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Delivering for Television Viewers: Retransmission Consent and the U.S. Market for Video Content

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About the Author

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Dr. Eisenach's consulting practice focuses on economic analysis of competition, regulatory, and consumer protection issues. He has submitted expert reports and testified in litigation matters, as well as in regulatory proceedings before the Federal Communications Commission, the Federal Trade Commission, several state public utility commissions, and regulatory bodies in Australia, Canada, and South America. He has also testified before the US Congress on multiple occasions. In 2006 he served as an expert witness for the US Department of Justice in ACLU v. Gonzalez, the landmark litigation on the constitutionality of the Child Online Protection Act.

Dr. Eisenach writes extensively on a wide range of issues, including industrial organization, communications policy and the Internet, government regulations, labor economics, and public finance. He is the author or co-author of a number of books, including The Digital Economy Fact Book, The Telecom Revolution: An American Opportunity, and America's Fiscal Future: Controlling the Federal Deficit in the 1990s. In addition, he has edited or co-edited five books, including Communications Deregulation and FCC Reform: What Comes Next? and Competition, Innovation and the Microsoft Monopoly: Antitrust in the Digital Marketplace. His articles have appeared in a range of scholarly journals as well as in such popular outlets as Forbes, Investors Business Daily, The Wall Street Journal, The Washington Post, and The Washington Times.

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Executive Summary

Video content markets around the world are undergoing a period of profound change with an increasing number of delivery platforms fragmenting markets and challenging free-to-air broadcasting models. In the United States, the retransmission consent scheme recognizes the role broadcasters' play in investing in and delivering high-quality services to viewers and enables them to be compensated for delivering that content to competing platforms.

Retransmission consent is the system under which over-the-air television broadcasters can either opt for compulsory carriage of their channels by pay TV distributors[1] or negotiate for compensation from pay TV distributors in return for permission to carry their signals. Prior to 1992, U.S. broadcasters had no such right: Cable television companies were allowed to carry broadcast signals for free. In passing the Cable Television Consumer Protection Act of 1992, however, Congress specifically recognized that allowing broadcasters to obtain compensation for their signals was both fair and economically efficient. In particular, Congress concluded that the inability of broadcasters to be compensated for their signals had created:

> *a distortion in the video marketplace which threatens the future of over-the-air broadcasting…. [by supporting] a system under which broadcasters in effect subsidize the establishment of their chief competitors.*[2]

For the first decade after retransmission consent was implemented, cable TV operators refused to pay cash compensation to broadcasters. But with the entry of satellite distributors and, later, telephone companies into TV distribution, broadcasters were successful in winning cash payments from distributors as competition in the TV distribution market increased and market power was eroded. In 2013, broadcasters received approximately $3.3 billion in retransmission consent payments. To be clear, this sum is exclusively for payments to broadcasters for free-to-air content, and does not include compensation paid to cable programming networks.

This study examines the effects of retransmission consent on the U.S. market for video content. It concludes that the system has played a significant role in revitalizing the over-the-air television sector and contributed to what many in the U.S. are referring to as a "golden age of television." Specifically, as detailed herein:

- Retransmission consent compensation accounted for nearly 15 percent of total broadcast television revenue in 2013, and is projected to account for 25 percent by 2019.
- Retransmission consent is crucial to the economic viability of television broadcasters: it has been estimated that the elimination of retransmission consent would cut the average profit margins of

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[1] As discussed detail below, in the U.S., the term "pay TV distributors" refers to firms that own cable, satellite or telephone-based infrastructure used to distribute TV programming to paying subscribers.

[2] See *Cable Television Consumer Protection and Competition Act of 1992* (S. Rep. No. 102-92, 102d Cong., 1st Sess., 1991; 1992 U.S.C.C.A.N. 1133) (hereafter *Senate Report*) at 1168.

broadcast television stations by nearly 80 percent, from 14.8 percent to 3.1 percent, and ultimately force many broadcasters to exit the industry. As TV advertising revenues continue to come under pressure from new media, retransmission consent is increasingly important.

