient size to support local TV. Therefore local TV will require other revenue sources for financial viability.

(ii) National advertising

If local advertising is unable to provide sufficient revenue by itself, what is the possibility for national advertising? Studies and experience point to the importance of national advertisers to the economy of an effective and sustainable local TV service. However, historically there are a number of significant challenges to the possibility of local TV utilising national advertising in the UK.

A significant problem is that national advertisers have been uninterested in local TV. Manchester's Channel M suffered significantly from a failure to attract national advertisers (its advertising was mostly local, including holidays, property, furniture and general retail). National TV advertisers demand robust audience measurement and are particularly attracted to media which adds to the unique coverage of a campaign. In order to accurately measure local audiences, the BARB audience measurement system would require notable and potentially disproportionately costly changes. Achieving acceptance of any alternative measurement systems by advertising agencies has not thus far been achieved, but sensible estimates may provide an

³² REF – Annex 5 Market Context Data

opportunity. However, there is a suggestion by a number of contributors that standalone local TV services may not generate sufficient audience numbers to be of interest to national advertisers anyway.

Further, there is currently a surfeit of supply of TV advertising minutage over demand. The market is already well served from existing sources. One broadcaster told the Steering Group that only 30% of one region's advertising opt-out is actually taken by local/regional advertisers. The rest is bought by national advertisers as cheap in-fill to their national campaigns.

Therefore, the national advertising market is unlikely to ascribe value to local TV advertising for standalone local TV stations. A network of local TV services, with sufficiently meaningful coverage of the UK population would be needed to facilitate access to national advertising revenues. Even then, the local TV network as a whole would be a relatively small player in the TV advertising market, meaning that particularly during a start-up phase, access would not be guaranteed without support from an agency with a significant existing advertising inventory.

There is a precedent for a remedy to help a new public service TV operation to get off the ground which may be helpful for local TV's prospects. When Channel 4 began trading, its airtime sales were handled by ITV and affixed proportion of total revenues (14%) guaranteed to the newcomer. Such an underwriting process or similar would at least deliver some default national advertising revenue to the local TV service. As the local TV service is embedded and audience figures rise, it will attract further advertising interest and eventually lose the need for this assistance with advertising. The underwriting of advertising sales would most likely come from existing PSBs and it is therefore an issue for the Government to pursue.

(iii) Combined advertising revenues

It is clear that advertising spend available for commercially funded local media has diminished due to the rise of the internet, consolidation of the commercial sector on the national level, and heightened competition. However, drawing comparisons to existing news channels, which command 1-2% of the addressable national audience, and Channel M which was able to reach as much as 25% of its addressable audience each week (equivalent to almost 300,000 viewers), it has been suggested that if local TV had a good level of quality and content, the audience could be in place to sustain it.

Following discussions with a number of industry executives, the Steering Group believes that national advertising supported by a national agency could generate £15m of revenue a year for a 10-conurbation local network. In the scenario of local TV distributed over local GI spectrum this is based on a technically addressable audience of 11 million and a viewing share within these targeted conurbations of 2%. This implies a national audience share of just 0.38% and a 39% discount to ITV1's TV advertising rates.³³

Access to national spectrum would make a figure of £15m seem more conservative and hence more likely an agency might be able to underwrite the figure. Due to improved population

³³ REF – Annex 9 Potential National Advertising Revenue for a Local TV Network

coverage, particularly within targeted local TV conurbations, the national audience share could rise to 0.60% with similarly conservative assumptions. This audience share would still place the local TV network below the 20 most-watched channels in the UK, and £15m of revenue would imply a discount of 61% to ITV.

Local services could supplement these national advertising revenues with local revenues. Given the absence of an established market for local TV advertising revenues in the UK, this source of funds has much less visibility. The Steering Group believes that this further rationalises the involvement of local media groups, who are likely to have existing relationships within local markets. Channel M, which between financial years 2007-2009, driven by significant investment in programming, was able to generate on average £2.8 million of revenue³⁴, driven primarily by local advertising and its affiliation with GMG's regional media operations. It should be noted that Manchester is one of the UK's larger conurbations, and Channel M benefited from carriage on Sky. Furthermore, Channel M supported these revenues with market tenure and a significantly higher content spend per viewer than envisaged for the local services. However, this gives some comfort to a network of 10 local services eventually being able to generate enough local revenues to break into profitability.

The Steering Group believes therefore that access to national advertising revenue is a condition for the viability of local TV, and that involvement of local media within the local services will help with facilitating local advertising revenues as a supplementary source of funding.

(iv) Rules governing advertising, sponsorship and product placement

The Communications Act and the EU Audio-Visual Media Services Directive (AVMS) set the standards for sponsorship and advertising in the UK. Ofcom has recently carried out a review of sponsorship and product placement and expect a new code to be in place by the end of 2010. The new code will liberalise the rules and potentially allow local TV to increase its potential revenue from advertising, sponsorship and product placement. The AVMS Directive requires that:

- Sponsorship and product placement must not impair the responsibility and editorial independence of the broadcaster.
- Sponsorship and product placement must be transparent (no surreptitious advertising).
- News and current affairs programmes may not be sponsored.
- News and children's programmes cannot contain product placement (UK law also prohibits product placement in current affairs, consumer advice & religious programmes).
- Sponsored programmes and those with product placement must not encourage the purchase or rental of goods or services.

³⁴ Based on filed Companies House accounts

In the UK all commercial references must be readily recognisable and distinguishable from editorial content. Advertising spots for non-PSB channels are limited to a maximum daily average of 9 minutes an hour of total transmission time, with a further daily average of 3 minutes an hour for teleshopping spots. PSBs are limited to a maximum average 7 minutes. Non-PSB channels may choose to use some or all of their advertising minutage for teleshopping spots, but may not use teleshopping spot minutage for standard advertising. In addition to teleshopping spots non-PSB channels may schedule an unlimited amount of longer teleshopping windows, provided each window is not less than 15 minutes. PSB channels may schedule no more than six hours of teleshopping between midnight and 6 am.

Further, it is possible to split the viewing screen and have adverts on a portion of the screen whilst a programme is still running. This is still subject to the 12 minutes per hour ad minutage rule. If it were not subject to this rule however, the split screen could be running for significant periods of the day. Using an AVMS Derogation, if the broadcasts are intended solely for the 'national territory' and cannot be received directly or indirectly by the public in one or more other EU Member States, it would not be limited by the 12 minute advertising rule. It would therefore be possible to run the split screen or other advertising for longer periods, which could increase potential advertising revenues.

(v) Sponsorship

A number of contributors suggested sponsorship could offer a viable alternative revenue stream for local TV. The specific example given to the Steering Group was of corporate sponsorship, i.e. similar to the sponsorship of the Barclays Cycle Hire Scheme in London, which totals £25m spread over 5 years. Incumbent TV and Media operators considered the possibility of a major corporation sponsoring a local TV service and argued that there were likely to be considerable issues around the sponsorship of news content, but it could be an interesting income stream to consider. Advertisers, however, speaking to the Steering Group did warn that sponsorship may not bring in significant revenues.

Sponsorship of individual programmes or of a whole channel should be fully explored within the local TV context. The Steering Group has spoken with a number of potential sponsors. Whilst the response so far has been cautious, the Steering Group considers this to be an important area for further consideration by the Government.

A number of individuals suggested that a relaxation of the current rules around news and sponsorship for local TV would help sponsors. But, the Steering Group was cautioned to treat the issue with care as the potential exists to undermine the current very high public confidence in broadcast news. Further, it seems that relaxation of the rules would not necessarily be needed to offer a sustainable sponsorship model.

Whilst sponsorship and product placement is not permissible on news (both local and national) and current affairs programmes (again, both local and national), they are permissible on a wide range of other programming. This may offer opportunities for local TV. Potential opportunities include:

- On-screen elements (e.g. clock)
- Weather
- Sports reports (local and national)
- Entertainment News
- What's On reports (might work well for local TV)
- Magazine programmes (but not in or around news segments)
- Local interest programmes (again, good for local TV)
- Reports on local initiatives (potential for public service announcements)
- Local user-generated content
- Acquired programmes

3.7 COMPETITION AND MARKET IMPACT

The Steering Group wanted to understand how the facilitation of new local TV could have an impact on existing local media. New entrants to the local space could affect advertising revenue streams as well as providing additional competition to newspapers and local radio in particular. The Steering Group was concerned about this effect and asked interested parties for their views.

They were told on separate occasions by prospective and current local media providers that local TV could have a significant impact on existing local media services. Current media players stressed that disruption to newspapers and radio from the wrong type of intervention in local TV could compromise the broader local media sector. However, in order to ameliorate this impact, contributors agreed that cross-working (and potentially cross-ownership) should take place where possible. This would mean that existing local media operators would in fact be involved in and have a commercial interest in the sustainability of local TV in the respective local markets. Incumbent media providers suggested that local radio and press could provide a good level of knowledge about the local market given the degree of penetration that currently exists.

The Steering Group noted that the Government is already minded to remove the local cross-media ownership rules and during the course of the review had asked Ofcom for further advice on full deregulation at the local level. The Steering Group considers that involvement in local services by local media groups, including significant ownership, would be highly beneficial.

It was also emphasised by local news operators that the provision of local TV should not be at the expense of local journalism. Indeed, a number of business groups interested in the local TV concept suggested that local TV would not necessarily challenge local press, but if run alongside the press, may directly benefit it. The Steering Group was told that a significant number of local newspapers already provide a daily online news broadcast. This could be built upon through expansion into another sector such as TV, though would only work if significant and secure sources of revenue (advertising or otherwise) were available.

3.8 LICENSING AND DEVELOPMENT OF LOCAL SERVICES AND A NATIONAL BACKBONE

(i) Regulatory and licensing structure

In order for local TV to offer a viable and sustainable service, it will need to be properly regulated and licensed. Discussions about the licensing of local TV will be complex and require further consideration following this report and legal advice on the best approach. Depending on the model chosen, local TV is likely to require at least two licences: one for spectrum (Wireless Telegraphy Act) and one for content (Broadcasting Act). The licensing structure could play a role in the success of local TV.

Government will need to consider the most appropriate award process and the Steering Group has already recommended further careful consideration of the technical options. A significant number of contributors suggested that if spectrum were made available to local TV services sufficiently long term, this would be enough to allow the development and sustainability of local TV. This is an issue for Government to consider. The Steering Group is of the opinion that licences should be awarded on the basis of sustainability of the local operator's business plan rather than their ability to pay the most at auction which could erode the ability of local services to invest in programming. This 'beauty contest' approach will have to be considered but is preferable to the less sophisticated auction approach.

