An hourglass-shaped graphic with a globe inside. The top bulb is dark blue, and the bottom bulb is light blue. The globe is centered in the narrow neck of the hourglass. The word "WikiLeaks" is written in white on a dark blue rectangular background at the bottom of the hourglass.

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Congressional Research Service

Report RL32027

*Market Structure of the Video Programming Industry and
Emerging Public Policy Issues*

Charles B. Goldfarb, Resources, Science, and Industry Division

Updated July 28, 2003

Abstract. This report provides a description of the current video industry market structure and explains how the various industry segments are interrelated. Given the successful entry of new technologies and the complex structure of many integrated media companies, the relationships across functional and technological segments of the industry are complex. Companion CRS Report RL32026 explains how and why underlying market forces (as well as some government regulations and deregulation) have created strong pressure for vertical and horizontal integration, and how the market consolidation could be used to benefit or to harm consumers. It also identifies public policy issues that may arise as a result of the vertical and horizontal consolidation.

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Market Structure of the Video Programming Industry and Emerging Public Policy Issues

July 28, 2003

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Market Structure of the Video Programming Industry and Emerging Public Policy Issues

Summary

The video programming industry has undergone fundamental structural change in the past 15 years. About 80 percent of U.S. households subscribe to cable or satellite systems offering multiple channels of programming. These alternatives to broadcast television now attract more than half the total viewing audience, although broadcast television still attracts a majority of viewers during prime-time when popular broadcast network fare is aired. Another seismic change is that movie producers receive more than twice as much revenue from video stores as they do from movie theaters.

At the same time, there has been widespread vertical and horizontal integration in the video programming industry. The industry is increasingly dominated by a small number of firms that finance the development of new programming through a wide variety of arrangements with content providers (including joint ventures and direct ownership), own extensive libraries of existing programming, own a variety of distribution channels for bringing content to the public, and also own retail pipelines such as local broadcast stations and video store chains (and, currently proposed, a direct broadcast satellite system).

These fundamental changes in the market structure affect the public policy issues that Congress faces. Today, there are more pipelines into the home and more distribution networks than ever before, but a small number of big media players control a large portion of both programming and distribution. Questions are starting to arise about how well the existing FCC ownership rules, which tend to focus on horizontal relationships involving only broadcast technology, address the impact of consolidated ownership of programming and distribution across broadcast, cable, and satellite technologies on the public interest goals of diversity, competition, and localism — and whether new rules that more directly recognize the new market structure could or should be formulated that would better serve those goals.

The purpose of this report is to provide a brief description of the current video industry market structure and to explain how the various industry segments are interrelated. Given the successful entry of new technologies and the complex structure of many integrated media companies, the relationships across functional and technological segments of the industry are complex. CRS Report RL32026 explains how and why underlying market forces (as well as some government regulations and deregulation) have created strong pressure for vertical and horizontal integration, and how that market consolidation could be used to benefit or to harm consumers. It also identifies public policy issues that may arise as a result of the vertical and horizontal consolidation.

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Market Structure of the Video Programming Industry and Emerging Public Policy Issues

Introduction

The video programming industry is a major force in American society, both as an important provider of news, information, and entertainment, and as an economic engine in itself. Annual industry revenues exceed \$136 billion.¹ More than \$75 billion of these come from direct payments by households — approximately \$687 per household per year — and the remainder from advertisers.

As shown in Figure 1, the video programming industry consists of three major functional segments:

- content providers — These are the program producers: the major motion picture and television production studios; independent studios, producers, writers, and editors; and also the programming departments of local television stations (and some cable systems) that produce their own local news programs. These providers also include the film and television program libraries of existing content that offer an alternative to newly created programming.
- program distributors and packagers — These are the broadcast and cable networks, the syndicators of first-run and rerun programming, the movie distributors that package and distribute films, and the distributors of video cassettes and DVDs. They often perform marketing and advertising services on a national scale that could not be performed as efficiently by the content providers or the retail pipelines.
- retail pipelines — These are the broadcast television stations, local cable systems, direct broadcast satellite systems, movie theaters, and

¹ Standard & Poor's estimated that in 2002, U.S. consumers would spend \$44 billion for television programming (delivered via basic cable, pay cable, and satellite programming), \$9 billion for theatrical movies, and \$22 billion for rental and purchase of prerecorded videocassettes and DVDs, and that the television industry also would be supported by \$61 billion in advertising expenditures, yielding total industry revenues of \$136 billion. Tom Graves, "Movies and Home Entertainment," Standard & Poor's Industry Surveys, November 14, 2002, at p. 7.

video stores that provide video programming directly to end user customers.²

In the not too distant past, ownership tended not to cross these functional industry boundaries. That is no longer the case.

The video programming industry has experienced two seismic changes in the past fifteen years: (1) successful market entry by multi-channel providers of video programming using cable and (more recently) satellite technologies, and (2) widespread vertical and horizontal integration³ across both functional and technological boundaries.

As shown in Table 1,⁴ in 2001 cable television service was available to 96.7 percent of U.S. households and 65.0 percent of households subscribed; at the same time, 17.7 percent of households subscribed to satellite service. These cable and satellite services offer multiple channels of video programming that expand substantially on the technologically limited number of channels available from the broadcast spectrum. Survey data from the FCC's 2002 Report on Cable Industry Prices⁵ show the average cable system devotes 82.5 channels to video delivery. Direct Broadcast Satellite (DBS) systems typically offer even more video channels.

The video programming industry now must produce enough programming to fill the schedules of hundreds of program channels, rather than just a handful. While initially much of the programming carried by the multi-channel systems was reruns from existing film and television program libraries, increasingly the public is demanding original programming. As a result, the sheer volume of video production has increased substantially.

The alternatives to broadcast television now attract more than half the viewing audience, though broadcast television still attracts a majority of viewers during prime-time when popular broadcast network fare is aired. According to the National

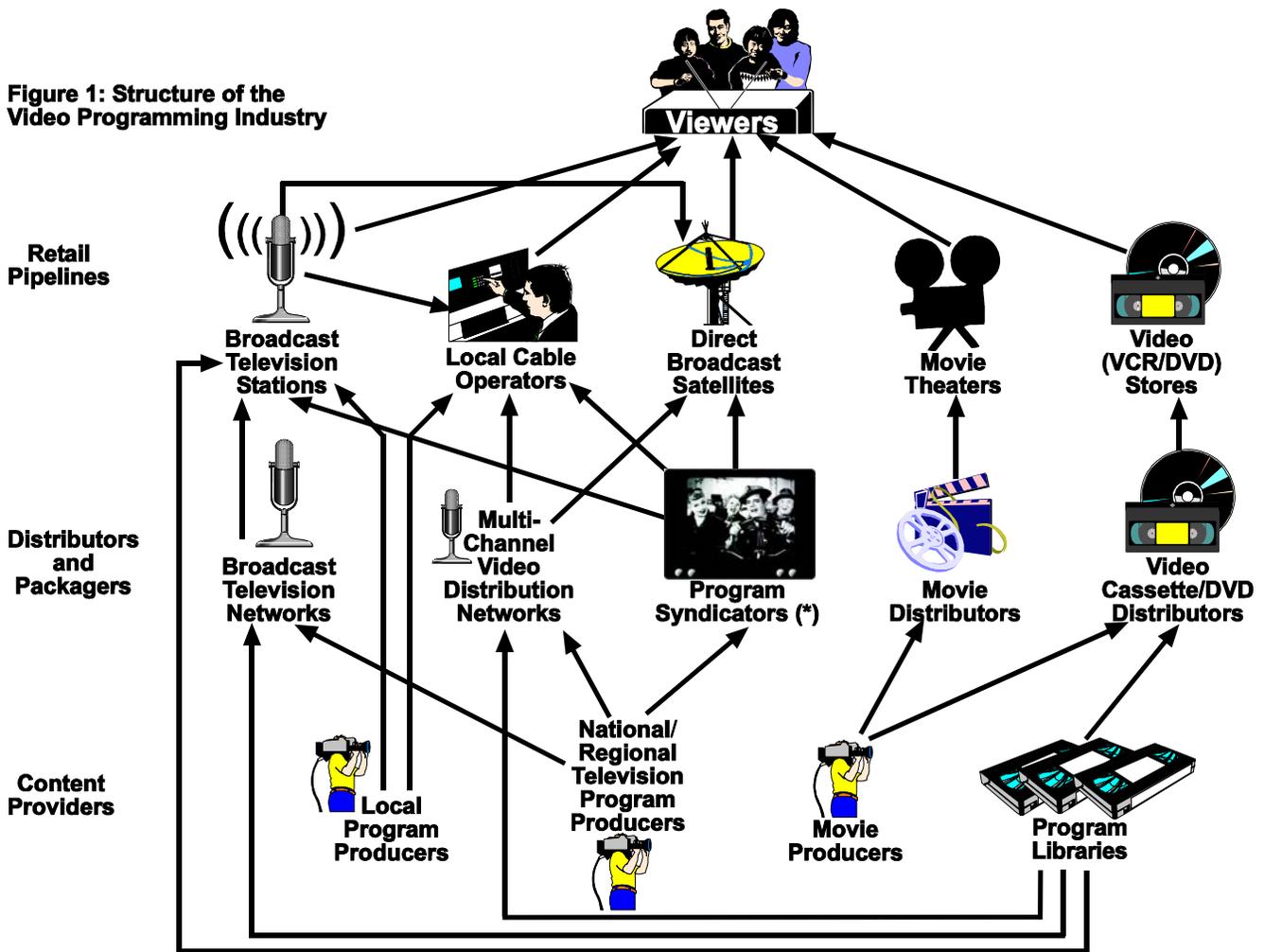
² In each of these three functional segments, there also are small players with minimal market impact. For example, multichannel multipoint distribution service (MMDS) systems, sometimes referred to as "wireless cable," transmit video programming and other services to approximately 700,000 subscribers through 2GHz microwave frequencies, but these systems are losing subscribers, primarily serve legacy customers, and are not significant competitors.