- Retransmission consent compensation accounts for more than one-third of all spending on broadcast television programming, allowing broadcasters to increase program quality and compete more effectively with pay TV networks for high quality programming, including winning back widely viewed sporting events such as NFL football games. It has also resulted in a significant increase in spending on (and number of hours of) news and other public interest programming. As Fox Networks explained in a regulatory submission to the Federal Communications Commission (FCC):

  > *Today, the broadcast business is facing new challenges and it is apparent that without creating a second revenue stream, broadcasters will no longer be able to acquire major sports events and the popular entertainment programming that consumers value and to produce local news.*[3]

- Retransmission consent helped to fund the changeover to high-definition programming and the launch of hundreds of new "multi-cast" television services made possible by digital broadcasting technology, as well as the airing of major sports events on free-to-air television. Retransmission fees have provided the financial capability for over-the-air broadcasters to invest in content and innovation and thus compete effectively in a highly competitive market for video content.

- As important as retransmission consent is to broadcasters, it accounts for less than three percent of cable operators' revenues and has little or no impact on pay TV prices.

- The U.S. television sector has outperformed the rest of the developed world – much of which does not have retransmission consent or any equivalent mechanism – in terms of viewership, revenues and other key metrics, without relying on significant public subsidies.

The combination of a minimal impact on pay TV prices together with the consistent delivery of high levels of investment in quality U.S. TV content demonstrates that the retransmission regime has served the public interest. As a result, it continues to command broad bi-partisan support in the U.S. Congress. As the Chairman of the House of Representatives Telecommunications Subcommittee put it in a December 2013 speech:

> *Americans enjoy quality and choice in video programming that is the envy of consumers in the rest of the world.… At the heart of this volume of video programming and choice lies retransmission consent: a recognition of the value of video programming.*[4]

Based on these conclusions and the other results reported herein, the U.S. retransmission consent regime provides a useful example for other countries interested in promoting a vibrant, competitive market for digital video content and distribution.

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[3] See Fox Networks, *Re: Fox/Cablevision Retransmission Consent Negotiations* (Letter from Fox to the FCC) (October 25, 2010) (hereafter *Fox Letter to FCC*) (available at http://transition.fcc.gov/fox-letter-2010-25-10.pdf).

[4] See Doug Halonen, "Rep. Walden: Not So Fast on Retrans Reform," *TVNewsCheck* (December 4, 2013) (hereafter Halonen (2013)) (available at http://www.tvnewscheck.com/article/72429/rep-walden-not-so-fast-on-retrans-reform).

I. Introduction

In many countries, broadcast television content is subject to a compulsory license or other forms of copyright exemption which prevent television broadcasters from charging cable operators and other video distributors for the right to resell broadcast programming to their subscribers. The economic impact of such exclusions is easy to predict: because there is less revenue than would be generated under a fully functioning market, less television broadcast content is produced than would be economically efficient, and the ability of broadcasters to invest in innovative, high-quality programming is reduced.

The U.S. operated under such a system until 1992, when Congress enacted the Cable Television Consumer Protection Act ("Cable Act"), giving television broadcasters the right to negotiate with cable systems for reasonable compensation ("retransmission consent"), or alternatively, to require cable systems to carry their signals on an uncompensated basis ("must carry"). Initially, retransmission compensation took the form of in-kind services, but beginning in 2005 distributors (including cable, satellite and telephone company-based services – referred to herein as multichannel video programming distributors, or "MVPDs") – began offering cash. In 2013, retransmission consent payments to U.S. broadcasters totaled over $3.3 billion.

By allowing television broadcasters to capture more of the value created by their programming, retransmission consent has generated a new revenue stream that has contributed significantly to the overall health of the U.S. broadcasting industry specifically and the market for television content in general, and has played a role in creating what some are calling a "golden age of television" in the U.S. – high quality, diverse, innovative programming, leading ultimately to an increase in overall viewership despite growing competition from the Internet and other non-traditional sources. The success of retransmission consent in the U.S. demonstrates that allowing broadcasters to be compensated for their investments in programming is good economics and generates benefits for the entire digital video ecosystem.