Concern was also expressed by a number of potential local TV providers that when local TV is launched, the most profitable localities will be 'cherry picked', potentially leaving smaller less profitable areas less well served (or not at all), and smaller channels unable to compete with larger ones. It will therefore be important that the licensing arrangements take this into account, and counteract the possibility by ensuring all areas are offered an equal chance of success.

(ii) The national backbone

The nature of the relationship between the individual local TV services will help to define the licensing process. During discussions with current and prospective operators, the Steering Group was told that a national network backbone actively supporting local TV will be vital for success. Incumbent media operators added that a network centre could provide a backbone of programming, which local services could use in order to provide a 24 hour service to the viewer. TV distributors noted that existing local TV companies would like a syndication model, for

example the broadcast of network-wide PSB content (the majority of a channel's content) around their own local content (the minority).

Affiliation to a wider network or backbone seems therefore to be vital in supporting the local TV model, especially for generating national advertising and potentially reducing shared costs. The local TV operators added that a national network backbone could be underpinned by a sales force to identify revenue sources, including potentially network sponsorship and funding across the nationwide-branded content. Essentially, there will need to be a national operation in place to 'manage' the backbone and its processes.

(iii) Ownership models for the local services and national backbone

The major objectives of the structure of the relationship between the national backbone operator and the local services are likely to include:

- Alignment of interests to maximise service quality and commercial viability
- Sufficient ownership and control to ensure local media groups are willing to participate
- Management, governance and technical/programming co-ordination to ensure success of local TV
- Ensuring strategic objectives of all parties over the long-term are consistent with the local TV service mandate
- Facilitate roll out of additional local services where possible

Potential models for the ownership structure include³⁵:

- Integrated structure, where the controlling shareholder is the TV network operator. Local media groups are mandated through service agreements and contracts. The local media may participate as a minority shareholder alongside the TV operator.
- Local service-centric structure, where local services are owned by local media groups and local enterprise, with oversight or a service contract with the national operator. The backbone is structured as a service provider.
- Split ownership structure, where the backbone is owned and controlled by the national backbone operator. Local TV services are owned by local media groups.
- Cross-ownership structure, whereby the backbone shareholder has minority ownership in local services, while local services collectively have controlling shareholding in the backbone.

In determining the most appropriate ownership model, a number of issues need to be taken into account, including: the potential long-term funding of the sector – i.e. whether this will be through national or local advertising; Government objectives on localness which could impact

³⁵ REF – Annex 10 Illustrative Schematics of Local TV Ownership Options

on the branding and identity of local services; and the requirement to secure involvement of key groups such as local media players and the backbone operator.

The Steering Group heard a slightly cynical view that local media players could attempt to sabotage local TV by taking ownership of it and then running it badly. The Steering Group thought this to be a reasonably unlikely outcome, as there would always be another group willing to take up the licence if the first group failed. Further, it would be helpful for local media operators to be part of local TV as they have the history, experience and knowledge. As the internet and IPTV develops, more and more audiences will turn to the multimedia sphere to access information and local news. Involvement in the local TV proposition could therefore help local media – this gives the opportunity for existing local media operators to develop their models. With an understanding of the need to use more alternative technologies is an understanding that local TV can play an important role in local media. This will be assisted by the Government's aim to remove cross-media ownership rules. However, it would also be desirable if room was left for local enterprise to be involved and take part-ownership, and for the national network to have some ownership interest in the local service too through mutual ownership.

The Steering Group considers that all of the above models have merits and risks, and realise that appointment of the backbone could be a tricky proposition. It is suggested that – in order to align the interests of all parties – the local service element of the network could be partially owned by local media groups and local enterprises that together would likely have over 50% ownership of each local service to satisfy likely control requirements and align local owners to source local advertising revenues where possible. The Government will need to consider the extent this might be achieved through any licensing or award regime. At least some common ownership between the backbone and the local services (with a target holding in the backbone by the local services in aggregate of over 50%) would help ensure that the centre of gravity and ultimate control of the overall local TV network is kept with local services, rather than a national operator. Furthermore, cross ownership between the national backbone and local services would help give all participants an interest in the performance of the whole, helping to align overall objectives. It would seem appropriate for the backbone to be created first in order to give certainty to prospective bidders to provide the local services.

3.9 ROLE OF PUBLIC SERVICE BROADCASTERS

The PSBs in the UK are well-established and may provide significant opportunities to aid the development of local TV. Indeed, their involvement is seen as very important to the long-term success of local TV. In the context of significant competition, a successful local TV service will require regular publicity. As part of pressing home the public purpose delivered by local TV, public service broadcasters could be mandated to promote the service, as outlined in the 'Audience promotion' section (3.4). Existing PSB TV services benefit from must-carry provision on all platforms, strong EPG positions and legacy audiences. If local TV services could share these advantages, they would be afforded the best possible chance of success.

The final decision on the role of PSBs is for Government. A number of discussions that have already taken place with PSBs and the Steering Group has fed knowledge and ideas into this process. However, no formal arrangements have come about yet – other than the licence fee settlement with the BBC as below – and so further discussions are still necessary.

(i) The BBC

The BBC Licence Fee settlement, which was agreed at the time of the Comprehensive Spending Review in October 2010, gives support for local TV. The BBC will provide resources to meet capital costs of up to £25m in 2013/14 for up to 20 local TV services and up to £5m will be available per annum from 2014/15 for three years to acquire content for BBC use. This provision - if carefully managed - will significantly boost the potential for sustainable local TV.

Prospective local TV operators had previously encouraged the Steering Group to explore potential relationships with the BBC, particularly in buying content or using local TV journalists and skills to improve national BBC programming, through something like a 'citizen journalist' network. There was some warning though that local TV would have to produce high quality, accurate and impartial content to be of interest to a purchaser - and also a question was posed as to how much local material is of interest when played away from its home location.

The involvement of the BBC should help to ensure higher quality, particularly if use of BBC facilities and training is included in a partnership model. The BBC already has precedents for news partnerships with other agencies. Training and accreditation of local TV operators would contribute to the long term sustainability of the service. The amount of content the BBC will buy from local TV and the way in which this will be organised is a matter for BBC and Government discussion and is subject to regulatory and European rules. The BBC is positively engaging in the debate and continuing to investigate ways that it can help facilitate local TV and is likely to come to a conclusion in the New Year.

(ii) ITV and Channel 4

ITV already provides regional programming, through its regional news broadcasts which follow the national news. Channel 4 does not currently provide any regional news provision. It is not for this report to determine what the role of the PSBs should be in relation to local TV, but it is clear that there are many opportunities for them to be involved.

As mentioned in previous chapters, the PSBs could be involved in cross-promotion to local TV from their existing channels. The exact nature of this cross-promotion, whether it is piggybacking or red button technology, will be determined by the technology used and the nature of the relationship between the PSB and the local TV service.

The outline of the possibility of underwriting advertising revenues given in the Advertising chapter gives a further indication of the potential for PSB involvement. Underwriting of national advertising for local TV for its first few years of service could be enough to put local TV onto a sustainable footing.

Discussions between the Government and PSBs are ongoing, but it is important that these are concluded soon, in order to continue the momentum towards delivery of local TV.

4 CONCLUSION

4.1 CONDITIONS NECESSARY FOR COMMERCIALLY VIABLE LOCAL TV

This report has considered the complexities of the possible local TV landscape in the UK. Its aim was to consider what a sustainable and commercially viable model for local TV delivered by DTT could look like. It was clear at the time of writing the Interim Report and it is clear now that it will take significant effort to make local TV a success. This report suggests that to give local TV a possibility of being commercially viable, a number of conditions need to be addressed.

- In the long-term, local TV looks set to be delivered through IPTV technology; therefore, any steps the Government takes through new regulatory interventions to facilitate local TV should have regard for this
- Local services may initially be focused in and around 10 to 12 conurbations; determining these areas should be based substantially on the quality and sustainability of business plans together with transmission considerations
- Local services in these conurbations should seek to produce a core of, on average, at least two hours of reasonably low cost but high quality content a day; a national backbone should be tasked with the role of filling the schedule to help attract audiences and ensure a coherent offering
- Government should seek to secure EPG prominence across as many platforms as possible – where applicable this prominence may be a single common EPG position across the UK; the prominence might be derived from cross-promotion from an existing highly placed channel
- Local TV is unlikely to be viable if it is dependent on local advertising revenues alone. The agreement already in place with the BBC will be helpful in both providing an additional source of revenue and ensuring an adequate level of quality. In addition, the Government may need to help facilitate access to national advertising revenue through an existing agency that has a significant existing inventory – for example a national PSB. An underwritten national advertising contract of £15m per annum for at least the first three years will be required to have confidence in commercial viability
- The Steering Group recommends the Secretary of State discusses technical options with Ofcom. The final decision on technical delivery options should take into account cost, ability to localise, and total population coverage achieved
- A desirable structure of ownership would recognise that the local TV network should be driven by local services rather than a national backbone. The participation of

local media groups and local enterprise should be encouraged through providing sufficient control in local services

- It is recommended that licences be awarded on the basis of a ‘beauty contest’ rather than an auction; this should encourage innovation, quality and level of service rather than financial risk taking

4.2 REPORT RECOMMENDATIONS

Assuming the steps outlined above are followed, commercially viable local TV may be possible in the UK. A significant number of those spoken to by the Steering Group suggested that it would be helpful to initially run a pilot with a few local TV propositions, before expanding these further. The Steering Group therefore proposes that once the conditions highlighted have been met, the next step could be to establish local TV in 10 to 12 conurbations across the UK.

This will offer a means to establish demand, understand supply, identify problems and elicit interest in other parts of the country. It will also help to develop local TV so that when IPTV reaches significant coverage of the UK, it can naturally transfer across and lessons will have been learnt and brands established in the meantime.

The locations of these services are not for the Steering Group to decide, but should be determined based both on potential audience viewing figures, the ultimate decision on distribution technology and spectrum, and based on the quality and visibility of plans submitted by potential operators through the licensing process.