³ Horizontal integration occurs when firms that compete directly with one another combine. Vertical integration occurs when firms that are in a supplier-customer relationship combine. The supplying firm can be providing products (e.g., programming) or services (e.g., distribution services) that are inputs for the customer.

⁴ Reproduced from Jonathan Levy, Marceline Ford-Livene, and Anne Levine, "Broadcast Television: Survivor in a Sea of Competition," OPP Working Paper 37, Federal Communications Commission, September 2002, Table 1, p. 4 (2010 projections omitted).

⁵ *Implementation of Section 3 of the Cable Network Consumer Protection and Competition Act of 1992, Statistical Report on Average Prices for Basic Service, Cable Programming Services, and Equipment*, MM Docket No. 92-266, Report on Cable Industry Prices, 17 FCC Rcd at 6313, Table 11 (2002).

Figure 1: Structure of the Video Programming Industry



(*) Copy Right: Desilu Productions, 1958. Adapted by CRS

Cable & Telecommunications Association,⁶ basic cable networks and pay cable services captured a 59 share of the viewing audience in 2002, while broadcast network affiliates, independent broadcast television stations, and public television stations captured only a 53 share.⁷ The FCC reports⁸ that the prime-time share of all cable networks increased from 51.9 in July 2000 - July 2001 to 56.5 in July 2001 - June 2002, while the prime-time share of all broadcast television networks fell from 63 to 59 during the same period.

⁶ "Viewing Shares: Broadcast Years: 1991/92-2001/02," *Cable Developments 2003*, National Cable & Telecommunications Association, at p. 16, citing data from Nielsen Media Research and Cable Status Report Data, published by the Cablevision Advertising Bureau in *Cable TV Facts*, 1993 through 2003.

⁷ A program's or network's "share" is defined as the percentage of the television households watching television at a given time that are tuned to that particular program or network. The sum of all shares typically exceeds 100 because in some households there will be multiple televisions being watched at the same time.

⁸ *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, Federal Communications Commission, MB Docket No. 02-145, Ninth Annual Report, released December 31, 2002, at pp. 5 and 6.

Table 1. Availability of Video Media

	1975	1980	1985	1990	1995	2000	2001
Total Households (millions)	71.5	81.8	87.6	94.8	97.5	104.1	107.4
TV Households (TVHH) (millions)	69.6	79.9	85.9	93.1	95.9	102.2	105.5
Cable Subscribers/TVHH (%)	14.1	24.0	42.7	55.5	64.8	67.0	65.0
Cable Houses Passed/TVHH (%)	33.2	43.7	75.3	92.4	96.7	96.7	96.7
Satellite Subscribers/TVHH (%)	0.0	0.0	0.0	0.9	4.8	15.7	17.7
Cable + Sat. Subscr/TVHH (%)	14.1	24.0	42.7	56.4	69.6	82.7	82.7
VCR Homes/TVHH (%)	0.0	1.0	27.7	66.1	79.7	86.1	85.2
DVD Homes/TVHH (%)	0.0	0.0	0.0	0.0	0.0	8.8	13.0

Sources: Total HH and TVHH: Television Bureau of Advertising, “Television Households, Trends in Television,” at [<http://www.tvb.org>] (citing Nielsen); Cable subscribers 1975: Kagan World Media, *Broadcast Cable Financial Databook*, July 2002, at p. 7; Cable subscribers 1980-2001: Paul Kagan Associates, *Cable TV Investor*, May 24, 2002, at p. 9; Cable houses passed 1975-2001: Paul Kagan Associates, *Cable TV Investor*, May 24, 2002, at p. 9; DBS and C-Band subscribers 1995-2001: Kagan World Media, *Economics of Basic Cable Networks 2002*, Sept. 2001, at pp.23-27; C-Band subscribers 1990: 1995 MPVD Competition Report at Table G-1; VCR and DVD Homes 1990-2001: Veronis Suhler, *Communications Industry Forecast*, 2001, at pp. 192 and 194; VCR and DVD Homes 1980-1985: Television Bureau of Advertising, “Cable, Pay Cable & VCR Households, Trends in Television,” at [<http://www.tvb.org>].

Over the past decade, technology-driven market forces and relaxation of government rules have led to widespread vertical and horizontal integration in the video programming industry (and more generally in the media sector). Some of these integrated firms are very large, with extensive holdings in multiple industry segments, crossing both functional and technological boundaries.⁹ This has raised concerns in some quarters that the firms could use their market positions to harm competition and that media concentration reduces the diversity of independent voices and lessens sensitivity to local needs, interests, and standards. Other policymakers have found benefit to consumers from efficiency gains made possible by such

⁹ Horizontal consolidation can occur both within and across technologies. For example, since the same programming can be, and is, used on broadcast, cable, and satellite pipelines, acquisitions that place both a broadcast network and cable networks under the same ownership represent horizontal consolidation in the video programming distribution market. Similarly, acquisitions that place a satellite system and a group of local broadcast stations under the same ownership represent horizontal consolidation in the video retail pipeline market.

consolidation, and have pointed to some empirical evidence that consolidation has increased the amount and quality of local news programming.¹⁰

The video programming industry is simultaneously expanding its boundaries and program offerings and consolidating ownership. On one hand, the emergence of cable television, direct broadcast satellites, and video cassette and DVD rentals and sales has expanded the video options available to viewers. Viewers clearly value these options — they continue to increase their levels of video viewing and they have demonstrated a willingness to pay for their additional programming.¹¹

On the other hand, the industry is increasingly dominated by a limited number of vertically integrated firms that finance the development of new programming through a wide variety of arrangements with content providers (including joint ventures and direct ownership), own extensive libraries of existing programming, own a variety of distribution channels for bringing content to the public, and also own retail pipelines such as local broadcast stations and video store chains (and, currently proposed, a direct broadcast satellite system).

These fundamental changes in market structure affect the public policy issues that Congress faces. In the 1960s, there were few programming pipelines into the home. There were three broadcast networks and 90 percent of television viewers watched the network programming carried by these networks' local affiliates. There were too few geographic markets with more than three commercial television stations to support additional broadcast networks, and cable and satellite alternatives were not yet technologically viable. Given the technology-driven limitation on the number of video pipelines into the home and the number of distribution networks, various federal rules were adopted with the intention of fostering diverse voices despite the small number of gatekeepers.

In addition to limits on any entity's ownership of local or national broadcast properties, broadcast networks were required to obtain much of their programming from independent sources and to allow those independent producers to maintain syndication rights. Local stations were subject to news and public affairs programming requirements and to the Fairness Doctrine, which required them to cover issues of public importance in a "balanced" fashion.

As the number of pipelines into the home and distribution networks have increased, the broadcast station ownership restrictions have been relaxed, the

¹⁰ See, for example, Report and Order and Notice of Proposed Rulemaking, *2002 Biennial Regulatory Review — Review of the Commission's Broadcast Ownership Rules and Other Rules Adopted Pursuant to Section 202 of the Telecommunications Act of 1996*, MB Docket 02-277; *Cross-Ownership of Broadcast Stations and Newspapers*, MM Docket 01-235; *Rules and Policies Concerning Multiple Ownership of Radio Broadcast Stations in Local Markets*, MM Docket 01-317; *Definition of Radio Markets*, MM Docket 00-244; *Definition of Radio Markets for Areas Not Located in an Arbitron Survey Area*, MB Docket 03-130, adopted June 2, 2003 and released July 2, 2003, at ¶ 344.

¹¹ A more detailed description of consumers' video viewing and spending behavior is presented in CRS Report RL32026.

program ownership restrictions on broadcast networks have been eliminated, and the Fairness Doctrine and programming requirements on local stations have been eliminated.

Today, there are more pipelines into the home and more distribution networks, but a relatively few big media players control a large portion of both programming and distribution. For example, one observer¹² claims that “[f]ive companies¹³ own all the broadcast television networks,¹⁴ four of the major movie studios,¹⁵ and 90 percent of the top 50 cable channels¹⁶ [and] also produce three-quarters of all prime-time programming.”¹⁷ Figure 1 shows both the functional segments and

¹² James Surowiecki, “All in the Family,” *The New Yorker*, June 16 & 23, 2003, at p. 76. Footnotes have been added to provide data sources that confirm or refute Mr. Surowiecki’s claims, for which he did not provide underlying data sources.