As television broadcasters around the world confront growing competition, the distortionary effects of forcing them to provide content to competing distribution platforms on an uncompensated basis are becoming more apparent. As a result, interest in reform is growing, and the U.S. retransmission consent regime is being looked at as a possible model. The purpose of this study is to inform such discussions by presenting an independent assessment of the effects of retransmission consent on consumer welfare in the United States. In so doing, the study briefly reviews the history of retransmission consent in the U.S., discusses the economic rationale for such a system, assesses the progress of retransmission consent in practice and its impact on the markets for video content and video content distribution, and addresses some of the arguments advanced by critics. Overall, it concludes that retransmission consent has enhanced consumer welfare by creating a more efficient and robust market for digital content of all types.

The remainder of this paper is organized as follows. Section II provides a brief history of retransmission consent, including the 1992 Cable Act and the evolution of retransmission consent negotiations from "in-kind" compensation towards monetary compensation for broadcast

carriage. Section III explains the economic rationale for retransmission consent in the context of the market for video programming. Section IV assesses the role retransmission consent plays in the digital video ecosystem. Section V addresses criticisms of retransmission consent as it has operated in the U.S. Section VI presents a brief conclusion.

II. The Statutory Basis for Retransmission Consent

Prior to 1992, cable operators were not required to compensate broadcasters for carrying their signals. Under a series of decisions by Congress, the courts and the Federal Communications Commission (FCC), broadcasters were denied copyright in their content, and cable operators were allowed to retransmit broadcast signals without broadcasters' permission. In passing the Cable Act of 1992, Congress for the first time gave broadcasters *de facto* property rights by creating the system of retransmission consent, which has remained in place, largely unchanged, ever since. This section briefly reviews the history of cable carriage of broadcast signals before and after 1992.

A. Cable Carriage of Broadcast Content Before 1992

Cable television in the U.S. dates to the late 1940s, when "community antennas" were erected on mountains and hills in rural communities in order to capture television broadcast signals and distribute them to local residents who could not otherwise receive clear broadcast signals.[5] As cable grew from a purely "antenna" service into a mature industry that competes with broadcasters for advertising and other revenues, the issue of compensation for carriage of broadcast signals naturally arose. The issue was initially addressed by the FCC in 1959, when the Commission decided that the Communications Act did not require cable systems to obtain broadcasters' consent to retransmit their signals,[6] a decision which stood until passage of the Cable Act in 1992. Broadcasters' efforts to win compensation by asserting copyright protection were also unsuccessful, as the Supreme Court issued decisions in 1968 and 1974 concluding that broadcaster signals were not protected by the copyright laws.[7]

Thus, prior to 1992, cable operators were able to charge customers for viewing local broadcast signals without compensating the broadcasters – or even obtaining broadcasters' permission – for the right to retransmit the station's signal.[8]

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[5] For a more extensive discussion of the history of retransmission consent and related issues, see Jeffrey A. Eisenach, *The Economics of Retransmission Consent* (March 2009) (available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1424066). For an application to Canada, see Stephen M. Armstrong and Jeffrey A. Eisenach, *The Economics of Retransmission Consent Negotiations in the U.S. and Canada* (September 2009) (hereafter Armstrong and Eisenach (2009)).

[6] See *Senate Report* citing 26 F.C.C. 403, 429-30 (1959).

[7] See, e.g., Register of Copyrights, *Satellite Home Viewer Extension and Reauthorization Act, Section 109 Report* (June 30, 2008) (hereafter *Section 109 Report*) at 2 (citing *Fortnightly Corp. v. United Artists Television*, 392 U.S. 390 (1968) and *Teleprompter Corp. v. Columbia Broad. Sys., Inc.*, 415 U.S. 394 (1974)). The issue of copyright protection was revisited by Congress in its 1976 revision of the Copyright Act. While a compulsory license regime was established for out of market broadcast signals carried by cable operators, copyright protection was not extended to local signals. See *Section 109 Report* at 3-4.

