



Summary:

Teracom and terrestrial networks – media policy, monopoly and emergency preparedness

Audit background

The state-owned Teracom Group plays an important role in ensuring that the population throughout Sweden can receive radio and television broadcasts via terrestrial networks. These networks also have an important function for emergency preparedness and must be able to broadcast under more or less any conditions. In theory other companies can offer terrestrial broadcasting in competition with Teracom, but in practice the Group has a monopoly. For that reason the Swedish Post and Telecom Authority decided to price regulate the markets for terrestrial networks, to prevent the risk of overcharging customers.

While the terrestrial networks are important for media policy and emergency preparedness, technical advances have meant that a growing number of people consume radio and television via forms of distribution other than terrestrial networks. This has altered the conditions for the Teracom Group and its management is planning a comprehensive change of strategy in which telecom operations not linked to the terrestrial networks will be assigned greater importance.

Purpose of the audit, audit issues and delimitations

The purpose of the audit is to investigate the advantages and disadvantages of the operations with regard to whether they are effective in a wide sense in achieving the underlying objective that public service companies' broadcasts must be able to securely reach the entire population. The following audit issues applied to the audit:

- Does the Teracom Group manage to create value for the owner without mismanaging the public policy assignment or abusing its monopoly position?¹

¹ Teracom is one of the state-owned enterprises that is tasked with both creating value in a financial sense and performing a public policy assignment.

- Has the Government provided the Teracom Group with the conditions for responsibly managing its monopoly while creating long-term value?
- Is central government regulation, follow-up and control of the markets for terrestrial radio and television effective?
- Is Teracom's monopoly on terrestrial radio and television justified?
- Is state ownership of the Teracom Group justified?

The audit refers to the Teracom Boxer Group AB (the Teracom Group) and the government's governance of the company. The Swedish Post and Telecom Authority is also included in the audit.

However, questions concerning the content of the public service companies' remit are not included in the audit.

The audit takes into account that the Teracom Group has an emergency preparedness function and what it means for the Government's governance of the company. However, the emergency preparedness function and how the Group fulfils this function in practice are not examined in detail.

Audit findings

Teracom wants to change direction

Teracom's business originated in terrestrial networks for radio and television in Sweden, and the company's public policy assignment is closely linked to the terrestrial networks. An important aspect of the public policy assignment is that the terrestrial networks must be able to function in crisis and emergency situations. During its history as an independent company, however, the Teracom Group has also operated various types of ancillary activities to the terrestrial networks. The largest of these is the business in its subsidiary Boxer, which sells pay-tv subscriptions for the terrestrial network. In an ongoing strategic reorientation, the Teracom Group is planning (June 2016) to sell Boxer. Instead, in the future Teracom Group the management wants various telecom operations to grow; these are operations with weak or no links to the terrestrial networks.

The Government has not taken a position on the new strategy

According to the Swedish NAO the planned changes in the Teracom Group are so great that the Government needs to take an active position on the new direction. The new initiative is also associated with several different risks. Apart from the purely business risks of the new activities, an orientation away from terrestrial networks for radio and television may mean that the public policy assignment is marginalised. The new

orientation also means that Teracom will enter several markets that are exposed to competition. The assessment of the Swedish NAO is that this increases the risk of Teracom inhibiting private enterprise. This risk may be enhanced in that Teracom has better conditions in various ways than private actors, for example due to overcapitalisation in the form of substantial equity. Teracom's monopoly on terrestrial broadcasting also implies predictable revenue for a long time to come, which private actors cannot expect.

There are no grounds for state ownership of large parts of Teracom's business

Teracom's new orientation also highlights the question of whether the State needs to own all or part of the Group. In the opinion of the Swedish NAO the core of Teracom's business that has an explicit public policy assignment – i.e. the terrestrial networks – should remain state-owned, bearing in mind particularly its role for emergency preparedness. In the opinion of the Swedish NAO, other business should be assessed on the basis of its contribution to this public policy assignment.