¹³ AOL-Time Warner, Disney, General Electric, News Corp., and Viacom.

¹⁴ AOL-Time Warner owns WB, Disney owns ABC, General Electric owns NBC and partially owns Paxson, News Corp. owns Fox, and Viacom owns CBS and UPN.

¹⁵ According to the website of the Motion Picture Association of America, [<http://www.mpa.org>], there are seven major producers and distributors of motion pictures and television programs in the U.S., four of which are owned by one of the five companies — Disney (Disney), Paramount (Viacom), 20th Century Fox (News Corp.), and Warner Bros (AOL-Time Warner) — and three of which are independent of those five companies — Sony, M-G-M, and Universal Studios.

¹⁶ There are a number of possible ways to measure “top” cable channels: prime-time or total day audience size or audience share, total household subscribers, total revenues, total advertising revenues, total or average license fees per subscribing household, etc. Based on data from “Cable Network TV Household Growth (Ranked by 2001 TV Households),” *Economics of Basic Cable Networks 2003*, Kagan World Media, at pp. 34-35, of the top 50 cable networks in terms of household subscriptions, 34 are partially or fully owned by one of the “Big Five” companies; 9 additional cable networks are partially or fully owned by Liberty Media, about \$8 billion of whose holdings are in News Corp. and AOL Time Warner stock; one is wholly owned by Comcast, the largest multiple system operator of local cable systems; two are C-SPAN networks co-funded by the cable and satellite industry; and four are independently owned. Other measures of “top” cable networks yield similar ownership patterns.

¹⁷ The available data on ownership or production of prime-time programming are inconsistent, some supporting and some disputing this contention. According to the Coalition for Program Diversity, an umbrella group that is advocating that the FCC adopt a rule requiring the four major broadcast networks to purchase 25 percent of their prime-time programming from independent producers, the following percentages of 2003-2004 prime-time programming will be produced by companies that are owned by or affiliated with the network such that the network will retain the copyright on the programming: CBS, 97.5%; FOX, 80.0%; ABC, 71.45%; NBC, 57.9%. (See Paige Albinak, “Outlook Grim, Say Indie Studios,” *Broadcasting & Cable*, June 9, 2003, at p. 26.) According to Kagan World Media’s *The Economics of TV Programming & Syndication 2002*, network ownership of prime-time schedules, including productions and co-productions, in 2002-2003 were as follows: CBS, 77.3%; FOX, 73.3%; ABC, 53.8%; NBC, 43.2%. In contrast, at the May 22, 2003 Senate Commerce Committee hearing, Rupert Murdoch, President and CEO of News Corp. claimed that for this season FOX will obtain 40 percent of its programming from
(continued...)

technological components of the video programming industry. Several large companies have ownership interests — sometimes extensive — in virtually each “box” in Figure 1. This has engendered considerable debate on how well the existing FCC ownership rules address the impact of consolidated ownership of programming and distribution on the public interest goals of diversity, competition, and localism, and whether new rules that re-regulate the industry could or should be formulated that would better serve those goals.

The FCC has just completed a congressionally mandated biennial review of its media ownership rules and adopted a number of rule changes,¹⁸ most of which lessened ownership restrictions and are widely expected to lead to a new round of acquisitions.¹⁹ Because of the controversial nature of these rules, a number of bills have been introduced in the 108th Congress that reflect a range of positions on several of these rules.²⁰ In addition to the ownership rules, there are federal laws and rules that directly regulate conduct in the video market, such as copyright, nondiscriminatory access, and signal carriage requirements, that affect the relative negotiating strength of various segments — and thus affect market structure. Given the rapid and significant technology-induced market changes that have occurred this past decade, some of these ownership and conduct rules apply to some competitors but not to others, or are having impacts that were unanticipated when they were adopted. Congress can expect individual companies or representatives of industry segments to seek legislation to maintain, modify, or eliminate those laws and rules in the fashion that would give them the greatest competitive advantage.

¹⁷ (...continued)

producers that are independent of FOX. The apparent discrepancy among these claims may be due in part to the time period covered and in part to the definition used for “independent” producer. For example, how should an independently owned company that ceded copyright of its programming to FOX be categorized?

¹⁸ Report and Order and Notice of Proposed Rulemaking, *2002 Biennial Regulatory Review — Review of the Commission’s Broadcast Ownership Rules and Other Rules Adopted Pursuant to Section 202 of the Telecommunications Act of 1996*, MB Docket 02-277; *Cross-Ownership of Broadcast Stations and Newspapers*, MM Docket 01-235; *Rules and Policies Concerning Multiple Ownership of Radio Broadcast Stations in Local Markets*, MM Docket 01-317; *Definition of Radio Markets*, MM Docket 00-244; *Definition of Radio Markets for Areas Not Located in an Arbitron Survey Area*, MB Docket 03-130, adopted June 2, 2003 and released July 2, 2003. The rule changes, their impact on media markets, and resulting legislative policy issues are discussed in CRS Report RL31925, *FCC Media Ownership Rules: Issues for Congress*.

¹⁹ See, e.g., Yochi J. Dreazen and Joe Flint, “FCC Eases Media-Ownership Caps, Clearing the Way for New Mergers,” *Wall Street Journal*, June 3, 2003, p. A1; Alec Klein and David A. Vise, “Media Giants Hint That They Might Be Expanding,” *Washington Post*, June 3, 2003, p. A6; Frank Ahrens, “FCC Eases Media Ownership Rules,” *Washington Post*, June 3, 2003, p. A1; David Lieberman, Paul Davidson, and Michael McCarthy, “TV station will be bought, but probably not quickly,” *USA Today*, June 3, 2003, p. 1B; David Lieberman and Paul Davidson, “Five ways FCC altered the media landscape,” *USA Today*, June 3, 2003, p. 3B.

²⁰ See CRS Report RL31925, *FCC Media Ownership Rules: Issues for Congress*.

The purpose of this report is to provide a brief description of the video industry market structure and to explain how the various industry segments²¹ are interrelated. CRS Report RL32026, on the market dynamics in the video programming industry, explains how and why underlying market forces have created strong pressure for vertical integration across segments and horizontal mergers within segments and how that market consolidation could be used to benefit or to harm consumers. It also explains how certain government regulations as well as certain government deregulation have fostered consolidation. CRS Report RL32026 identifies public policy issues that may arise as a result of the vertical and horizontal consolidation.

Overview of the Video Programming Industry Market Structure

Companies in the video programming industry are involved in the creation and delivery of entertainment, information, and news programming for consumers. Most of the entertainment programming — even when broadcast live — is recorded on film, tape, or disc so that it can be seen or heard repeatedly.²² Increasingly, recorded entertainment is being stored digitally, which can both improve the quality of images and sounds, and make them easier to transmit and copy.

The new technologies available today tend to reduce the incremental costs associated with making video programming available to additional viewers, but do not reduce the large up-front costs associated with producing and marketing the programming. Not all video programs will generate enough revenues to recover their costs, so profits are needed from successful programming to cover the losses associated with other programming.

Whether the final product is broadcast television, multi-channel (cable or satellite) television, theatrical films, or rental videos, the three functional segments — content providers, distributors and packagers, and retail pipelines — must work cooperatively to achieve success. At the same time, there is natural market tension among them. Each wants to get the biggest share of dollars from successful programming and each wants to bear the smallest share of risk. Since tension and risk make market transactions more difficult, there are strong market incentives to bring functional transactions within the boundaries of individual companies through vertical integration.²³ The structural relationships among these functional segments are discussed below for the various consumer products.

Broadcast Television

²¹ The purpose for identifying industry segments is purely descriptive. It is not intended to suggest that an industry segment represents a product market for antitrust purposes.

²² The following industry description is drawn in part from Tom Graves, “Movies & Home Entertainment,” Standard & Poor’s Industry Surveys, November 14, 2002.

²³ These market incentives are discussed in greater detail in CRS Report RL32026.

As of March 31, 2003, there were 1,721 licensed full-power broadcast television stations in the United States, 1,340 of which were commercial stations and 381 educational.²⁴ Half the population can receive 13 or more broadcast television signals; half can receive fewer.²⁵ More than 65 percent of U.S. television households subscribe to cable television and therefore receive their local broadcast signals over cable, not off the air.²⁶

Approximately 860 of the full-power commercial stations are affiliated with one of the four major television networks — ABC, CBS, FOX, or NBC.²⁷ Of these, approximately 61 are owned and operated by one of the networks.²⁸ The United Paramount Network (UPN) and the Warner Brothers Television Network (WB), both of which began operations in January 1995, have formed affiliation agreements with more than 325 commercial television stations not linked to the four national networks. There is also a smaller Paxson network.