[8] As discussed further below, part of the rationale for the lack of compensation was that the primary function of cable in those days was to make it possible for consumers who did not receive clear over the air signals to receive

While cable operators were not required to pay for their use of broadcast signals, beginning in 1966 they were required, under the FCC's "must carry" rules, to carry them.[9] The must carry rules, however, were invalidated by the Supreme Court in 1985.[10] Until the must carry requirement was reinstated in the 1992 Cable Act, cable operators were not obligated to carry local broadcast stations on their systems, and many did not.[11] The rationale for the must carry obligation is that it is in public interest for all television viewers, including subscribers to MVPD services, to have ready access to free over-the-air broadcast content. As the retransmission consent regime has evolved since 1992, nearly all commercial stations have transitioned from must-carry to retransmission consent, but public and educational stations (which are not eligible for retransmission consent), and some commercial stations, continue to rely on must carry.[12]

Direct broadcast satellite (DBS) distribution services emerged in the 1970s and 1980s. In 1988, in the Satellite Home Viewer Act, Congress permitted (and established a compulsory copyright license for) DBS operators to retransmit programming from distant, out-of-market broadcast network stations, but limited that right to serving otherwise *unserved* households, i.e., those where the DBS operator does not offer local broadcast channels and who are without the ability to receive local broadcast signals using a rooftop antenna.[13]

Thus, as of the late 1980s, cable operators and satellite providers were permitted to retransmit local broadcast programming, and broadcasters had no rights to even negotiate for compensation. Furthermore, after the repeal of the FCC's must-carry rules in 1985, neither cable nor DBS systems were required to carry broadcast programming on their systems.

B. The 1992 Cable Act and Its Implementation

As cable and DBS grew rapidly in the late 1980s and early 1990s, reaching more than 50 million subscribers in 1990,[14] Congress became concerned that the inability of broadcasters to be compensated for their signals was creating "a *distortion in the video marketplace which threatens the future of over-the-air broadcasting…. [by supporting] a system under which*

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broadcast television. Until at least the 1970s, there was little cable-originated programming and virtually all cable programming consisted of retransmitted broadcast signals. See *Section 109 Report* at 2.

[9] See 2 F.C.C. 2d 725. See also FCC, *Retransmission Consent and Exclusivity Rules: Report to Congress Pursuant to Section 208 of the Satellite Home Viewer Extension and Reauthorization Act of 2004* (Sep. 8, 2005) (hereafter *SHVERA Report*) at ¶7.

[10] See *SHVERA Report* at ¶7; see also *Quincy Cable TV, Inc. v. FCC*, 768 F.2d 1434 (D.C. Cir. 1985).

[11] See *Senate Report* at 1175-77. The Supreme Court ultimately upheld the Cable Act's must-carry requirements. See *Turner Broadcasting System, Inc., et al. v. Federal Communications Commission*, et al. 520 U.S. 180 (1997).

[12] Stations which elect must carry report their status to the FCC, but no systematic records are kept of the elections. It is generally agreed that virtually all network affiliates and other significant commercial stations now receive retransmission consent compensation.

[13] See, e.g., *Section 109 Report* at 83. Also see FCC, *Information Sheet, Television Broadcast Channels on Satellite* (October 2006).

[14] See SNL Kagan, *Broadband Cable Financial Databook*, 2013 Edition (December 2013) at 8.

broadcasters in effect subsidize the establishment of their chief competitors,"[15] i.e., cable and DBS operators and cable programming networks. It responded by passing the 1992 Cable Act,[16] which created the retransmission consent regime and re-imposed must-carry obligations.

Under the Cable Act, commercial broadcasters must, every three years, elect to be eligible for must carry or, alternatively, choose to negotiate retransmission consent.[17] If they choose must carry, they are guaranteed carriage on cable systems operating within their geographic broadcast footprints, but receive no compensation; if they choose retransmission consent, they are not guaranteed carriage, but have the right to "negotiate in good faith" for compensation.[18]

In passing the Cable Act, Congress specifically recognized that the market for broadcast programming had changed dramatically. The Senate report accompanying the bill noted, for example, that the FCC's 1959 decision to allow free retransmission occurred at a time when "cable systems had few channels and were limited to an antenna function of improving reception of nearby broadcast signals." Thus, it said, the FCC's 1959 decision "did not unreasonably disrupt the rights that broadcasters possess in their signals."[19] However, the report continued:

> *That situation… has changed dramatically. Cable systems now include not only local signals, but also distant broadcast signals and the programming of cable networks and premium services. Cable systems compete with broadcasters for national and local advertising revenues. Broadcast signals, particularly local broadcast signals, remain the most popular programming carried on cable systems… It follows logically, therefore, that a very substantial portion of the fees*

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[15] See *Senate Report* at 1168.