Some of the ancillary business clearly contributes to reducing customers' costs for broadcasting in the terrestrial network, for example placing equipment in Teracom's masts or services where Teracom's service corps are hired out. It is uncertain whether such operations can be separated from the terrestrial network operations without negative consequences. It is true that pay-tv operations in Boxer make a major contribution to the costs of the terrestrial network, but do not need to be owned by Teracom to do this. Operations in Teracom's new orientation do not currently contribute at all to the costs of the terrestrial network and it is uncertain whether they will do so in the future.

All in all, the Swedish NAO therefore considers that it is warranted for the State to retain the terrestrial network operations and some operations that are difficult to separate from the terrestrial networks. According to the Swedish NAO, other operations, including telecom, do not need to be state-owned on the basis of the current public policy assignment.

The Government has not taken a position on whether Teracom should be a tool for more policy areas

The Teracom Group's management argues for the company receiving a new public policy assignment that includes for example secure telecommunications between public agencies.

On the basis of such a change in the public policy assignment Teracom could be a tool for more policy areas than at present. The Swedish NAO has not assessed in substance whether a new public policy assignment is appropriate but notes that this is a matter on which the Government must take a position. A substantially amended public policy assignment could also change the assessment of which parts of the Group's operations should be state-owned.

It is not given that a limited company is the appropriate corporate form for the terrestrial networks

Even if the Swedish NAO considers that the terrestrial networks should be state-owned it is not given that the current corporate form with a profit-making limited liability company is the most suitable. The State's corporate governance is largely aimed at state-owned enterprises operating under conditions that are similar to those for private companies. If this ambition is taken to its logical conclusion the advantages of State ownership from the point of view of emergency preparedness can be undermined.

The terrestrial network markets are static but treated as though they were dynamic

The Swedish NAO considers that the monopoly for terrestrial networks should be regarded as natural, i.e. that the economies of scale are such that it is not realistic to expect other actors to be able to compete with Teracom in these markets.

In practice there is also an insight among all relevant bodies (the Government Offices, the Post and Telecom Authority, the Swedish Broadcasting authority and public service companies) that Teracom is the only realistic supplier of terrestrial network services. Nevertheless, the governance and regulation used is adapted to markets with normal competition conditions. As a consequence, a number of public bodies are engaged in determining how much Teracom's customers must pay for broadcasting services. Sveriges Radio and Sveriges Television conduct public procurements, despite the fact that Teracom is the obvious supplier. The Post and Telecom Authority uses administrative resources to make detailed analyses of facts that are well known and to exercise oversight of Teracom. Teracom in turn must disclose costs separately in accordance with a complicated system. However, Teracom does not oppose some of the Post and Telecom Authority decisions, and therefore the issue of price has not been appealed.

The Swedish NAO considers that the present arrangement, in which terrestrial network markets are treated as if they were dynamic, is ineffective in two ways. Firstly, public

resources are used in a zero-sum game that fundamentally concerns whether at most around ten million is to be used in the public service companies or be distributed as profit to the State as owner. Secondly, the form of price regulation contributes to reducing the pressure on Teracom to improve the effectiveness of its operations.

The Swedish National Audit Office's recommendations

The Swedish National Audit Office recommends that the Government:

- takes a position on the public policy assignment that Teracom should have, and thereafter review which of Teracom's operations need to remain in state-ownership.
- considers the most suitable corporate form for the terrestrial networks.
- reviews the possibility of making price regulation of the terrestrial network markets in accordance with the Electronic Communications Act redundant, for example through corporate governance.
- uses corporate governance to ensure that the company does not risk inhibiting private enterprise by using the advantages the company enjoys from being state-owned and holding a monopoly.
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The Swedish National Audit Office recommends that the Post and Telecom Authority:

- Considers using a price regulation model that does not remove Teracom's incentive to improve its effectiveness, to the extent price regulation of terrestrial network markets continues.