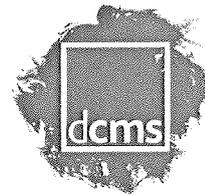
5 GLOSSARY

- AVMS Audio Visual Media Services Directive
- BARB Broadcasters' Audience Research Board
- BIS Department for Business, Innovation and Skills
- DCMS Department for Culture, Media and Sport
- DTT Digital Terrestrial Television
- DSO Digital Switchover
- EPG Electronic Programme Guide
- GI Geographic Interleaved (Spectrum)
- IPTV Internet Protocol Television
- MUX Multiplex
- PSB Public Service Broadcaster / Broadcasting
- RSL Restricted Service Licence
- SDN Scottish Digital Network
- WTA Wireless Telegraphy Act 2006

ANNEX 1: SHOTT REVIEW REMIT

CMS 145089/asg

Nicholas Shott
Vice Chairman
European Investment Banking
and Head of UK Investment Banking
Lazard & Co Limited
50 Stratton Street
London W1J 8LL



department for
culture, media
and sport



host government
department

22 June 2010

De Nick,

I am delighted you have agreed to advise me on my ambitions for local television in the UK on a *pro bono* basis.

By the end of your study, we will want to understand how the Government can maximise the potential for local television to emerge in the UK and have a clear view of the value for delivering local TV from the point of potential investors.

In particular, it would be helpful to understand the following:

- What are the conditions necessary in which local television can be commercially viable;
- the scope of revenue opportunities from advertising or other sources;
- which barriers should be reformed/removed to nurture a new generation of profitable local media companies; and
- how might existing industry players help achieve this.

I would be very grateful to receive your conclusions by mid-September 2010. I am also clear that you will produce these conclusions independently of Government.

DCMS stands ready to support you in this work. Dominic Lake, Head of Media Policy: dominic.lake@culture.gsi.gov.uk, 020 7211 6957 is your main point of contact.

To safeguard the process and your independence, please could you complete and sign the enclosed confidentiality agreement and declaration of interests.

My office will be in touch with yours to arrange suitable times for us to remain in touch.

Yours ever

A handwritten signature in black ink, appearing to read "Jeremy". The signature is written in a cursive style with a long horizontal stroke at the end.

Rt Hon Jeremy Hunt MP
Secretary of State for Culture, Olympics, Media and Sport

ANNEX 2: STEERING COMMITTEE BIOGRAPHIES

Terms of Reference

The Secretary of State asked Nicholas Shott to advise him on his ambitions for local television in the UK. This was on a pro bono basis and independent of Government.

The brief was to understand how the Government can maximise the potential for local television to emerge in the UK and have a clear view of the value for delivering local TV from the point of potential investors.

In particular to understand the following:

- What are the conditions necessary in which local television can be commercially viable;
- The scope of revenue opportunities from advertising or other local sources;
- Which barriers should be reformed / removed to nurture a new generation of profitable local media companies; and
- How existing industry players might help achieve this.

BIOGRAPHIES

Nicholas Shott, Vice Chairman, European Investment Banking & Head of UK Investment Banking, Lazard & Co.

Nicholas Shott joined Lazard in 1991, following a career in the media industry. As well as being Vice Chairman of European Investment Banking and Head of UK Investment Banking, he is European Head and International Co-Head of Media for the firm.

Mr Shott's transaction experience includes advising ITV in relation to a takeover proposal by a private equity consortium; advising Emap on its acquisition of SRH through a successful "bear hug"; advising Premiere TV on its IPO in Germany; advising Hollinger on its sale of The Telegraph Group; advising Granada in numerous situations, including its merger with Carlton to form ITV, the merger with Compass Group, the IPO of Granada Media, the acquisition of United News & Media's broadcast interests, the demerger of its Hospitality division, the disposal of HTV to Carlton, and the merger of its Rental division with Thorn; advising DMGT in the consolidation of radio interests into GWR Group; advising Tempus in its "hostile sale" to WPP; advising Esporta in its takeover by Duke Street Capital; advising Montagu Private Equity in acquiring BSN Medical; advising Candover Partners in the sale of ISS; advising Private Equity firms in relation to the possible acquisitions of Northcliffe Newspapers and Emap France; advising Permira in relation to its acquisition of All3Media and subsequent acquisition of MME in Germany; advising GMG in relation to the sale of 49% of TMG to Apax; advising the Board of EMAP in relation to the sale of EMAP's consumer media business to Bauer and EMAP's B2B business to Apax; advising the Independent Directors of Shed Media in relation to a possible MBO; advising Carillion in the sale of its IT services business; advising DMGT in the sale of The

Evening Standard, advising INM on the sale of The Independent and advising GMG on its recent £150m equity injection to EMAP.

Mr. Shott's clients also include Cookson, Uniq, Quarto and Tui Travel.

Claire Enders

Claire Enders is one of the most experienced TMT analysts and forecasters working in the UK, with 25 years of experience in these sectors, with particular expertise in UK and international media. She is founder and CEO of Enders Analysis, which has become one of the leading independent TMT research companies in the UK. Claire holds an MBA from London Business School.

Richard Eyre

Richard Eyre's career began in advertising media where he spent 16 years. He became Chief Executive of London's Capital Radio plc in 1991, after which he was Chief Executive of ITV. In February 2000 he became Chairman and CEO of Pearson Television, producing TV programmes in 35 countries. When Pearson was merged with Bertelsmann's TV and Radio assets to found RTL, Richard became a Director of Content and Strategy. He is now a full-time non-executive director with board and advisory roles for a range of organisations primarily in media, mobile and the internet where he chairs the Internet Advertising Bureau.

Baroness Kingsmill

Baroness Kingsmill is a member of the House of Lords, whose career has encompassed periods as a leading lawyer, Deputy Chair of the Competition Commission and as a non-executive director of plc, private, charitable, arts and government boards.

Baroness Kingsmill has headed two Government enquiries: one into women's pay and employment and the other into the manner in which companies manage their Human Capital. In 2007 she led an enquiry on behalf of the Government, the Mayor of London and the British Fashion Council into the role of the fashion industry in eating disorders and women's health.

Currently, Baroness Kingsmill is a non-executive director of British Airways, Korn Ferry International, Horizon plc and a member of the Microsoft European Policy Council and sits on the PWC Advisory Board. She is a member of the influential House of Lords Economic Affairs Committee. She writes a regular column for Management Today and writes and speaks on a wide range of business and political issues.

Brian Linden

Brian Linden joined Cinven in 1985. Transactions he has been involved in include Truvo, Springer, Aprovia, MediMedia, Dynacast, IPC, Gardner Merchant, NCP and Ziggo. He is a member of the TMT sector team.

Before joining Cinven, Brian worked at Deloitte & Touche. Brian is a Business Finance graduate.

ANNEX 3: LIST OF INDIVIDUALS MET DURING COURSE OF THE STUDY³⁶

Will Abbott, Freesat
David Abraham, Channel 4
Geraldine Allinson, KM Group
Sly Bailey, Trinity Mirror
Lluís Borrell, Analysys Mason
Travis Baxter, Bauer
Kevin Beatty, Associated Newspapers
Greg Bensberg, Ofcom
Trevor Birney, Below the Radar
Tim Blott, Herald & Times Group
Daniel Cass, United for Local Television
Alex Connock, Ten Alps
Jamie Conway, Element TV
Charlie Cox, DMGT
Julie Craik, FifeScreen & TayScreen Scotland
John Cresswell
Alan Cummings, Channel 9
Edmund Curran, Belfast Telegraph
Keith Daniell, Digital Nottingham
Geraint Talfan Davies, Institute of Welsh Affairs
Huw Eurig Davies, Boomerang Plus
Jacques de Souza, City TV Broadcasting Ltd
Jaqui Devereux, Community Media Association
Andrew Dixon, Creative Scotland
Mark Dodson, formerly Channel M
Alan Edmunds, Media Wales Ltd
Jim Eglinton, HCVF Television
Dave Ellis, Arqiva
Carolyn Fairbairn, ITV
Steve Folwell, Guardian Media Group
David Fordham, Newspaper Society's Independent Publishers Forum
John Fry, Johnston Press
Liv Garfield, BT
Mostyn Goodwin, OC&C
Philip Graf, Ofcom
Mike Grant, Analysys Mason
Jason Hadden, City TV Broadcasting Ltd
Richard Halton, Project Canvas (now YouView)
Will Harding, Global Radio
Andrew Harrison, RadioCentre
Leon Hawthorne, Videobite
Khalid Hayat, ITV
Fru Hazlitt, ITV
James Heath, BBC
Phil Henfrey, ITV Wales

³⁶ This includes individuals met by Nicholas Shott, members of the Steering Group and the DCMS secretariat

Jeff Henry, TellyLinks
Richard Hooper, Former IFNCs Panel Chair
Richard Horwood, Blink TV
John Howells, Department for Heritage (Welsh Assembly Government)
Ilse Howling, Freeview
Steve Hunt, South of Scotland Alliance
Marilyn Hyndman, Northern Visions Television
Fiona Hyslop MSP
Edgar Jardine, Department of Culture, Arts & Leisure (Northern Ireland)
Blair Jenkins, Scottish Digital Network Panel
Alun Ffred Jones AM
Ron Jones, Tinopolis
Marian Kelly, Department of Culture, Arts & Leisure (Northern Ireland)
Pat Loughrey
Michael Macmillan, Macmillan media
Ian Mackenzie, Channel 4
Peter Madry, Ofcom
David Mahoney, Ofcom
Jim Marshall, Aegis Media
Glyn Mathias, Ofcom Advisory Committee for Wales
John McCann, UTV
Stuart McGann, Clyde & Forth Press
Stephen McGowan, Department of Culture, Arts & Leisure (Northern Ireland)
John McEwen
Ian Mecklenburgh, Virgin Media
Kip Meek, Ingenious Media
Peter Miles, SubTV
Paul Moore, Ofcom Content Board Member for Northern Ireland
Martin Mumford, Town and Country Broadcasting
Alistair Murray, Highlands and Islands working group / Bigbox
Dorothy Nixon, Citybeat Radio
Mark Oliver, Oliver & Ohlbaum Associates
Arwel Ellis Owen, S4C
Roger Parry, Mediasquare
Lance Paterson
William Perrin, Talk about Local
Helen Philpot, Channel 7
Gill Pritchard, Channel 4
Stewart Purvis, City University London
Najma Rajah, BBC
Mark Read, WPP
Alan Revell, Blink TV
Carles Riba, MON TV
Ed Richards, Ofcom
Caroline Righton, Caroline Righton Communications
John Rossetti, Taunton TV
Dave Rushton, Institute of local Television
Cathie Russell, South Lanarkshire Council
Fiona Ryder, StreamExchange.tv
Philip Schlesinger, Ofcom Advisory Council for Scotland
Phil Shepherd, Community Media Association