[16] See *Cable Television Consumer Protection Act of 1992*, Pub. L. No. 102-385 (1992); the FCC's implementing regulations are at 47 C.F.R § 76.55-62 (cable must carry) and 47 C.F.R. § 76.64 (cable retransmission consent).

[17] Public television stations, which are non-commercial and are funded in part by the Corporation for Public Broadcasting, only operate in the must carry framework. See e.g., United States Government Accountability Office, *Issues Related to the Structure and Funding of Public Television*, GAO-07-150 (January 2007) at Introduction and 20; and Corporation for Public Broadcasting, *Alternative Sources of Funding for Public Broadcasting Stations* (June 20, 2012) at 33.

[18] In passing the Cable Act, Congress recognized that satellite operators were treated differently from cable operators in the 1976 Copyright Act, and thus did not impose retransmission consent on DBS. It extended retransmission consent to DBS operators in 1999 in the *Satellite Home Viewer Improvement Act* (SHVIA), while at the same time permitting DBS operators to carry local broadcast signals even to households that were not "unserved." DBS operators are not subject to the must carry requirement. However, if they choose to carry any local broadcast stations, they are required to carry all stations that have elected must carry (the "carry one, carry all" rule). See *SHVERA Report* at ¶¶13-14. SHVIA was extended in 2004 by the *Satellite Home Viewer Extension and Reauthorization Act of 2004*, Pub. L. No. 108-447 (2004) (SHVERA); implementing regulations are at 47 C.F.R. §76.66. SHVERA also made several changes in the compulsory license regime affecting distant signal carriage by DBS operators. See *SHVERA Report* at ¶¶15-16.

[19] See *Senate Report* at 1168.

> *which consumers pay to cable systems is attributable to the value they receive from watching broadcast signals.*[20]

The effect of retransmission consent, the report concluded, would be to "establish a marketplace for the disposition of the rights to retransmit broadcast signals" without "dictat[ing] the outcome of the ensuing marketplace negotiations" – negotiations which, Congress recognized, might result in monetary compensation, in-kind compensation, or no compensation at all.[21]

Thus, the Cable Act established a market-based mechanism for setting compensation for carriage of broadcast signals by MVPDs, based on voluntary agreements between broadcasters and operators, while at the same time (by re-imposing must carry) ensuring that cable operators and consumers would continue to have access to all broadcast channels.

As discussed below, retransmission consent compensation was initially limited to various forms of in-kind compensation. Broadcasters did not begin receiving cash compensation until 2005.

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[20] See *Senate Report* at 1168.
[21] See *Senate Report* at 1168-1169.

III. The Economics of Retransmission Consent

The economic effects of retransmission consent are determined in large part by three distinguishing characteristics of markets for video content and distribution.

- First, video production and distribution markets exhibit strong economies of scale and scope, meaning that the profitability, and ultimately the economic viability, of video producers and distributors depends on the ability to distribute their products and services to the widest possible audience.

- Second, video content markets are classic "multi-sided" markets in which providers compete on their ability to attract both "upstream consumers" (e.g., advertisers, content) and "downstream consumers" (e.g., distributors, viewers).

- Third, the market for retransmission consent compensation is a bargaining market, in which firms negotiate to determine how the value created by carriage of broadcast signals is divided between MVPDs and broadcasters.

As discussed below, all three of these characteristics are important for understanding the impact of retransmission consent on the video marketplace and on consumer welfare in general.

A. Economies of Scale in TV Broadcasting

Television broadcasting is subject to economies of scale associated with the need for large capital investments in broadcasting equipment and production facilities and with the "first copy" property – i.e., the fact that the "first copy" of a television program is expensive to produce, but distribution to additional users is essentially costless.[22] In economic terms, television broadcasters and content producers experience high fixed costs and low marginal costs. Such firms have high break-even points: before earning any profits, they must produce sufficient output to earn a return on their invested capital and to pay for their fixed operating costs.