Although their market share is eroding, the four major broadcast television networks remain the largest force in U.S. television programming. For national advertisers, they continue to provide household penetration and viewership levels that are not available elsewhere.²⁹ Table 2 shows the prime-time ratings of the network-affiliated broadcast television stations, the non-network broadcast stations, and advertiser-supported cable networks for the 2002-2003 season (until the start of the

²⁴ “Broadcast Station Totals as of March 31, 2003,” Federal Communications Commission News Release, May 5, 2003. In addition, there are more than 2,200 low power television stations licensed to operate in the U.S.

²⁵ Jonathan Levy, Marceline Ford-Livene, and Anne Levine, “Broadcast Television: Survivor in a Sea of Competition,” OPP Working Paper, Federal Communications Commission, September 2002, at p. 3.

²⁶ According to a Television Bureau of Advertising analysis of Nielsen Media Research data for May 2003, from May 2002 to May 2003, wired cable penetration fell from 70.6% to 68.1%, its lowest level since April 1996, while alternate delivery service (primarily DBS) grew from 15.1% to 17.0%. (“Wired Cable Alternatives Skyrocketing; Cable Penetration Hits 7-Year Low, Drops 2.5 Points in 12 Months,” [http://www.tvb.org/localnumbers/current_ads.html] viewed 7/15/23.) Other sources, such as Kagan’s *Economics of Basic Cable Networks 2003*, estimate that 65% of U.S. television households subscribe to cable television. Because of limits on capacity that do not allow satellite systems to offer local broadcast signals to customers in certain locations and charges to consumers to cover associated costs when the local service can be provided, some direct satellite television subscribers either cannot receive or do not choose to receive local broadcast stations over their satellite systems.

²⁷ This number is expected to increase when the FCC’s recently adopted 45% National Television Ownership cap, replacing the old 35% cap, is in place. See CRS Report RL31925, *FCC Media Ownership Rules: Issues for Congress*.

²⁸ In addition, CBS-parent Viacom owns 19 broadcast television stations affiliated with its UPN network and NBC-parent General Electric owns 32 percent of the Paxson Television Network, which owns 72 stations.

²⁹ See, e.g., Harry A. Jessell, “Plenty of Nothing: As broadcasters lose more viewers, they make more bucks,” *Broadcasting & Cable*, June 2, 2003, p. 75.

broadcast summer re-run season).³⁰ The four major networks had a combined average prime-time rating of 27.90. That is, on average, 27.9% of all U.S. television households were viewing one of the Big Four networks at any time during prime-time — an average viewership of about 7% per network. The smaller broadcast networks had ratings of about 2% each. All advertising-supported cable networks, in aggregate, had a rating of about 29, but that is divided among more than one hundred cable networks. TNT, the highest-rated cable network, had a rating of only 1.56%.

Even for individual programs, broadcast television enjoys viewership levels not approached by programming provided by any other advertiser-supported pipelines. According to the Television Bureau of Advertising,³¹

In the month of April, all 100 of the top 100 primetime programs, based on HH [household] rating, aired on the broadcast networks. At the top of the list was CBS's stalwart "CSI," which delivered a 15.4 HH rating. NBC's "Friends" came in second, with a 13.3 HH rating, and CBS's coverage of the NCAA Basketball Championships delivered a 12.6 HH rating to finish in third place.

The highest ranked ad-supported cable program came in at number 146; it was Fox News Channel's "The O'Reilly Factor," which delivered a 3.2 HH rating.

Table 2. Prime-Time Ratings for Advertising-Supported Broadcast and Cable Television Networks

(2002-2003 Season to Date: 9/23/02 - 5/21/03)

Network	Household Rating
Broadcast Networks	
CBS	8.28
NBC	7.75
ABC	6.34
FOX	5.52
WB	2.20
UPN	1.74
Paxson	0.81
4 Major Networks	27.90
7 Broadcast Networks	32.64
Total Broadcast	35.32
Cable Networks	

³⁰ A program's or network's "rating" is the percentage of total television households (approximately 107 million) viewing that program or network.

³¹ "Top 100 Programs on Broadcast & Cable: Apr-2003," Television Bureau of Advertising, [<http://www.tvb.org/rcentral/viewertrack/monthly/top100-b-c/top100.asp?ms=Apr-2003.html>], viewed 6/20/03.

TNT	1.56
Lifeline	1.41
Nickelodeon	1.37
Fox News Channel	1.37
USA	1.25
TBS	1.23
ESPN	1.21
TOON	1.14
CNN	0.97
TLC	0.81
Top Ten Ad-Supported Cable	12.32
Total Ad-Supported Cable	29.08

Sources: “HH Ratings - Primetime Broadcast and Ad-Supported Cable Season-to-Date 2002-2003 v. Season-to-Date 2001-2002” and “HH Ratings - Primetime Top Ranked Ad-Supported Cable Networks Season-to-Date 2002-2003 v. Season-to-Date 2001-2002,” Television Bureau of Advertising, [<http://www.tvb.org/rcentral/viewertrack/monthly/top100-b-c/top100.asp?ms=Apr-2003.html>], viewed 6/20/03.

According to Kagan World Media,³² the bottom 10 broadcast television shows in the 2001-2002 season had an average rating of 3.9. Thus the biggest advertiser-supported cable hits captured a smaller audience than the worst broadcast network failures.

The advertiser-supported cable networks attract larger audiences, however, during broadcast television's traditional summer re-run period. According to *Cable World*,³³ for the week of June 16-22, 2003, the aggregate prime-time audience for advertiser-supported cable networks exceeded the aggregate audience of the seven broadcast television networks by almost 10 million households. *CableFAX* claims that advertiser-supported cable networks' aggregate audience share has exceeded that of the seven broadcast networks for twenty consecutive summer weeks,³⁴ with the disparity reaching 17 share points. Cable networks strategically introduce new programs during the broadcast re-run season.

Although cable networks and systems have made significant in-roads, broadcasting continues to capture the lion's share of U.S. television advertising revenues — with those revenues relatively evenly split between the networks and local stations. According to the Television Bureau of Advertising,³⁵ the breakout in 2002 was as follows (in millions of dollars):

Big Four Network Advertising	\$ 15,000
National Spot Advertising (local stations)	\$ 10,920
Local Spot Advertising (local stations)	\$ 3,034
Syndication and Three Small Networks	\$ 13,114
Total Broadcast Television	\$ 42,068
Cable Network Advertising	\$ 12,071
Cable Non-Network Advertising	\$ 4,226
Total Cable Television	\$ 16,297

With advertiser-supported cable audience share now substantially exceeding that of the broadcast networks, at least during the summer months, but the broadcasters continuing to capture upwards of 75% of advertising revenues, the cable industry has announced its intention to educate the advertising industry about what it terms a

³² Kagan World Media, *The Economics of TV Programming & Syndication 2002*, August 2002, at p. 6.

³³ Shirley Brady, "Bolting Out of the Gate," *Cable World*, June 30, 2003.

³⁴ "Broadcast, Cable Television Ratings Analysis," *CableFAX*, June 26, 2003.

³⁵ "Estimated Annual U.S. Advertising Expenditures 2001-2002," *Trends in Advertising Volume*, Television Bureau of Advertising, [http://www.tvb/central/mediatrendstrack/trends/trends.asp?c=2001-2002], viewed on 6/20/03.

“pricing disparity.”³⁶ To successfully capture additional advertising revenues, however, the cable industry will have to create efficient and effective ways for advertisers to aggregate fragmented cable audiences with favorable demographics comparable to those provided by broadcast television.

Another market threat to broadcast television comes from growing prime-time audience erosion to premium cable networks, such as HBO and Showtime, that offer premium programming for monthly subscriber charges. In 2003, 40,760,000 U.S. households subscribed to pay cable channels — or 38.2% of all television households.³⁷ Since some households subscribe to multiple premium channels, U.S. households subscribed in total to 66,200,000 premium cable units at the end of 2002.³⁸ Even though no premium network is subscribed to by as many as one-third of all television households, hit shows such as HBO’s *The Sopranos* and *Sex and the City* regularly attain ratings of 6.0 and higher.³⁹ For its final season premiere last month, *Sex and the City* attracted 7.3 million viewers, or approximately 6.8% of all television households.⁴⁰ As networks that are only available to those households that subscribe to them, HBO and Showtime are successfully following a strategy of providing programming with adult themes that broadcasters cannot air without risking offending some viewers, especially those who do not want their children to view such programming. In addition, HBO and other premium channels package their hit programs on DVD for sale or rental.

The differential in audience size between broadcast television and cable is partially due to broadcast television networks enjoying large footprints that cover almost the entire U.S. population — and offering service that is “free” to viewers. Even though 96.7% of television households have access to (in industry jargon, are “passed by”) cable television systems,⁴¹ only 65% of television households subscribe to cable systems, and no cable network is carried by all cable and satellite systems, so none has a footprint approaching those of the broadcast networks. But footprint cannot fully explain the entire difference in audience size. Some cable networks are carried in more than 94% of all multichannel households.⁴² Thus these cable

³⁶ *Id.*

³⁷ “Cable, Pay Cable & VCR Households,” Television Bureau of Advertising, [http://www.tvb.org/rcentral/mediatrendstrack/tv/tv.asp?c=cable] viewed 6/20/2003.