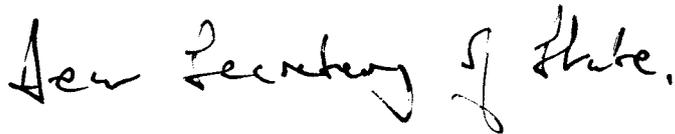
Catherine Smadja, BBC
Adam Smith, GroupM
Bill Smith, Latest TV
Wil Stephens, Cube Interactive
Alan Stewart, Ofcom
Kate Stross, Ofcom
Tim Suter, Perspective Associates
John Tate, BBC
Darwin Templeton, News Letter
James Thickett, Ofcom
Caroline Thomson, BBC
Christopher Thomson, DC Thomson
Mark Thompson, BBC
Brian Thornton, Former MD of ITV Local
Nick Toon, Channel 4
Jannine Waddell, Waddell Media / PACT
Richard Waterstone, MON TV
Marc Watson, BT
Tony Watson, Press Association
David Wheeldon, BSkyB
Richard Wilkins, Scottish Government
Peter Williams, United for Local Television
Rhodri Williams, Ofcom Wales
Richard Williams, Northern Ireland Screen
Michael Wilson, UTV
Denis Wolinski, Ofcom Northern Ireland
Mark Wood, formerly Scottish News Consortium
Rob Woodward, STV

ANNEX 4: SHOTT REVIEW INTERIM REPORT

50 Stratton Street
London W1J 8LL

Rt. Hon. Jeremy Hunt M.P.,
Secretary of State for Culture, Olympics, Media and Sport,
Department for Culture, Media and Sport,
2-4 Cockspur Street,
London,
SW1Y 5DH

24th September 2010



Local Television in the UK

I am writing in relation to your request that I advise you on this matter.

My first act, upon being appointed by you, was to form a Steering Group to assist in the investigations. I have been exceptionally fortunate that Baroness Kingsmill, Claire Enders, Richard Eyre and Brian Linden all agreed to be members of the Group. They have all given more generously of their time than I could reasonably have expected; more importantly, their individual and collective wisdom has been invaluable. I cannot adequately express how grateful I am to each of them.

The fundamental question we have sought to address - within the context of your stipulation that local TV should be delivered principally (although not solely) by DTT - is: "What are the conditions necessary for local television in the UK to be commercially viable on a sustainable basis?" In addressing this, we have felt it important - in fact, essential - to have regard to the possible implications for the existing, wider local and regional media sector.

During the course of our enquiries to date, members of the Steering Group have held 16 separate meetings with a total of 81 individuals, all of whom have made valuable contributions to our understanding. We have more to do: for example, we believe it is vital to take account of the views and particular requirements of the Nations and the Regions, a process on which we have embarked but which we have not yet completed; and we need to investigate further the important matter of technical delivery options (an area in which Ed Richards and his colleagues at Ofcom are being extremely helpful to us).

Despite this need for further work, I feel that in many respects a consistent picture is beginning to emerge and that, accordingly, now is an appropriate moment to submit this Interim Report to you. Given my comments above, I should stress that the contents of this Interim Report do not represent firm conclusions; rather, they summarise our findings to date and our emerging thoughts.

In essence, our key early views are that:

- local television in sparsely populated areas is unlikely to be commercially viable on DTT, because of the twin pressures of significant transmission costs and weak advertiser demand for dispersed audiences;
- logically, local TV should stand a better chance of success in urban areas. However, even in densely populated urban areas, the economics of a TV business funded mainly by advertising will still be challenging, given the steady structural decline in local and regional advertising expenditure, caused partly by the continuing rise of the internet and partly by the fact that High Streets are increasingly populated by national chains. It is significant that the local radio sector is endeavouring to meet this change by trying to become more national, as witness the progressive rebranding of Global Radio stations to adopt the 'Heart' and 'Capital' brands;
- additional revenue sources will therefore need to be explored exhaustively: in particular, we believe that the possibility of locally generated news content being sold to other broadcasters should be closely examined; and we believe there may be scope for the local TV sector collectively to be sponsored (at least in the early years) by a large corporate wishing to be seen to support local/community life - a reasonable parallel for this is Barclays' sponsorship of the London bicycle scheme, worth £25m over five years. It may be that some relaxation of existing regulations will be required to maximise the range of revenue sources;
- new technology should allow for much reduced costs without necessarily resulting in a reduction in production quality. However, in general, great care must be taken to ensure that the understandable drive for ever lower costs does not result in impaired quality of content: we profoundly believe that inferior quality will be fatal. In this connection, we believe that the inevitable requirement for there to be a minimum quality threshold as part of any contract for supply of news content to another broadcaster (referred to above) would be a positively good thing, for all that the assessment of quality against the threshold will require an element of subjective judgement;
- audience demand for local content is likely to be driven primarily by news or news-type programming, implying that maintaining audiences at viable levels for lengthy periods will be challenging, to say the least; but that, symmetrically, on the supply side filling an entire schedule may well be equally challenging. It may therefore serve us well to think not of local TV channels, but of local TV services;
- local TV businesses should work together, either loosely or on some formal (i.e. shareholding) basis, to share costs wherever possible, to promote the generic concept of local TV and to improve the national advertising revenue proposition; they may also be able to create and share programming to augment the schedule. In particular, we believe that having a channel number for local TV which is common to all such services and which is in a prominent position on the EPG is highly desirable;

- even if local TV businesses co-operate as described above, it will still be a great challenge to build an audience from scratch and maintain it. We therefore believe there may need to be some form of support from existing networks and we are exploring two possibilities:
 - (i) one of the existing national channels being a 'host' channel for local TV, with audiences being directed to their local TV service (should one exist in their area) at certain times of the day and then directed back to the host channel. Red button technology could help in this regard, giving the viewer an 'opt in/opt out' opportunity but also safeguarding the host channel. Having such a 'host' channel would, of course, deal with the requirement for a prominent position on the EPG; and
 - (ii) as an alternative, national PSB channels having a 'pop-up' prompt at certain times of the day, advising viewers that their local TV service (again, if one exists in their area) can be accessed by pressing the red button; and
- DTT is undoubtedly a good way to reach large audiences, but the transmission network architecture is some 50 years old, and will require engineering solutions to produce even a reasonable patchwork of local TV coverage. We therefore regard it (at least for local TV) as an interim distribution technology which will eventually give way to distribution to television sets over IPTV, a technology that is some years from reaching worthwhile market penetration but which should offer far more scope for local services at much lower cost. It may be, therefore, that the best way forward in the near term will be to facilitate the creation of a select number of local TV services, based on major conurbations and using DTT, in order to establish and refine the local TV model before it naturally migrates to IPTV, at which point a larger number of services, potentially covering the whole country, becomes a real possibility.

This is but a synopsis of our thoughts to date. As I have said, we have more work to do and I hope to be able to submit a final report and recommendation by late November or early December.

In the meantime, we have started discussions with senior management of the BBC about ways in which the BBC might be able to offer support and help. These are showing early promise.

Finally, I should return to the point about the possible implications for existing local and regional media businesses. We are acutely conscious of the risk of unintended consequences - in other words, the possibility that by enabling the creation of local TV services, existing media are inadvertently weakened. As it happens, we believe not only that the prospects for local TV services would be improved by the involvement of existing operators (because of their established news gathering capabilities, their market knowledge and audience relationships and also because of the opportunities for cross-promotion), but also that such an involvement of operators could be good for them too. This is in part because of the structural changes that are taking place in their businesses and, in all likelihood, will continue to take place come what may. It is highly likely that, in due course, IPTV will be the best delivery means for local TV, enabling more local material to be accessed by the viewer; but it should also present an opportunity, for

example, to newspaper publishers at least to maintain, if not recover, classified advertising revenues through the facility of IPTV to combine video, text and web links. We believe that (with relaxation of cross-media ownership rules where necessary) existing local and regional media businesses should be encouraged to become shareholders in local TV services (although we believe it would be healthy if they were not 100% owners, so that room could be left in the ownership structure for local enterprises). This holds out the prospect of cross-media enterprises with multi-layered, multi-platform propositions.

It has been difficult to see a clear path to commercial viability for local TV and, as I have said, we have more work to do before we can say definitively that local TV in the UK either can, or cannot, be commercially viable. However, on the basis of our work to date and assuming that all of the points outlined in this Interim Report were acted upon, we can at least see the possibility of a commercially viable local TV sector.

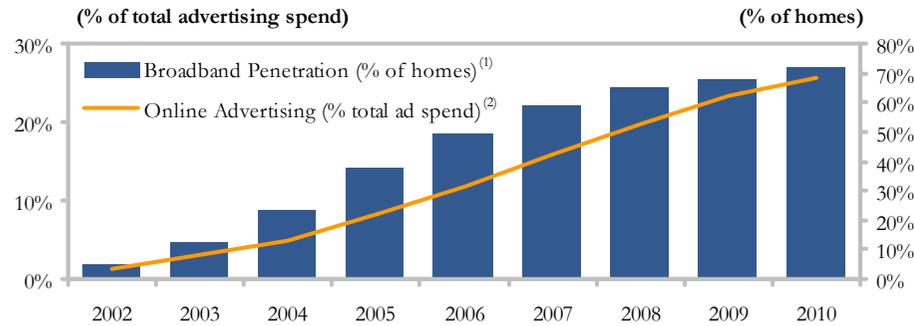
Yours sincerely,

A handwritten signature in black ink, appearing to read "Nicholas Shott". The signature is written in a cursive style with a horizontal line underneath the name.