Empirical estimates of the extent of economies of scale in television broadcasting show that smaller stations (e.g., as measured by total revenues) have significantly higher costs per unit of output than larger ones.[23] There is also substantial evidence that the production of public affairs programming (i.e., news) is positively correlated with station revenues.[24]

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[22] See e.g., Bruce M. Owen and Steven S. Wildman, *Video Economics* (Cambridge: Harvard University Press, 1992).

[23] See Jeffrey A. Eisenach and Kevin W. Caves, *The Effects of Regulation on Economies of Scale and Scope in TV Broadcasting* (June 2011) at 14 (available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1894941) (hereafter Eisenach and Caves (2011)) (finding that output rises 22 percent faster than costs over the relevant range).

[24] See Eisenach and Caves (2011) at 46-47 for a summary of the relevant literature.

The presence of strong scale economies in television broadcasting means that legal or regulatory barriers to achieving the efficient level of broadcast station revenues have a disproportionate impact on industry output both in terms of the amount of programming produced and in terms of overall financial viability and thus the number of broadcast stations. As discussed below, the evidence suggests that retransmission consent has played an important role in enabling the continued growth of the television broadcasting sector in the U.S.

B. Video Distribution as a Multi-Sided Market

The market for broadcast television is a classic multi-sided market which creates value, in part, by bringing different types of customers – i.e., advertisers, content creators, and viewers – together in a marketplace (sometimes referred to in the economics literature as a "platform").[25] The economic efficiency of such markets is determined by the market operator's ability to set prices and product characteristics in such a way as to achieve the most efficient blend of different customer types. To take a simple example, a newspaper filled with advertising but no news stories could be sold at a low price to readers, but its value to most readers would be limited. Conversely, a newspaper with no advertising might be desirable to many consumers, but without advertising revenues, the price charged to readers might limit its appeal. While the economics of multi-sided platforms are complex, it is generally true that the prices charged to each type of customer are positively related to their elasticity of demand: In simple terms, the customers that value participation most pay the highest prices, while customers who place a lower value on participation pay less – or may even be subsidized.[26]

The two-sided nature of television broadcasting has obvious and important implications for retransmission consent. Increasing competition on the advertising side of the traditional television broadcaster business model (e.g., from online advertising) has likely made the demand for television advertising more elastic, while increasing demand for content has reduced the elasticity of demand for their broadcast content. The appropriate economic response (from both a profit maximization and consumer welfare perspective) is to shift some of the costs of television broadcasting from the advertising side to the content side of the market. In the U.S., as discussed below, retransmission consent has provided a means for accomplishing this economic transformation.

C. Retransmission Consent as a Bargaining Market

The market for retransmission consent is a bargaining market, meaning that prices and terms are negotiated between upstream and downstream firms for the exchange of complementary inputs. Economists assess such markets using bargaining models, in which the division of value between

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[25] See generally Jean-Charles Rochet and Jean Tirole, "Platform Competition in Two-Sided Markets," *Journal of the European Economic Association*, 1;4 (June 2003) 990-1029.

[26] Elasticity of demand is the percentage change in quantity demanded that results from a change in the price of a good. Goods with more elastic demand react more sharply to a change in price than goods with inelastic demand.

the parties is determined by each party's alternatives in the event of an impasse: If one party to the transaction loses relatively little (compared to a situation in which the transaction does not occur) and the other loses a great deal, the party that would lose less from the absence of a deal is regarded has having greater bargaining power.[27]

In the U.S., the emergence of alternative distribution systems – first DBS and more recently telephone companies – was accompanied by what many interpret as a shift in bargaining power. As noted above, for the first 13 years after retransmission consent was put in place, compensation was only paid in-kind, suggesting that broadcasters did not have sufficient bargaining power to insist on more substantial payment or, put differently, that the lack of competition in the downstream market limited the impact of the retransmission consent regime. The implication for nations considering adopting retransmission consent as a means of revitalizing their broadcast television sectors is that it is important to examine market structure and bargaining power issues and to consider adopting mechanisms – such as the U.S. requirement to "negotiate in good faith" – to ensure that the goals of the policy are ultimately achieved.[28] In particular, in circumstances where there is market power in the downstream market for distribution, there may be a case for regulatory oversight.