³⁸ *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, Federal Communications Commission, MB Docket No. 02-145, Ninth Annual Report, released December 31, 2003, at ¶ 21, Table 2, citing Kagan World Media, *Cable TV Investor*, May 24, 2002, and Kagan World Media, *Broadband Cable Financial Databook*, July 2002.

³⁹ See, e.g., “Ratings: Weekly Pay Cable,” [http://www.allyourtv.com/ratingscablepay.html] viewed 7/15/2003.

⁴⁰ “Weekly Numbers,” *CableFAX*, Vol. 14, No. 122, June 25, 2003.

⁴¹ See Table 1 above.

⁴² According to Kagan World Media, *The Economics of TV Programming & Syndication 2002*, August 2002, at p. 9, TBS had the greatest distribution of any cable network in 2001, (continued...)

networks are received by almost two-thirds of all U.S. television households, either by cable or by satellite. But with the exception of *The Sopranos* and *Sex and the City*, their ratings do not approach two-thirds of broadcast television network ratings.

Given their on-going and unique success in capturing larger (if falling) audiences than their cable and satellite competitors, from 1990 to 2000 the broadcast television networks were able to increase the quantity of prime-time commercials aired by 16.4 percent (from an average of 7 minutes and 47 seconds per hour to an average of 9 minutes and 3 seconds) and also to obtain on average 3.8% annual increases in the rates (“cost per thousand”) they charged advertisers.⁴³

However, broadcast television suffers one technology-driven disadvantage vis-a-vis cable and satellite television. Because it is not technologically or economically viable to charge viewers directly for broadcast programming, broadcasters are entirely dependent on advertising revenues. But advertising revenues are far more cyclical — subject to downturns in the economy — than direct cable or satellite fees on viewers, and therefore broadcasters are hurt more by a slowing economy.⁴⁴

The four major networks provide their owned stations and affiliates with more than 20 hours of programming per week; the smaller networks provide less. In exchange, networks obtain the right to sell the bulk of the advertising time during the periods when their shows are airing.⁴⁵ Most affiliates also receive a fee, called compensation, from the networks. That fee varies significantly depending on the situation in the local market, and is the subject of very hard bargaining. Since network programming attracts much larger audiences than most non-network programming, affiliates are able to charge much more for their spot advertising accompanying network programming than they would be able to absent that program. This strengthens the networks’ bargaining hands. Also, where there are more local television stations in the market than networks with which to affiliate, the networks are in a relatively strong negotiating position vis-a-vis the local stations, and therefore can negotiate low compensation payments or even, on occasion, require the local station to pay them compensation to affiliate. In contrast, in markets with few local stations, the local stations are in a stronger negotiating position than the networks.

Another parameter in the relationship between broadcast networks and affiliates is the degree of discretion affiliates have to preempt the broadcast feed to offer local programming. Local affiliates may at times prefer to offer local sports or other

⁴² (...continued)

reaching 95.3 percent of multichannel homes, while Discovery and ESPN tied with 94.2 percent penetration.

⁴³ Bear Stearns, “Broadcasting/TV & Radio,” Equity Research Media, November 2001, at p. 23.

⁴⁴ See, e.g., written testimony of Scott Cleland, CEO, Precursor Group, Senate Judiciary Committee Antitrust Subcommittee hearing, June 18, 2003, at p. 2, or Standard & Poor’s, “Broadcasting & Cable,” Industry Survey, July 25, 2002, at p. 1..

⁴⁵ Although costs are typically higher for shows they produce themselves, affiliates get to sell more advertising time during such programs than during network offerings.

events of particular interest to their viewership or may not want to air programming they believe is inconsistent with local community standards. Preemption by any affiliate, however, reduces the network's footprint, and therefore harms its ability to sell national advertising. This, in turn, can harm all affiliates if the network's "Swiss cheese" footprint generates diminished advertising revenues needed to fund future programming. Many network-affiliate contracts today have a "three strikes and you're out" clause that puts a local station's affiliation at risk if it preempts three network feeds in a year (though preemptions made on a local standards basis typically do not count toward the three strikes).

Local broadcast television stations remain quite profitable. As shown in Table 3,⁴⁶ both the profits and the cash flow of commercial television stations were positive for every market size in 2000, and were especially robust for stations in large markets. This is consistent with the testimony at recent Senate Commerce Committee hearings in which representatives of both broadcast networks and local broadcast stations agreed that local stations in medium and large markets enjoy profits (as a percentage of revenues) in the range of 20 to 50 percent.⁴⁷ FCC staff compared the data for 2000 to data for 1990 and concluded that "It appears that cash flow margins for the average station have increased over the past decade.... [I]n every category but one, profits and profit margins are up in 2000 over 1990."⁴⁸ By contrast, both the authors of the FCC study and the participants in the Senate hearing agreed that broadcast television networks are not particularly profitable and the newer networks definitely are losing money. Presumably, if this differential between station and network profitability continues, the networks will attempt to renegotiate their affiliation agreements, either to reduce the compensation they pay affiliates or to increase the amount of advertising time they retain for themselves to obtain national advertising revenues.

The broadcast networks and broadcast stations face the same competitive threat from the multi-channel systems and share the incentive to continue to create the popular programming needed to retain the large audiences valued by advertisers. Moreover, although the broadcast stations are more profitable than the broadcast networks today, all of the networks are now part of larger media companies whose holdings include large video programming studios and multiple cable networks that could use the cable and satellite pipelines as well as — or instead of — the broadcast pipeline.⁴⁹

⁴⁶ Reproduced from Jonathan Levy, Marceline Ford-Livene, and Anne Levine, "Broadcast Television: Survivor in a Sea of Competition," OPP Working Paper 37, Federal Communications Commission, September 2002, Table 14, at p. 33.

⁴⁷ See the discussion between Mel Karmazin, president and CEO of Viacom, Inc., and Jim Goodmon, president and CEO of Capitol Broadcasting Company, Inc. at Senate Commerce Committee Hearing on Media Ownership, May 13, 2003.

⁴⁸ Jonathan Levy, Marcelino Ford-Livene, and Anne Levine, "Broadcast Television: Survivor in a Sea of Competition," FCC OPP Working Group Series # 37, September 2002, at p. 31.

⁴⁹ See, e.g., the written testimony of Scott Cleland, CEO, Precursor Group, Senate Judiciary Committee Antitrust Subcommittee hearing, June 18, 2003, at p. 2, in which commenting (continued...)

The broadcast network-affiliate relationship has become much more complex as the broadcast networks have integrated into cable programming. For example, in the fall of 2002, Disney Chairman and CEO Michael Eisner unveiled a plan to merge the management of the Disney-owned ABC broadcast television network with the Disney-owned cable networks, and to focus on promoting two “core brands” — Disney and ESPN.⁵⁰ Eisner stated:⁵¹

Each one of our dayparts at the ABC network will be run horizontally with the same businesses in cable. The people that run The Disney Channel, Toon Disney and Playhouse Disney will also run ABC broadcast Saturday morning. The people that run daytime at ABC will run SoapNet, and the people that run the ABC prime time schedule will run ABC Family.

Table 3. Average Pre-Tax Profits, and Cash Flow of Commercial Television Stations, 2000

Market Rank	Average Pre-Tax Profit (\$ million)	Profit as % of Net Revenue	Average Cash Flow (\$ million)	Cash Flow as % of Net Revenue
1-10	\$ 27.8	46.2%	\$33.5	55.6%
11-20	\$11.3	32.7%	\$15.5	44.8%
21-30	\$6.5	24.1%	\$10.8	40.0%
31-40	\$3.5	18.4%	\$7.3	38.4%
41-50	\$1.3	9.3%	\$4.9	35.0%
51-60	\$3.5	25.5%	\$5.9	43.1%
61-70	\$2.2	20.0%	\$4.5	40.9%
71-80	\$0.2	2.1%	\$3.0	30.9%
81-90	\$2.0	18.5%	\$4.1	38.0%
91-100	\$0.7	7.4%	\$3.2	34.0%
101-110	\$1.0	12.8%	\$3.0	38.5%
111-120	\$0.4	5.9%	\$2.1	30.9%
121-130	\$0.6	8.8%	\$2.1	30.9%

⁴⁹ (...continued)

on the proposed News Corp-DirecTV merger, he states: “This merger enables NewsCorp. to switch horses mid-race from the tired-old over-the-air broadcast model, which is near to being put out to pasture, to the new DBS thoroughbred, which is in its prime.”

⁵⁰ For a detailed discussion of this internal Disney reorganization, see Steve McClellan and Dan Trigoboff, “Eisner touts a ‘national’ duops; Disney chief’s turnaround plan couples ABC, cable networks by daypart,” *Broadcasting & Cable*, October 7, 2002, at p. 6.

⁵¹ Id. at p. 6.