Nicholas Shott

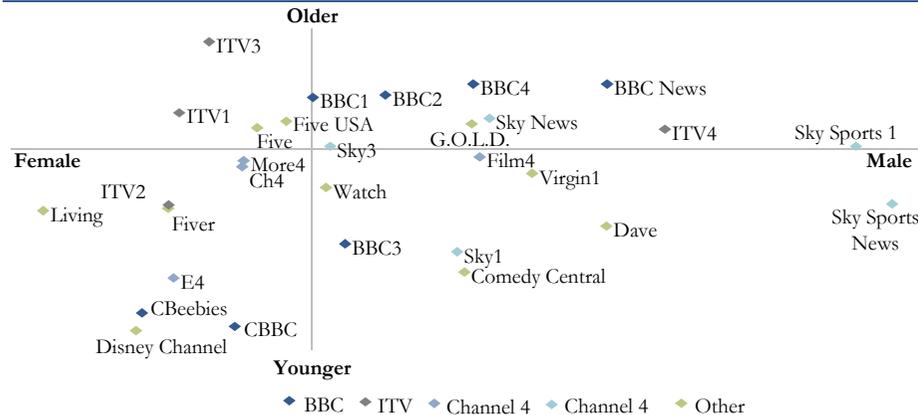
ANNEX 5: MARKET CONTEXT DATA

BROADBAND PENETRATION VS. ONLINE ADVERTISING



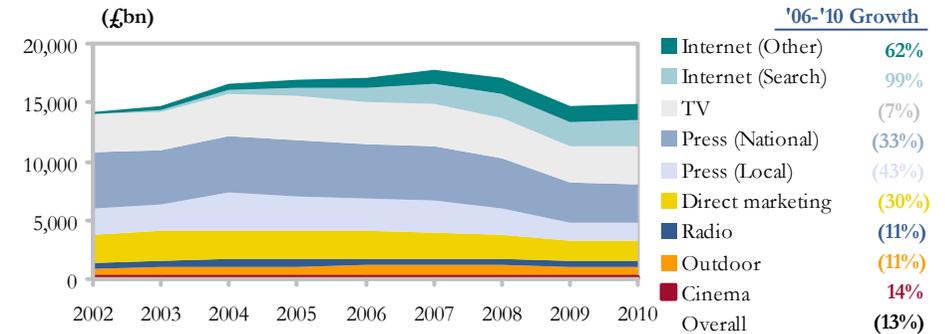
High speed internet usage has increased dramatically since 2000...

AGE AND GENDER OF THE 30 MOST-VIEWED CHANNELS (4)



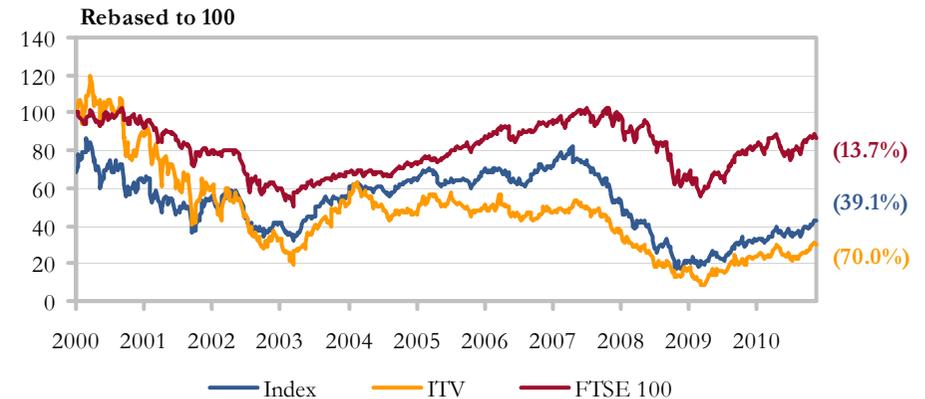
In the meantime, to maximise advertiser ROI, brands across various forms of media including in TV have proliferated across consumer demand niches, increasing competition

ADVERTISING SPEND BY MEDIA FORMAT(3)



...leading to advertising spend being directed away from newspapers, radio and TV

UK MEDIA INDEX (5)



Structural decline and increased competition has impacted the comparative performance of traditional media companies

¹ Source: Ofcom

² Source: Enders Analysis

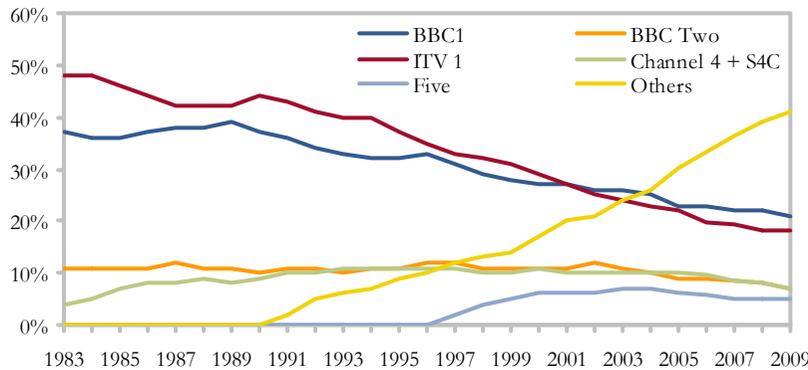
³ Source: Enders Analysis, Internet (Other) includes display and classified

⁴ Source: BARB. Channels plotted according to the percentage of all viewing coming from male and 45+ viewers compared to total TV in multichannel homes

⁵ Index based on share price performance weighted by company's market capitalisation. Index consists of DMGT, Independent News and Media, ITV, Johnston Press, Trinity Mirror and WPP
Source: Datastream (as at 1 December, 2010)

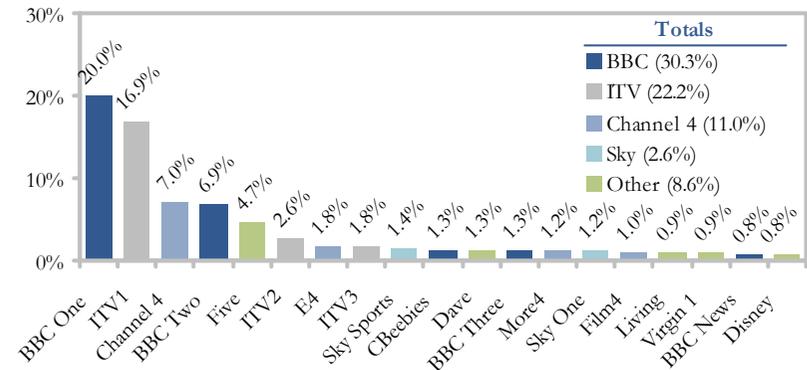
ANNEX 5: MARKET CONTEXT DATA (cont'd)

AUDIENCE SHARE PER CHANNEL⁽¹⁾



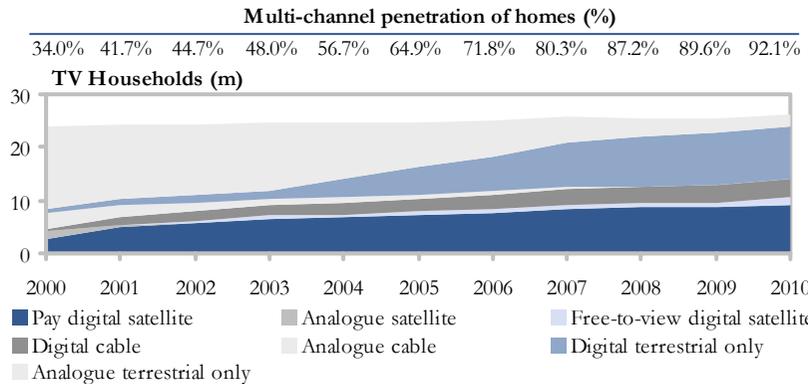
Proliferation of channels over time has eroded the audience share of BBC1 and ITV1...

COMMERCIAL TV MARKET SHARES⁽²⁾



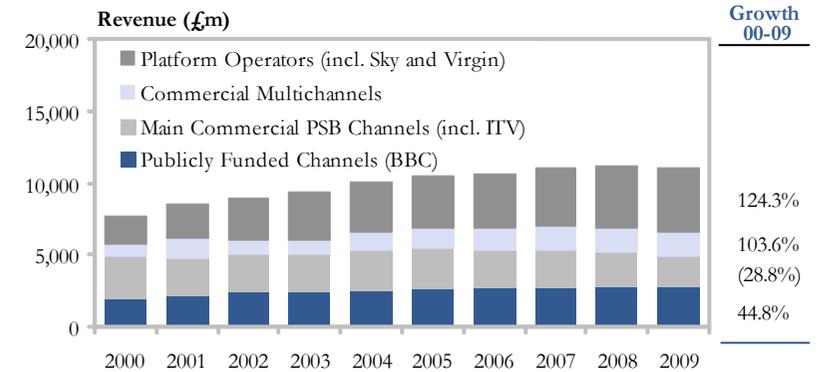
... however, top 5 viewing shares remain concentrated with a long tail of channels with a c.1% share that typically broadcast syndicated content

MULTI CHANNEL TAKE UP⁽³⁾



Households have shown significant willingness to pay for new platform packages leading to a reduction in free-to-air household share...

SPLIT IN TV REVENUES OVER TIME⁽⁴⁾



... leading to platform operators increasing their share of industry revenues, and commercial PSB operators facing decline

¹ Source: Ofcom / Broadcasters

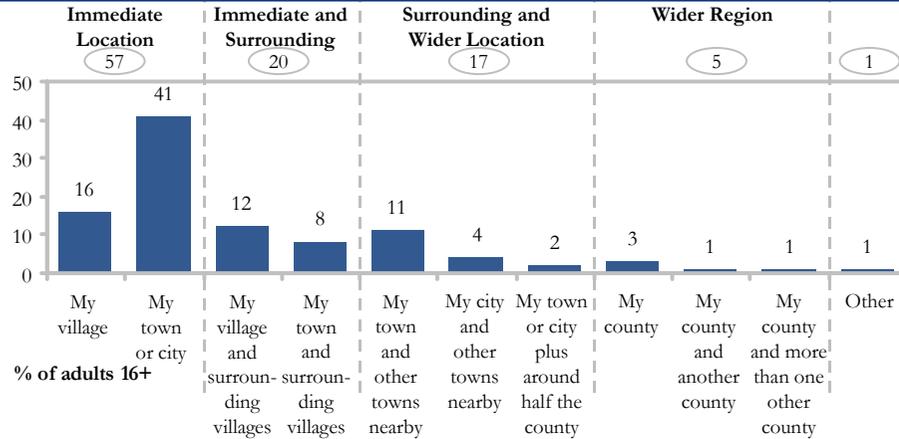
² Share of total viewing time on multi channel platforms source: BARB