[27] See generally Ken Binmore, Ariel Rubinstein and Asher Wolinsky, "The Nash Bargaining Solution in Economic Modelling," *The RAND Journal of Economics*, 17(2) (1986) 176-188.

[28] As noted above, the Communications Act requires both parties to "negotiate in good faith." The FCC has implemented the good faith provision using a two-part framework; first a list of seven objective negotiation standards and beyond those a "totality of circumstances" standard. (FCC, *In the Matter of Amendment to the Commission's Rules Related to Retransmission Consent, Report and Order and Further Notice of Proposed Rulemaking*, MB Docket No 10-71 (March 31, 2014) at ¶10). During the Canadian consideration of a retransmission consent regime, some parties advocated adoption of a "baseball-style" arbitration regime. (See Armstrong and Eisenach (2009) at 29).

IV. The Impact of Retransmission Consent in the U.S. Video Market

The ability of broadcasters to obtain compensation for their programming from MVPDs has had profound effects on the market for video content in the U.S. Initially, retransmission consent compensation took the form of in-kind payments, including agreements by cable operators to carry new cable channels offered by the broadcast networks. More recently, cash compensation for retransmission consent has become a key revenue source that has allowed broadcasters to not only remain financially viable, but to invest in new technologies and to create innovative, high quality programming. As a result, the video market in the U.S. is thriving, with increasing revenues, enhanced consumer choices and higher levels of viewership, and free-to-air television remains a strong and viable choice for U.S. consumers. This section begins by describing the structure of the U.S. video distribution market. Next, it discusses the nature and magnitude of retransmission consent compensation. Finally, it assesses the economic significance of retransmission consent to the broadcast sector.

A. Structure of the U.S. Video Content and Distribution Market

The U.S. video distribution market has traditionally been comprised of two main sectors, the broadcast sector and the multichannel video programming distribution (MVPD) sector; as in other countries, it also now includes an emerging over-the-top (OTT) sector which uses broadband Internet connections to distribute video programming.

- The broadcast sector includes broadcast television stations, most of which are owned by station groups, and the broadcast networks that create much of the programming shown on broadcast stations. Broadcast stations broadcast signals over-the-air, currently in digital format. Their signals are also distributed by MVPDs.
- The MVPD sector includes cable operators (those operating more than one system are referred to as multiple system operators, or "MSOs"); direct-broadcast satellite ("DBS") operators; and, telephone companies that have entered the video distribution business ("telcos"). In 2013 about 100 million households subscribed to an MVPD, accounting for 86 percent of all television households. In addition, cable networks (or "channels") create the content (in addition to broadcast content) that is distributed by MVPDs.
- OTT providers, such as Netflix, package programming and make it available over broadband Internet connections.

According to the FCC, there were 1,388 full-power commercial television broadcast stations and 395 non-commercial ("educational") stations operating in the U.S. as of March 2014.[29] The vast

[29] See FCC, *Broadcast Station Totals as of March 31, 2014* (April 9, 2014) (available at http://transition.fcc.gov/Daily_Releases/Daily_Business/2014/db0409/DOC-326518A1.pdf). Of these, 1,030 commercial and 288 educational stations operated in the UHF band and the remainder in the VHF band. In addition, there were 429 "Class A" stations (with lower power ratings) and approximately 6,000 "low power" and "translator" stations. As discussed below, the number of full power commercial broadcast stations has grown steadily

majority of these stations (about 92 percent) are affiliated with one of the nationwide broadcast networks, which provide content in the form of prime-time programming, national news programs, and sports. The four so-called "major" networks are ABC, CBS, FOX and NBC. Others include general programming networks like The CW and MyNetworkTV; Spanish language networks such as Univision, Telemundo and TeleFutura; religious networks like TBN; and, a variety of regional networks. The broadcast networks make varying amounts of programming available to their affiliates. For example, ABC, CBS and NBC provide about 22 hours of prime time programming each week, while Fox provides 15 hours per week. Networks also provide daytime programming in varying quantities.[30] The remainder of broadcast programming is produced locally.