131-150	\$0.6	10.5%	\$1.9	33.3%
151-175	\$0.7	13.2%	\$1.9	35.8%
176+	\$0.7	17.5%	\$1.5	37.5%

Source: National Association of Broadcasters, *Television Financial Report*, 2001 edition, at pp. 2-3.

That plan did not sit well with ABC affiliates. From their perspective the plan appeared to spell the end of ABC as a discreet business and would allow Disney to focus on its cable networks at the expense of the ABC broadcast network. At the time of the announcement, the affiliates had just completed negotiating a two-year affiliate agreement that included provisions that attempted to limit Disney's ability to use the ABC network to promote its cable networks, with which the ABC affiliates compete.⁵²

Until recently, the broadcast networks most frequently obtained first-run prime-time shows from program suppliers through license agreements, which let them air each episode of a series several times. In a licensing arrangement, the program supplier retains ownership of a show. Typically, the license fee does not fully cover the up-front costs of production, since the program supplier will have the opportunity to generate additional revenues from the programming through sale or lease of syndication rights (for reruns) and foreign rights.

However, since the repeal in the early 1990s of the Financial Interest and Syndication ("Fin-Syn") Rules that restricted network ownership of programming, broadcast network companies are increasingly producing themselves, or acquiring ownership interests in, the programming that they air. Doing so usually involves a higher initial investment, but it can also generate greater returns if a program becomes a hit.

Following the lifting of the Fin-Syn restrictions, two major programming conglomerates purchased networks — Walt Disney Company purchased Capital Cities/ABC in 1996 and Viacom purchased CBS in 2000. One independent program supplier, Columbia, had a long-running agreement with CBS to produce programs for the CBS prime-time schedule, but within a year of the CBS-Viacom merger, the company closed its doors on television production, stating that a non-vertically integrated company had little chance for survival in today's risky television business.⁵³ Another non-vertically integrated company that did not survive was

⁵² Under the agreement, ABC was prohibited from "repurposing" more than 25% of its prime-time schedule to cable outlets. Repurposing is the practice of showing programs on cable networks just a matter of days or weeks after they appear on the broadcast network. Disney also was allowed to air only two ESPN promotional spots per hour in ABC Sports programs. It also was limited to airing 50 spots a week on ABC promoting co-owned cable network programs, and only 10 of those could mention program day, date, and time. Affiliates did continue to pay \$34 million a year to help ABC/ESPN pay for the National Football League contract.

⁵³ Kagan World Media, *The Economics of TV Programming & Syndication 2002*, August (continued...)

Artists TV Group, which in its first season, 2000-2001, had 14 pilots and five series picked up for the season, but all the series were cancelled and the company closed down in 2001-2002. Today, all the major broadcast networks except NBC own major production studios, and NBC has been reported to be ready to bid for the Universal television studios currently owned by Vivendi.⁵⁴ As explained in footnote 16, there is some question about the proportion of prime-time broadcast television programming now produced or co-produced by the networks, but it certainly exceeds 50 percent and may exceed 75 percent.

Syndication

Syndicating a television program historically has meant licensing a program to individual television stations around the U.S. on a market-by-market basis. More recently, cable networks have become important licensees of syndicated programming — increasing their share from 26.5 percent of total syndicated revenues in 1992 to 42.4 percent in 2001.⁵⁵ (Though as cable networks continue their current pattern of producing more original programming, cable demand for syndicated programming may decline.) The local broadcaster or cable network pays for the programming and keeps all the advertising revenues it is able to generate.

It is very difficult for syndicators to break into the market for first-run programming. With the development of FOX, UPN, and WB networks, there are very few local broadcast stations not affiliated with a broadcast network, and therefore the size of the market for syndicated first-run programming has shrunk.⁵⁶ The traditional pre-prime-time hour, running between the network national news programs and the start of the network prime-time schedule, is largely locked in by longstanding syndicated programs such as *Jeopardy*, *Wheel of Fortune*, and *Entertainment Tonight*.

There is a more vibrant syndication market for reruns, known as “off-net syndication,” since both network affiliates and non-affiliates need non-prime-time programming. Because of the relatively smaller audiences during non-prime-time hours, however, the focus is on low cost programming — most frequently reruns of half-hour situation comedies, rather than reruns of hour-long dramas.

Bartering is a variation on syndication. The supplier receives at least a portion of its revenues from selling advertising time on the stations that air its program. By

⁵³ (...continued)
2002, at p. 3.

⁵⁴ See, e.g., Martin Peers, Emily Nelson, and Kathryn Kranhold, “Vivendi Bid Shows NBC Peacock’s New Hues,” *Wall Street Journal*, June 25, 2003, at p. B1.

⁵⁵ Kagan World Media, *The Economics of TV Programming & Syndication 2002*, August 2002, at p. 8.

⁵⁶ According to Kagan World Media, *The Economics of TV Programming & Syndication 2002*, August 2002, at p. 4, programmer-broadcast network mergers and the development of the three new broadcast networks have cut into the syndication market and resulted in consolidation in that market as well.

giving the syndicator advertising time, the local station is able to make lower licensing payments. If the syndicator wants to attract national advertisers for this advertising time, it typically must be able to provide coverage of 70 percent of U.S. households.

Multi-Channel (Cable and Satellite) Television

Multi-channel television is the fastest growing segment of the video programming industry. As shown in Table 4, between 1990 and 2000, total cable and satellite television revenues almost tripled, from \$18.4 billion to \$53.3 billion, and now substantially exceed broadcast television revenues, which have grown far more slowly. That trend continues.

Table 4. End-User Expenditures on Various Video Media, 1990-2000

(millions of dollars)

	1990	1995	2000
Total Broadcast Television	\$26,716	\$32,720	\$44,802
Network Advertising Revenues	\$9,963	\$11,600	\$15,888
Syndication Advertising Revenues	\$1,109	\$2,016	\$3,108
Stations' Advertising Revenues (local + national sport)	\$15,644	\$19,104	\$25,806
Total Cable Video-Related Revenues	\$18,401	\$26,870	\$44,808
Total Cable Television Operators' Revenues ^a	\$16,604	\$22,898	\$34,352
Operators' Video Subscriptions ^b	\$16,128	\$21,823	\$31,992
Operators' Advertising Revenues	\$476	\$1,075	\$2,430
Basic Cable Network Advertising Revenues	\$1,797	\$3,972	\$10,456
Total DBS Revenues	\$0	\$663	\$8,467
DBS Video Subscriptions	\$0	\$63	\$8,440
DBS Advertising Revenues ^c	\$0	\$0	\$27
Total Subscription Video-Related Revenues	\$18,401	\$27,533	\$53,275
Filmed Entertainment^d	\$16,129	\$21,023	\$29,906
Box Office	\$5,022	\$5,494	\$7,453
Home Video	\$11,107	\$15,529	\$22,453

Sources: Broadcast Television Revenues: Television Bureau of Advertising, "Trends in Advertising Volume," [http://www.tvb.org/tvfaxts/trends], visited June 26, 2002; Cable Operator Revenues: Kagan World Media, *The Economics of Basic Cable Networks* (date and pages not provided); DBS Revenues: Kagan World Media, *The State of DBS 2002*, Dec. 2001, at p. 16; Filmed Entertainment Revenues: Veronis Suhler, "Communications Industry Forecast," July 2001, at p. 203.

a. Only video-related revenues are listed here. Revenues from installations, equipment, and non-video services like high-speed Internet access services and telephony are not included.

b. Includes home shopping commissions.

c. DBS advertising is the equivalent of cable's "local avails," though they are sold as national time.

d. Filmed entertainment in this table includes movie theater box office and video stores. The data source for filmed entertainment includes expenditures on television programming as a third category. Because programming is an input into television, cable, and DBS services, it is not listed separately under filmed entertainment.

Multi-channel television is comprised of cable and satellite systems that provide anywhere from a few dozen to a few hundred channels of programming to end users, cable networks that package (and sometimes produce) the programming for those systems, and a large number of integrated, affiliated, or independent content providers. Cable networks are reducing their dependence on libraries of existing movies and television programs, increasingly producing their own new programming or contracting with other producers for new fare.

Today there are just under 10,000 local cable systems⁵⁷ plus two direct broadcast systems with footprints covering large portions of the country (DirecTV and EchoStar). In addition, a small and declining number of households continue to be served by systems using technologies (MMDS and home-satellite dishes) that have not succeeded in the market. Only a small number of communities are served by more than one cable company, and there appears to be no market support for such “overbuilds.”⁵⁸ Direct competition among multi-channel television providers primarily occurs between the local cable system and one or both DBS systems. Programming for these multi-channel systems is provided by more than 300 cable networks.⁵⁹

But consolidation is increasingly placing both systems and networks in fewer ownership hands. Most households are served by local cable systems that are owned by large multi-system operators (MSOs). The ten largest multi-system operators serve almost 60 million of the approximately 72 million households receiving basic

⁵⁷ “Industry Statistics, State Data,” National Cable and Telecommunications Association, [<http://www.ncta.com/industry>], lists 9,947 cable systems, citing Warren Communications News, Inc. (viewed on 6/11/2003).