³ Ofcom. Note analysis is for primary sets only. Figures include Q1 10 figures

⁴ Source: Ofcom / Broadcasters

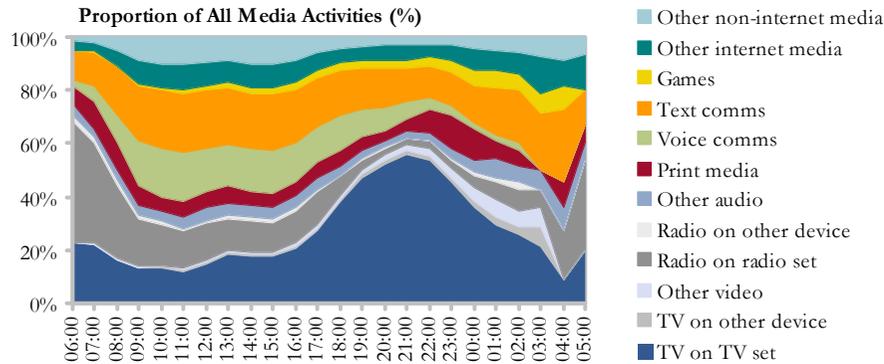
ANNEX 5: MARKET CONTEXT DATA (cont'd)

DEFINITION OF LOCAL TV⁽¹⁾



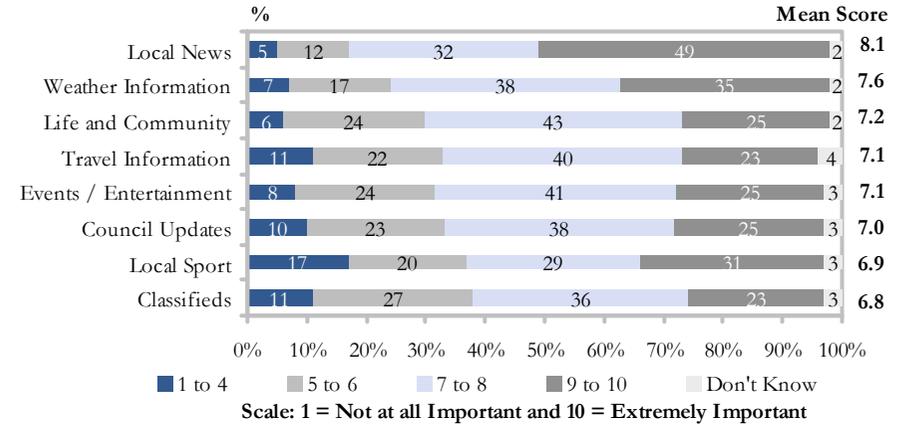
Consumers tend to define their own village or town as being local...

DAILY MEDIA USAGE BY TYPE⁽²⁾



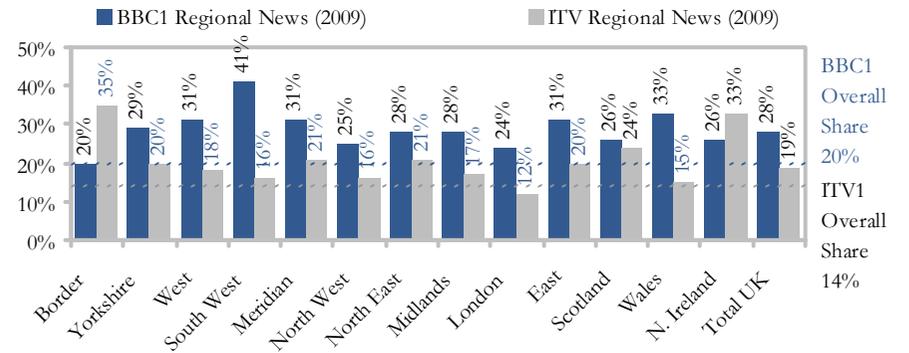
Overall TV watching tends to peak in the evenings, with news being positioned around breakfast, lunch and early evening audiences

INTEREST IN LOCAL CONTENT BY GENRE⁽¹⁾



...while they are mostly interested in local news, weather, life and community and traffic

REGIONAL SHARE OF VIEWING AT TIME OF BROADCAST (BARB)⁽³⁾



Regional news enjoys significant audience share, however this neither proves nor disproves satisfaction with regional news or pent up demand for additional news

¹ Source: Ofcom, Local and Regional Media in the UK

² Source: Ofcom, Communications Market Report, 2010

³ Source: BARB

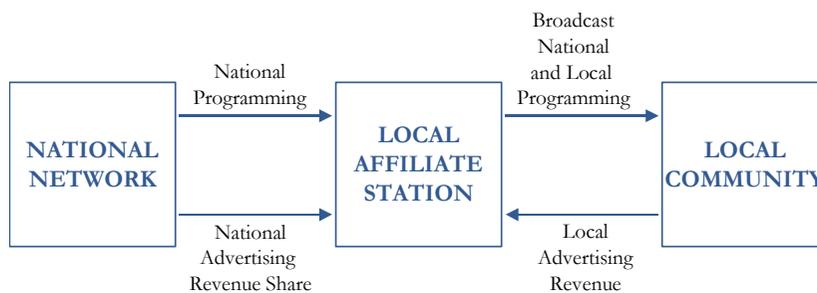
ANNEX 6: COMPARISON TO OTHER COUNTRIES

The US market is structurally different in its size, propensity for firms to advertise locally, low cost/high bandwidth cable distribution and network-affiliate heritage

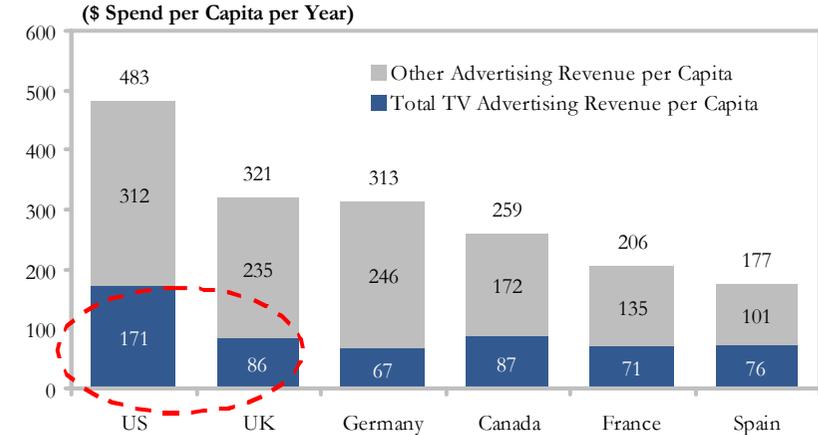
OBSERVATIONS

- Local stations have long been the cornerstone of the TV industry in the US; this is unique to the US and explained by:
 - significant distances between population centres
 - long-established network/affiliate licensing practices
- Significantly higher TV advertising spend per capita than Europe
- Large city stations are owned by the national networks, while smaller stations are independent, and have long-term network contracts
 - networks cite a 0.5m population conurbation as the minimum for a full service station, assuming a 7-8% audience share
- Full service local stations are able to apply for 'must carry' obligations of cable operators, allowing the channels to be carried free of charge
- Local advertising is a greater proportion of the whole

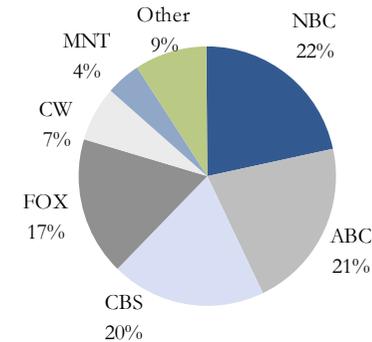
ILLUSTRATIVE NETWORK AFFILIATE MODEL



ADVERTISING MARKET COMPARISON⁽¹⁾



BROADCASTERS' MARKET SHARES⁽²⁾



¹ Source: Zenith Optimedia 2010

² Source: JPMorgan estimates and Lazard analysis. Represents shares of underlying station revenues at the national network level.

ANNEX 6: COMPARISON TO OTHER COUNTRIES

Europe and Canada are closer comparables to the UK. However, to the knowledge of the Steering Group, none of these markets have been able to provide broad local TV coverage without some kind of subsidy

COUNTRY	MODEL	COMMENTARY	SUBSIDY DETAIL
	Network-affiliate model, plus subsidised community TV	<ul style="list-style-type: none"> ■ Long-term political interest in maintaining Canadian programming in both French and English given US proximity ■ Most towns have one or more broadcast stations, most of which are affiliated with a national network ■ Five major cities also have a city TV station ■ Community channels are funded by cable providers who must provide facilities and funding (6% basic revenues) when they have at least 6,000 subscribers 	<ul style="list-style-type: none"> ■ Local stations benefit from affiliate arrangements and legislation requires that cable broadcasters support community channels
	Regional opt-out model (like UK) and numerous local cable channels	<ul style="list-style-type: none"> ■ Dominated by PSB France 3, which provides limited daily regional content and some local opt-outs ■ Following a new program of licensing organised by the regulator (CSA), there has been an increase in the number of DTT channels, including some local broadcasters ■ 100+ non-terrestrial local channels, usually broadcasting on cable, provide Local programming; these channels usually operate in an amateurish manner, broadcasting poor quality content often for just a few hours each day 	<ul style="list-style-type: none"> ■ Regional content is subsidised through France 3 ■ Some regional governments provide further subsidies
	Regional opt-out model; State subsidised local channels	<ul style="list-style-type: none"> ■ Germany benefits from significant cable penetration ■ Seven regional channels (collectively Die Dritten) broadcast local opt outs (NDR Fernsehen broadcasts five, for example) through cable, satellite and IPTV. This content is sourced locally ■ Most cities also have a local station broadcasting only on cable, usually subsidised by the Lander ■ RTL (largest commercial broadcaster) runs local subsidiaries and broadcasts brief local content daily 	<ul style="list-style-type: none"> ■ Government subsidy – the Lander subsidise most local stations
	Regional opt-out model; government-run regional channels	<ul style="list-style-type: none"> ■ National public broadcaster Television Espanola broadcasts regional content, and ten regional governments operate their own regional channels, collaborating to buy programme rights and sell advertising. DSO will make some of these channels available outside their region ■ Since 2005 around 800 licences to broadcast local DTT have been awarded 	<ul style="list-style-type: none"> ■ Around 50% of local stations are funded by local governments. Almost all of the rest are supported by larger media groups