⁵⁸ There appears to be a niche in densely populated areas for companies like RCN/StarPower to negotiate non-exclusive franchise agreements in order to compete against traditional cable systems using the strategy of wiring large apartment buildings and offering video service bundled with telephone service.

⁵⁹ “Industry Statistics, State Data,” National Cable and Telecommunications Association, [<http://www.ncta.com/industry>], lists 308 national video programming services/networks as of December, 2003, citing the FCC (viewed on 6/11/2003).

cable service (83.3%); the five largest serve 71.2% and the two largest serve 45.2%.⁶⁰

At the same time, six major media companies — AOL Time Warner, Disney, General Electric, Liberty Media, News Corp., and Viacom — are full or partial owners of 43 of the top 50 cable networks as measured by number of households reached; 30 of the top 34 as measured by average prime-time ratings; and 28 of the 30 cable networks with average license fees (paid by cable systems to cable networks) per subscriber per month of \$0.14 or more.⁶¹

The largest MSOs also increasingly have full or partial ownership in the largest cable networks. In addition to AOL's full or partial ownership of seven of the 50 largest stations, as measured by households served, Cox Communications has an ownership share in four, Comcast in three, and Cablevision in three. There are only six "independent" cable networks in the top 50 — two C-SPAN networks funded by the entire industry, the Weather Channel, two networks owned by Scripps, and one network owned by the Tribune Company.

Given the small audience shares attained by any cable network (as shown in Table 2, the highest rated cable network has attracted only 1.56 percent of television households, on average, during prime-time during the 2002-2003 season), cable networks continue to depend more on revenues generated by fees paid by subscribers than by advertising. The FCC reported estimated total 2002 video-related cable industry revenues (i.e., excluding revenues from equipment and installation, high-speed Internet access, cable telephony, and interactive services) of \$41.3 billion.⁶²

⁶⁰ The NCTA website, [<http://www.ncta.com/industry>], lists 71,897,250 basic cable customers as of May, 2003 (based on A.C. Nielsen Media Research), and lists the number of subscribers of the largest MSOs as of September 2002 (based on data from Kagan World Media, *Cable TV Investor*) as follows:

Comcast Corp.	21,625,000
Time Warner Cable	10,862,000
Charter Communications	6,697,900
Cox Communications	6,263,400
Adelphia Communications	5,775,400
Cablevision Systems Corporation	2,968,500
Advance/Newhouse Communications	2,100,000
Mediacom Communications Corporation	1,588,000
Insight Communications	1,289,000
CableOne	721,400

⁶¹ Data from Kagan World Media, *Economics of Basic Cable Networks 2003*, "Cable Network TV Household Growth" at pp. 34-35, "Average Prime-Time Ratings" at p. 42, "Average License Fee per Subscriber per Month by Network" at pp. 53-54, and "Cable Network Ownership" at pp. 59-63.

⁶² *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, Federal Communications Commission, MB Docket No. 02-145, Ninth Annual Report, released December 31, 2002, at ¶ 29, Table 4, citing data collected by Kagan Media World.

According to the Television Bureau of Advertising,⁶³ cable television advertising revenues totaled \$16.3 billion in 2002 — \$12.1 billion in cable network advertising and \$4.2 billion in cable non-network advertising. The non-advertising cable revenues are generated by per subscriber license fees charged to cable systems, pay-per-view charges, and home shopping revenues.

Cable system operators (and satellite systems) make their programming available to consumers in tiers:

- the basic service tier, typically consisting of a package of local stations (local broadcast stations and public, educational, and governmental (PEG) access programming) plus a few advertiser-supported cable networks that are transmitted to the local cable system by satellite (and hence sometimes referred to as satellite channels).⁶⁴
- the cable programming service tier, sometimes referred to as the enhanced basic service tier, typically consisting of a much larger package of advertiser-supported satellite channels than the basic service tier. Cable operators require subscribers to purchase the basic service tier in order to purchase the enhanced basic service tier. Approximately 90% of subscribers purchase the enhanced service tier.
- various “premium” tiers, typically consisting of a package of “premium” programming, usually (but not always) without commercial advertising.
- “pay-per-view” channels with programming that subscribers pay for on a program-by-program basis.

Cable and satellite operators attempt to assign individual cable networks to these tiers based on their projections of what will generate the most profits for them. In doing so, however, they must take into account the terms and conditions under which the programming is made available to them by the large companies that own most of the popular cable networks. Often, there is no conflict; the profits of both the MSO and the large programming company are maximized by the same choice of tier for a particular cable network. But sometimes the large programming companies want the MSOs to place certain of their cable networks in tiers that would not maximize the MSOs’ profits, resulting in difficult negotiations or even an impasse. For example, there have been a number of recent incidents in which the large media companies attempted to require MSOs to offer their high-priced sports cable networks as part of an enhanced basic package, but the MSOs resisted because only a small portion of their enhanced basic subscribers sought that programming. The MSOs feared the

⁶³ “Estimated Annual U.S. Advertising Expenditures 2001-2002,” *Trends in Advertising Volume*, Television Bureau of Advertising, [http://www.tvb/central/mediatrack/trends.asp?c=2001-2002, viewed on 6/20/03].

⁶⁴ Local cable systems are required to have a basic offering that includes the local broadcast channels and PEG channels. See “Consumer Options for Selecting Cable Channels and the Tier Buy-Through Prohibition,” Federal Communications Commission Fact Sheet, February 2003, at p. 1.

high price of the sports programming would require them to raise the package rate for all their enhanced basic subscribers. They preferred placing these sports networks in a separate premium package.⁶⁵

Given the popularity of broadcast television network programming (see Table 2) and local news programming, local cable systems almost always want to carry the signals of the local affiliates of the four major networks.⁶⁶ To obtain this “must have” programming, they must negotiate a retransmission consent agreement with the local broadcast station. In recent years, some local broadcast stations have come under the same ownership as many cable networks (the parents companies of each broadcast television network also own local television stations and cable networks), and in their negotiations with local cable systems frequently have required those systems to carry all of their cable networks in order to get permission to carry their local broadcast signals.⁶⁷

At the other extreme, especially in markets with many local broadcast stations, some of the small independent broadcast stations may not have large audience shares and the local cable systems may not want to carry those stations. But since more than 65 percent of TV households receive their local broadcast signals via cable, and therefore are unlikely to have antennas or other equipment needed to receive broadcast signals over the air, if these independent stations are not carried on the local cable system they will have a very difficult time reaching any audience. Congress therefore has imposed a “must carry” obligation on local cable systems, requiring them to carry the signals of all local stations who make their signals available without a charge.⁶⁸

Although most local cable (and satellite) systems now have capacity to carry 80 or more networks, with more than 300 existing cable networks it is becoming increasingly difficult for new networks to get onto systems. As start-ups in a business with high up-front production costs, they face even more directly than existing networks the need to get onto as many local cable systems as possible, as quickly as possible. One strategy that new networks have used is to offer their programming to MSOs and local cable systems without charging any per subscriber license fee — or even paying the cable systems to carry their programming. This limits the cable networks’ revenues to advertising revenues, and unless they are carried by many local systems they cannot command very much in terms of advertising rates. As a result, start-up networks have increasingly been forced to

⁶⁵ See, e.g., the testimony of Charles F. Dolan, Chairman of Cablevision Systems Corporation, before the Senate Commerce Committee on May 6, 2003.

⁶⁶ In fact, the primary market impediments to satellite television are the capacity constraints on the ability of the satellite systems to carry local broadcast signals and the costs associated with making those signals available to subscribers.

⁶⁷ The policy issues surrounding retransmission consent are discussed in CRS Report RL32026.

⁶⁸ Section 614(b)(4)(B) of the 1996 Telecommunications Act, which was adopted as part of a larger must carry/retransmission consent scheme set forth in the Cable Television Consumer Protection and Competition Act of 1992. Pub. L. No. 102-385, 106 Stat. 1460, codified at 47 U.S.C. § 521 *et seq.*

follow one of two strategies. Some new cable networks have agreed to give the major MSOs — especially Comcast and AOL Time Warner — substantial equity interests in their networks in exchange for being carried on their systems.⁶⁹ Alternatively, some new cable networks have agreed to give “mega-programmers” such as Viacom, Discovery Networks, or Disney, substantial equity interests in their networks in exchange for becoming part of those companies’ line of cable channels, taking advantage of those larger entities’ ability to negotiate carriage with the MSOs. Data on cable network television household penetration from 1994 through 2001⁷⁰ show that the only new networks able to gain rapid and high levels of household penetration during that period were owned in whole or in part by one of the major program distributors or MSOs.

As the number of channels on cable and satellite systems grows, there is a rising need for cable networks to develop signature programming — shows that viewers identify with a particular channel. This is especially true for premium cable networks. Examples include *The Sopranos*, *Sex and the City*, and *Six Feet Under* on HBO, *Larry King Live* on CNN, and *South Park* on Comedy Central. Cable network also are increasingly investing in original “one-time” programming, such as major-league sports events and made-for-television movies. However, reruns of shows that originally aired on broadcast networks are still being prominently scheduled on cable channels. Theatrical films typically become available on one or more of the pay networks about a year after they debut in theaters, after the video rental demand has dwindled.

Direct broadcast satellite (DBS) is the fastest growing retail pipeline of programming for end user customers, as shown in Table 1. For many customers located in rural areas in which cable service is not economically feasible, satellite represents the only viable means of multi-channel distribution — and in some locations where broadcast signals are extremely weak, it represents the only access to high quality television reception. Since it is a new technology, without an embedded base of customers with old customer-premises equipment, it faces fewer hurdles to implementation of digital television programming.

Satellite television’s primary market weakness had been its inability to offer local broadcast signals. This was largely alleviated when Congress passed the Satellite Home Viewer Improvement Act of 1999, which gave satellite companies the option of providing a local broadcast station’s signals to subscribers living in the station’s local market area. This is known as local-into-local service.⁷¹ Today, the two major

⁶⁹ See, e.g., R. Thomas Umstead, “Indie Nets Face Barren Landscape: New Programming Ventures Find It’s Hard to Stake a Digital Claim Without Corporate Ties,” *Multichannel News*, 6/9/2003. “Operators are seeking steep ownership stakes in new programming services in return for carriage.”

⁷⁰ “Cable Network TV Household Penetration,” Kagan World Media, *Economics of Basic Cable Networks 2003*, September 2002, at pp. 36-37.

⁷¹ Under SHVIA, if the satellite company decides that it will not provide the local broadcast station signals to subscribers in a geographic area, the consumers still may receive local broadcast station signals by using an antenna or basic cable service. But subscribers
(continued...)

DBS services offer local-into-local service to most customers, though at an additional charge to cover the associated costs. Frequently the satellite systems offer an enhanced basic package with digital quality service plus local-into-local service for a combined price that is no higher than the competitor cable system's enhanced basic service (which includes local broadcast signals but is only analog service) — but the consumer sees a separate price tag on local-into-local service. To the extent that consumers perceive the additional charge for local-into-local service as an extra charge they do not have to pay with cable service, satellite systems have an incentive to be able to offer local-into-local service to all customers so they can market a single package price that includes local service for all subscribers. In some (mostly rural) locations, however, satellite companies still cannot offer local broadcast signals because of a lack of satellite capacity.

But satellite systems do not face certain government-imposed requirements that cable systems do. Cable systems must pay franchise fees to the localities in which they operate, which they typically recover through a separate franchise charge on subscribers' bills; satellite systems face no franchise fees. Also, as discussed earlier, cable companies are required to make some of their channels available for public, educational, and governmental (PEG) access programming; satellite systems are not. Under most cable franchise agreements, the cable system also must provide or help finance the equipment needed by the locality to provide such PEG programming. Typically, satellite systems are not able to offer the PEG channels. Although those channels do not attract large audiences, there are some viewers who value those access channels highly and therefore will not subscribe to satellite service.

Theatrical Movies, Video Cassettes, and DVDs

Movies today are typically made under contract between a major distributor, a production company, and a collection of free-lance talent. With a major theatrical film, a distributor typically funds a movie from start to finish or provides a portion of the financing in return for fees and a share of the proceeds. In some cases, a producer grants theatrical distribution rights to another. In most cases (and particularly for major films), the company handling the film's theatrical release also owns its distribution rights in the home video market. After arranging to have videos manufactured, the distributor typically sells them to video retailers. It may also distribute them through a revenue-sharing agreement, through which the distributor and retailer share consumers' rental fees for a video title.

Movie production costs vary widely. According to the Motion Picture Association of America,⁷² in 2002 the average “negative costs” (i.e., production costs, studio overhead, and capitalized interest) of “major” theatrical films financed by major distributors were \$58.8 million, and the average costs of advertising and

⁷¹ (...continued)

who cannot receive an over-the-air signal of Grade B intensity using a conventional, stationary rooftop antenna are eligible to receive distant broadcast television signals rebroadcast by the satellite system.

⁷² “U.S. Entertainment Industry: 2002 MPA Market Statistics,” Motion Picture Association Worldwide Market Research, at pp. 17-20.

duplication (making multiple copies for theaters) were \$31.0 million per film.⁷³ The distribution company typically pays these costs. Creative talent involved in a movie may be contractually entitled to a portion of the film's revenues or profits.

In recent years, the movie releases of six film distribution companies — Disney (including Miramax), Viacom (Paramount), Sony, Fox (majority-owned by News Corp.), AOL Time Warner (including New Line), and Universal Studios — typically have accounted for at least 70 percent of domestic box office revenues.⁷⁴ The only significant new entrant in the past decade has been DreamWorks SKG.

Although movie theater revenues continue to grow, for many films movie theater ticket sales are no longer the principal source of revenue. Today, profitability often depends heavily on contributions from various home video and television markets. According to Standard & Poor's,⁷⁵ for distribution of filmed entertainment, revenues from selling videos and from licensing films to television outlets in the U.S. likely exceeded \$10 billion in 2002, compared with the approximately \$4 billion received as their share of movie theater ticket sales. Standard & Poor's estimates that, on average, 20 percent of distributors' total revenues from new movies are derived from domestic theater rentals, another 20 percent from foreign theaters, 40 percent from domestic and international home video, and the remainder primarily from television.⁷⁶

New movies are typically released on tape and disc about four to six months after their theatrical debut. Some movies are not shown in theaters but reach consumers immediately through video/DVD release.

Ancillary Market Players

In addition to the three functional industry segments, there are several very important ancillary participants in the market:

Advertisers. Since broadcast television programming is almost entirely supported by advertising, and cable and satellite providers also receive significant advertising revenues, advertisers are major players in the market. Standard & Poor's projected \$61 billion in video industry revenues from advertisers in 2002.⁷⁷ In the recent "upfront" market, in which broadcast, cable, and syndication interests pre-sell advertising for the 2003-2004 programming season, broadcast television networks

⁷³ The average negative costs for films made by the subsidiaries of the major studios — including studio "classics" divisions such as Sony Pictures Classics, FOX Searchlight, New Line, and Miramax — were \$34.0 million in 2002 and the average affiliate marketing costs were \$11.2 million.

⁷⁴ Tom Graves, "Movies & Home Entertainment," Standard & Poor's Industry Surveys, November 14, 2002, at p. 7.

⁷⁵ *Id.*, at p. 15.

⁷⁶ *Id.*, at p. 16.

⁷⁷ Tom Graves, "Movies & Home Entertainment," Standard & Poor's Industry Surveys, November 14, 2002, at p. 7.

booked \$13.1 billion in advertising, cable networks booked \$5.7 billion, and program syndicators booked \$2.3 billion (representing double-digit growth).⁷⁸

The consolidation of broadcast television station ownership is also leading to consolidation in the advertising industry. According to one industry observer:⁷⁹

Thirty years ago, 27 different companies repped 650 television stations across the country, selling their local time to national and regional advertisers. Today, just three companies, with a total of eight TV rep divisions, serve 892 stations nationwide.

What led to so few serving so many? Deregulation, consolidation of station ownership and raw competition.

The rep business was affected by two big rounds of station consolidation, which followed the relaxation of FCC ownership rules. The first came in the mid-1980's and the second after the passage of the Telecommunications Act of 1996.

International. The United States is a major exporter of video programming. Standard & Poor's estimates that, on average 20 percent of U.S. movie distributors' total revenues from new movies are derived from foreign theaters and another significant portion of revenues are derived from foreign sales and rentals of video cassettes and DVDs.⁸⁰ The Motion Picture Association of America estimates international sales are even more important. According to MPAA,⁸¹ in 2002, revenues generated outside the U.S. accounted for 42.6 percent of U.S. companies' total theatrical film revenues; 36.6 percent of total television revenues; 55 percent of total pay-tv revenues; and 38.7 percent of total home video revenues. One of the major constraints on the latter is the difficulty in policing pirating of videos.

This report has provided an overview of the fundamental changes in the structure of the video programming industry that have occurred over the past 15 years. It described both the new options available to viewers thanks to technological changes and the vertical and horizontal consolidation that has given a few big media players control over a large portion of both video programming and video distribution. CRS Report RL32026 explains how and why underlying market forces and government actions have created strong pressure for vertical and horizontal integration and how such market consolidation could be used to benefit or harm consumers. It also identifies public policy issues that may arise as a result of the consolidation.

⁷⁸ "It's Way Upfront," *Broadcasting & Cable*, June 2, 2003, p. 1.

⁷⁹ Jean Bergantini Grillo, "Reps Brace For More Station Consolidation," *Broadcasting & Cable*, 3.31.03, at pp. 16-17.

⁸⁰ Tom Graves, "Movies & Home Entertainment," *Standard & Poor's Industry Surveys*, November 14, 2002, at p. 16.

⁸¹ Motion Picture Association of America, "Estimated Worldwide Revenues by Media for All U.S. Companies, MPAA WorldWide Market Research.