ANNEX 7: OFCOM'S INITIAL THOUGHTS ON THE INTERACTION BETWEEN A NATIONAL BACKBONE AND LOCAL SERVICES

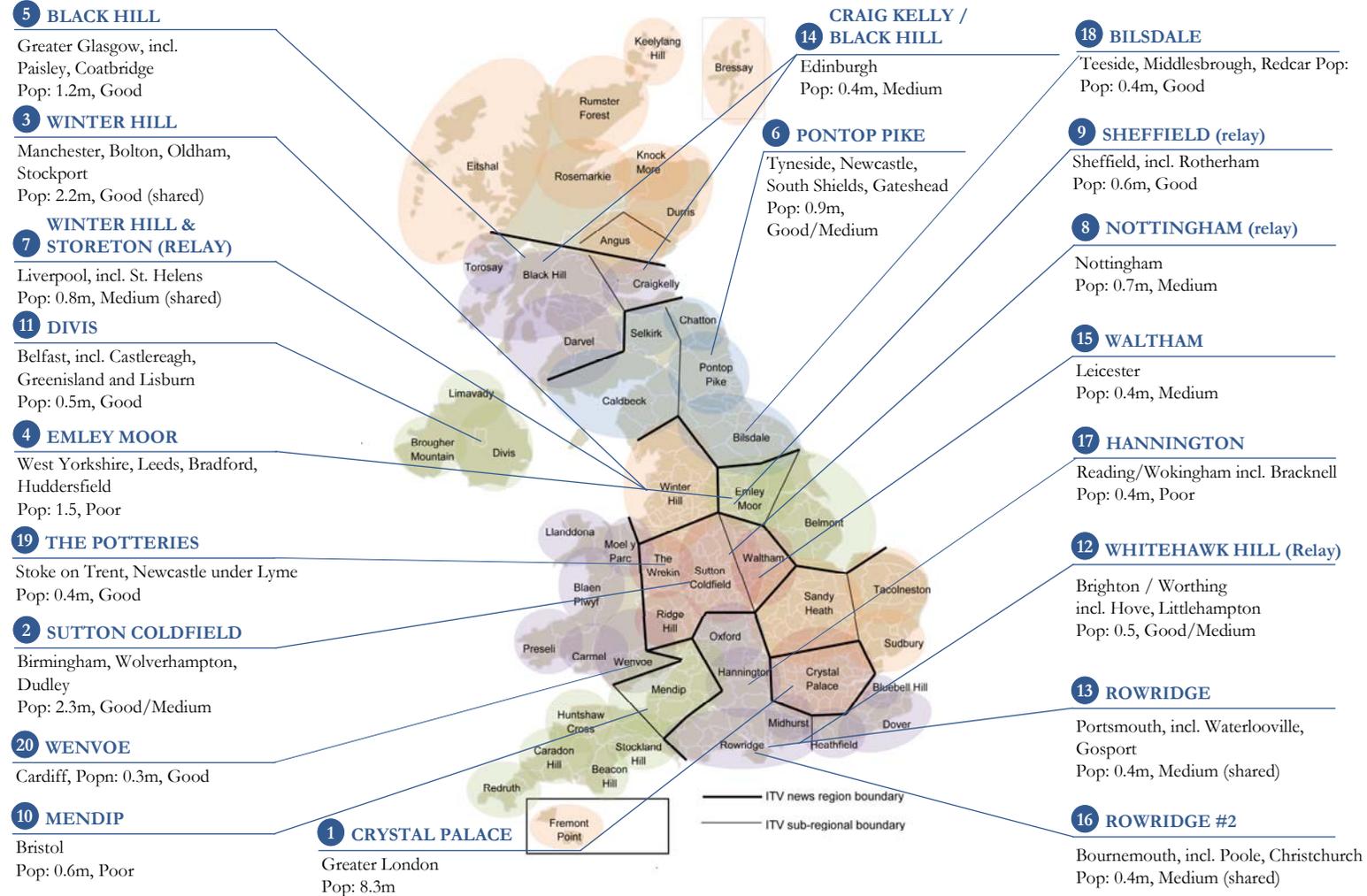
The following is a summary of Ofcom's initial thoughts on the interaction between the national backbone and local services carried on DTT using GI

Audience reach of local content could be driven by a combination of inherited audience and ease of access		EPG POSITION OF MAIN SERVICE	
		High EPG position	Low EPG position
The red button model	National backbone with red button link through to GI local content	<ul style="list-style-type: none"> MEDIUM Backbone content is easy to find, but local content reach is reliant on viewers pushing red button 	<ul style="list-style-type: none"> LOW Backbone content is more difficult to find, and local content is reliant on viewers pushing red button
The local prominence model	Backbone content on GI with peak time local content	<ul style="list-style-type: none"> MEDIUM / HIGH Backbone content is easy to find (although only in GI areas) and provides inherited audience for local content 	<ul style="list-style-type: none"> LOW Backbone is difficult to find (and only available in GI areas) but provides inherited audience for local content
Insertion model (GI optional)	National backbone with local content simulcast at peak time	<ul style="list-style-type: none"> HIGH Backbone content is easy to find and gives local content a large inherited audience 	<ul style="list-style-type: none"> MEDIUM Backbone content is difficult to find but gives local content an inherited audience
The GI local only model	Local content on GI only	<ul style="list-style-type: none"> MEDIUM Local content is easy to find in GI areas but does not benefit from inherited audience 	<ul style="list-style-type: none"> VERY LOW Local content is difficult to find and has no inherited audience to draw on

Potential audience reach of local content

ANNEX 8: ILLUSTRATIVE CANDIDATE CONURBATIONS IDENTIFIED BY OFCOM

Top 20 conurbations by population size shown



Note: Number indicates rank of conurbation population size. Geographical Interleaved spectrum has already been licensed in the case of Winter Hill and Cardiff.

Source: Ofcom. Population size is per the Office of National Statistics

ANNEX 9: POTENTIAL NATIONAL ADVERTISING FOR A LOCAL TV NETWORK

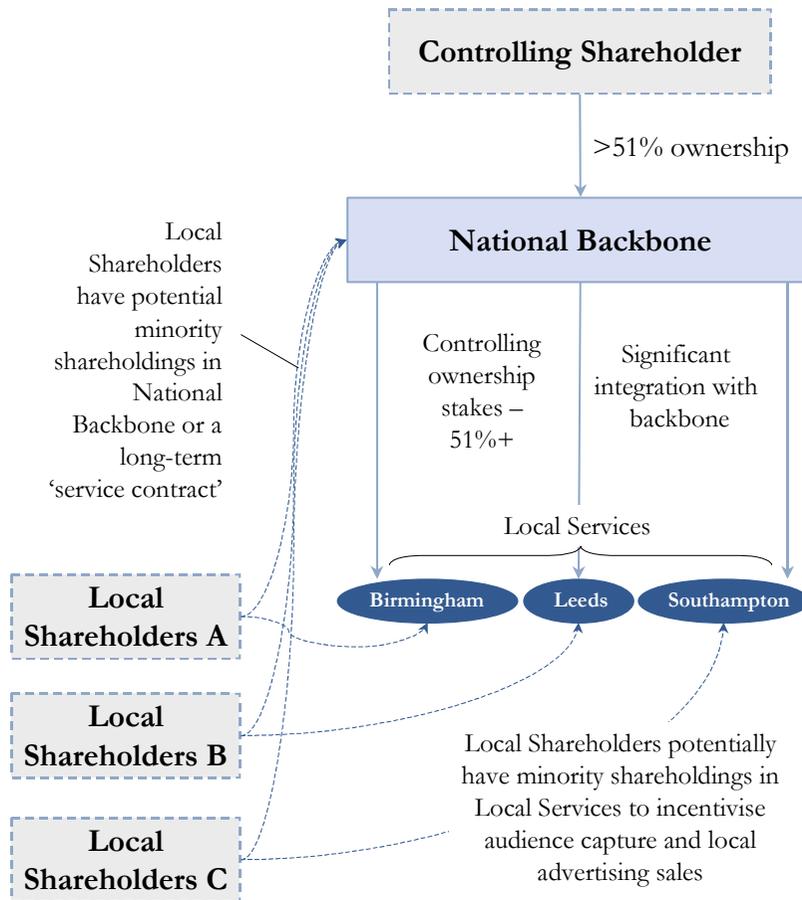
Potential national advertising revenue of £15m is supported by relatively conservative assumptions, particularly if national spectrum is available

INPUTS	GI	NATIONAL SPECTRUM	SOURCES
Demographics			
UK Population	58.8m	58.8m	■ UK population as per 2001 consensus (as used by Ofcom)
Local TV Addressable Audience			
Audience reach in targeted conurbations (Pop)	11.1m	14.0m	■ Top 10 conurbations have a population of 19.1m, this has been reduced by 26.8% to reflect the fact that only 73.2% of households view TV over DTT (reflecting in part penetration of satellite and cable) ■ Further reductions to reflect imperfect GI coverage applied in GI scenario (based on Ofcom coverage assessment and estimated coverage adjustments of up to 50% per conurbation)
Assumed TV audience reach in rest of country	n.a	29.1m	■ In a national spectrum usage scenario, the remaining population would access national backbone programming on DTT via the prominent EPG position
Total Population Reach	11.1m	43.0m	■ Approximate UK population able to receive local TV signal over DTT
<i>Implied % of total population</i>	<i>18.9%</i>	<i>73.2%</i>	
Local TV Audience Reach			
Assumed share of targeted local audiences reached	2.0%	2.0%	■ In the targeted conurbations, this would position the local channel below ITV2 and above E4 in terms of audience share; this is reliant on a strong EPG position
Assumed audience share of population in rest of country	n.a	0.25%	■ Audience share in areas with no local services (just national backbone content) is assumed to be considerably less
Equivalent National Audience Share	0.38%	0.60%	■ Equivalent share of all UK audiences; places local TV below the top 20 in both cases
<i>Implied (undiscounted) revenue for Local TV</i>	<i>£24.6m</i>	<i>£38.9m</i>	■ In 2009, ITV1 revenue was approximately £65m per percentage of national audience share. ⁽¹⁾ This has been applied to estimated local TV network share.
Discount Applied to Local TV Advertising Rates	39.1%	61.5%	■ Discount to ITV1 2009 advertising rates required to generated £15.0m in revenue for local TV network
Potential Revenue Based on Discounted Pricing	£15.0m	£15.0m	

¹ ITV1 audience share: 16.9% and ITV1 advertising revenue of £1,100m in 2009 implies average revenue of £65m per 1% of population. Source Ofcom, BARB
Source: Ofcom, BARB, Company information

ANNEX 10: ILLUSTRATIVE SCHEMATICS OF LOCAL TV OWNERSHIP OPTIONS

1 Example of Integrated Structure



BENEFITS

- ✓ Allows for centralised control / co-ordination of local service content and programming
- ✓ Likely to maximise prospects of sharing / reducing costs
- ✓ Whole entity aligned to maximise commercial viability / profitability – for example clear direction with respect to national marketing and promotion, and lower risk of regional performance variations

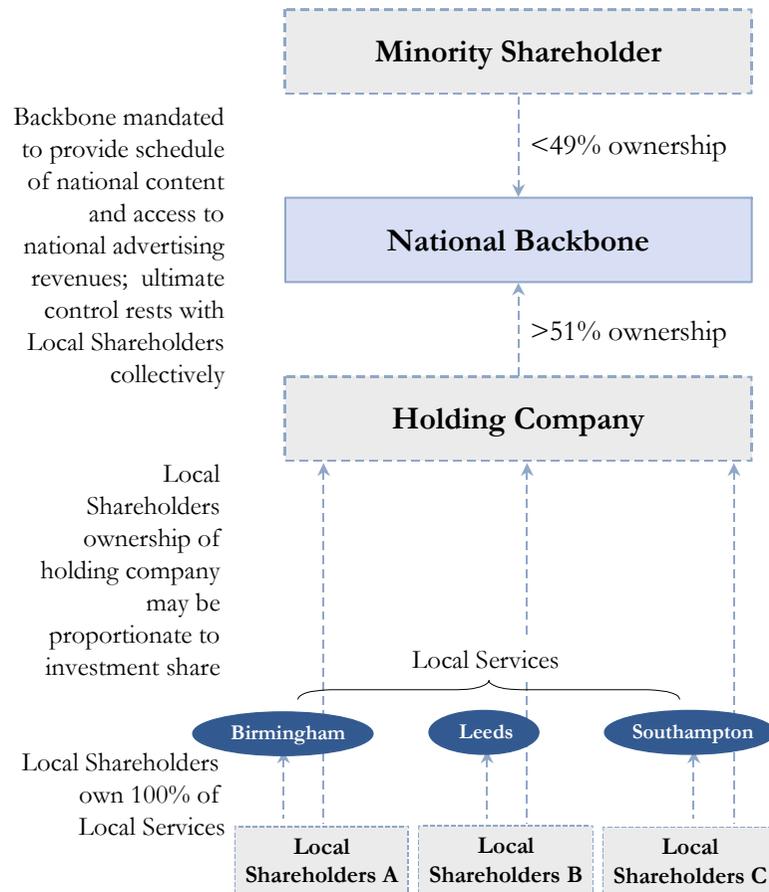
POTENTIAL ISSUES

- ✗ May not offer existing local media groups enough control to be "interesting"
- ✗ Branding and identity likely to be national rather than local – i.e. similar to ITV1/BBC1 models of national schedules with regional news opt-outs
- ✗ Over medium to long term, risk that network gravitates away from local content to improve profitability

Note: "Local Shareholders" refers to some combination of local media and local enterprise.

ANNEX 10: ILLUSTRATIVE SCHEMATICS OF LOCAL TV OWNERSHIP OPTIONS

2 Example of Local Service Centric Structure



BENEFITS

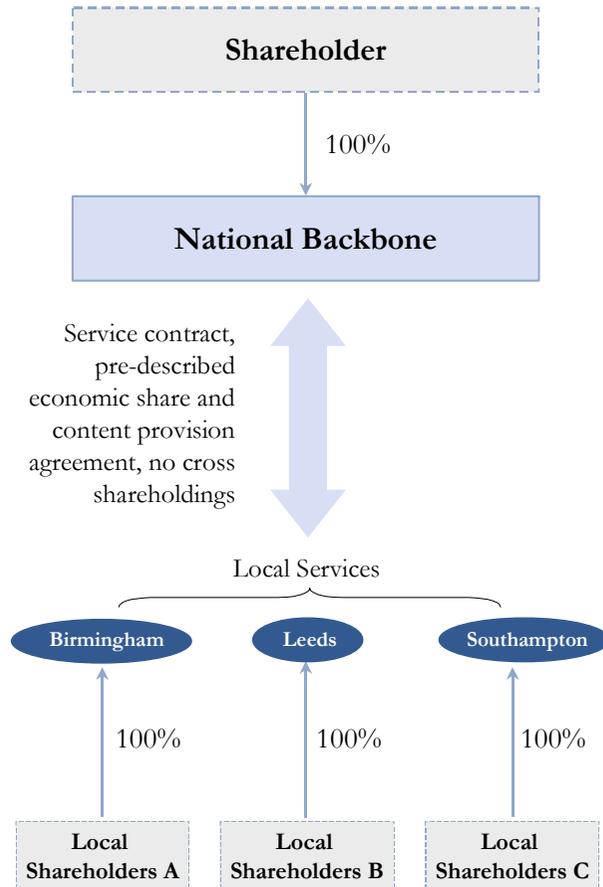
- ✓ Provides local shareholders with full control
- ✓ Fully incentivises local media groups to generate local revenues where possible
- ✓ More likely to facilitate local services with strong local identities

POTENTIAL ISSUES

- ✗ May give rise to coordination / control issues, e.g. coordinating local service content and quality
- ✗ May lead to interest alignment issues between different local services – e.g. how will current group be incentivised to add additional conurbations?
- ✗ May lead to lack of economic incentives for backbone operator to maximise national revenues and schedule quality
- ✗ Variability of performance / sustainability of local service groups may lead to failures

ANNEX 10: ILLUSTRATIVE SCHEMATICS OF LOCAL TV OWNERSHIP OPTIONS

3 Example of Split Ownership Structure



BENEFITS

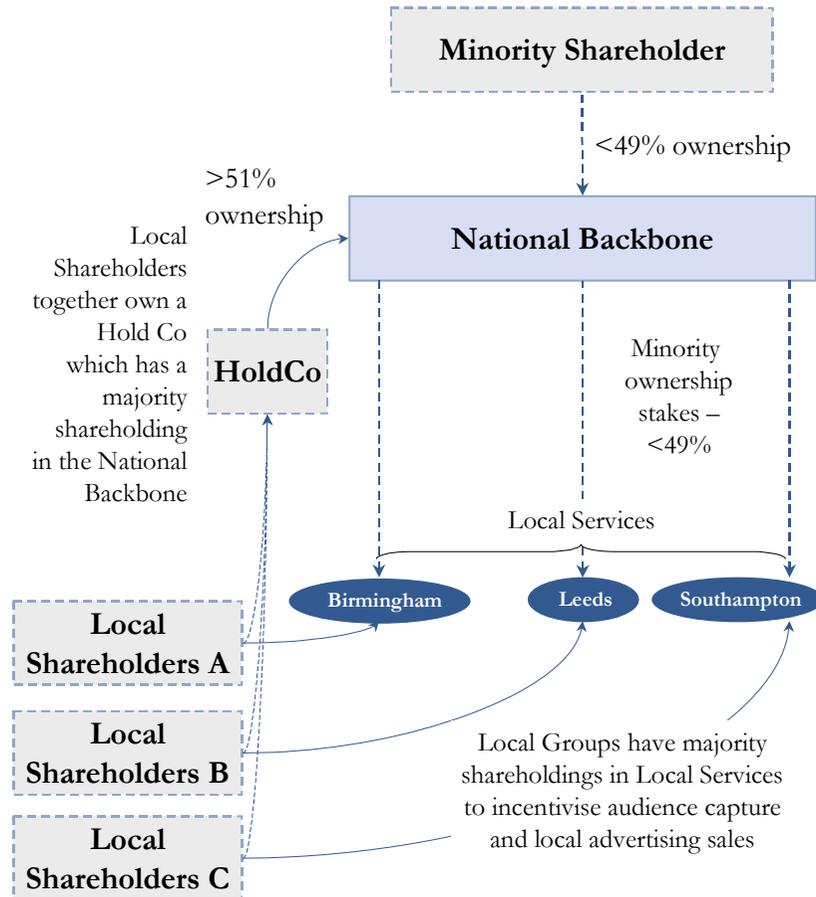
- ✓ Aligns national backbone to maximise quality of control and advertising revenues to maximise profitability
- ✓ Gives local shareholders increased control of individual operations and incentives to sell local advertising
- ✓ More likely to allow local services to have a distinct identity

POTENTIAL ISSUES

- ✗ Could eventually lead to divergence of interests between national backbone and local services, e.g. national backbone pulling away from local service obligations
- ✗ Could lead to variability of quality / performance between local service groups

ANNEX 10: ILLUSTRATIVE SCHEMATICS OF LOCAL TV OWNERSHIP OPTIONS

4 Example of Cross-Ownership Structure (recommended by Steering Group)



BENEFITS

- ✓ Provides national backbone operator with significant shareholder influence and economics, while integrating the backbone with the local services through minority equity interests
- ✓ Local Groups remain incentivised to run local services, while having significant influence over national backbone to alleviate 'national consolidation' risks
- ✓ Backbone operator retains significant economic incentive to maximise content quality and national revenues
- ✓ If backbone is created first, this gives greater certainty to the prospective local licence holder

POTENTIAL ISSUES

- ✗ Complexity – i.e. too many 'interests' at national backbone level?
- ✗ May not be sufficient ownership to attract a shareholder for the national backbone
- ✗ Potential governance/alignment issues
- ✗ It might be difficult to achieve through a licensing regime alone

ANNEX 11: SOURCE DOCUMENTS

This is a list of the principal documents the Steering Group considered during its review.

The economics of delivering local digital audio-visual and interactive services

Spectrum Strategy Consultants, November 2005

Digital Local: Options for the future of local video content and interactive services

Ofcom Report, January 2006

Digital Dividend Review

Ofcom Statement, December 2007

BBC Local Video Research Report

Prepared for the BBC Trust, October 2008

The Sustainability of Local Commercial TV: Prospects for big city and community local TV channels

For Ofcom by Oliver and Ohlbaum Associates Ltd, January 2009

Review of the local and regional media merger regime

Office of Fair Trading, June 2009

Creating Viable Local Multi-media Companies in the UK

Roger Parry, July 2009

Local and regional media in the UK

Ofcom Report, September 2009

Digital Dividend: 600 MHz band and geographic interleaved spectrum

Ofcom Consultation, Feb-April 2010

Technical delivery options for local television services in the UK

Ofcom Research Document, September 2010

The Communications Market

Ofcom, 2010

Case Studies on local and regional media outside the UK

Ofcom <http://stakeholders.ofcom.org.uk/binaries/research/tv-research/international.pdf> -

A number of confidential submissions from interested parties and stakeholders were also used in the production of this report.