Most broadcast stations are owned by broadcast owners groups, which own multiple stations in different markets throughout the U.S. Among the major ownership groups are stations owned and operated by the broadcast networks themselves (e.g., ABC, CBS, Fox, NBC; often referred to as "O&O stations") as well as station groups as seen in Table 1, such as Gannett Broadcasting, ION Media and Sinclair Broadcast Group. U.S. statutes and FCC regulations place limits on station ownership both nationally (no station group may own stations reaching more than 39 percent of U.S. television households)[31] and locally (through a complex formula based on the size of the market).[32]

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throughout the history of television broadcasting, and continues to do so. Local television markets are generally defined by the collection of geographic areas (counties) where audiences predominantly view the broadcast stations of a particular metropolitan area. These "Designated Market Areas" (DMAs) are defined by Nielsen, a television ratings company. There are about 210 DMAs in the United States. As of January 1, 2014, the DMAs ranged from New York with almost 7.5 million television households down to Glendive, Montana with a little over 4,000 television households. See Nielsen, *Local Television Market Universe Estimates* (January 2014) (available at http://www.tvb.org/media/file/TVB_Market_Profiles_Nielsen_TVHH_DMA_Ranks_2013-2014.pdf).

[30] See FCC, *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, Fifteenth Report* (July 22, 2013 at ¶153 (hereafter *15th MVPD Report*). CBS provides its affiliates with about 98 hours of scheduled programming per week, leaving 70 hours for the affiliate. See CBS Corp., SEC Form 10-K (December 2013) at I-30.

[31] See *15th MVPD Report* at ¶155.

[32] See *15th MVPD Report* at ¶157.

TABLE 1: TOP TV STATION GROUPS BY STATION COUNT (2013)

Station Group	Total TV Stations
Sinclair Broadcast Group, Inc.	103
ION Media Networks, Inc.	63
LIN Media LLC	61
Word of God Fellowship, Inc. d/b/a Daystar Television Network	55
Nexstar Broadcasting Group, Inc.	53
Univision Communications Inc.	51
Gray Television, Inc.	48
Raycom Media, Inc.	43
Entravision Communications Corporation	43
Tribune Company	41
Gannett Co., Inc.	38

Source: SNL Kagan.

The MVPD sector is comprised of cable MSOs like Comcast, Time Warner Cable[33] and Charter Communications,[34] satellite operators DirecTV[35] and DISH Network, and telephone companies that provide video such as AT&T and Verizon. Cable and telco operators serve limited jurisdictions: the largest, Comcast, has operations in 39 states and passes about 52 million out of about 130 million U.S. homes), but there are approximately 1,500 smaller cable and telco MVPDs serving much smaller areas, as well as hundreds of small telcos which have begun offering television service in addition to voice and broadband.[36] DBS operators provide services on a nationwide basis, but since the mid-2000s have been able to offer local programming by using "spot beam" technology which allows them to target local broadcast programming into local markets. As of the end of 2013, there were about 100 million MVPD video subscribers in the U.S., of which cable operators served about 54 million, DBS served about 34 million and telcos served about 12 million. MVPD subscribership peaked in 2011 and has been declining, albeit slowly, since.[37]

In addition to carrying broadcast stations, MVPDs also carry content from cable networks such as ESPN, CNN, Fox News, the Disney Channel and the Weather Channel.[38] As shown in Figure 1, there are approximately 800 cable networks operating in the U.S. Many of these are affiliated with broadcasting companies and/or cable operators like NBC/Comcast, The Walt Disney

[33] As of July 2014, Comcast and Time Warner Cable are awaiting approval from the U.S. Department of Justice and the FCC to consummate Comcast's acquisition of Time Warner Cable.

[34] Approximately 25 percent of Charter Communications is owned by Liberty Media.

[35] As of July 2014, DirecTV and AT&T are awaiting approval from the U.S. Department of Justice and the Federal Communications Commission to consummate AT&T's acquisition of DirecTV.

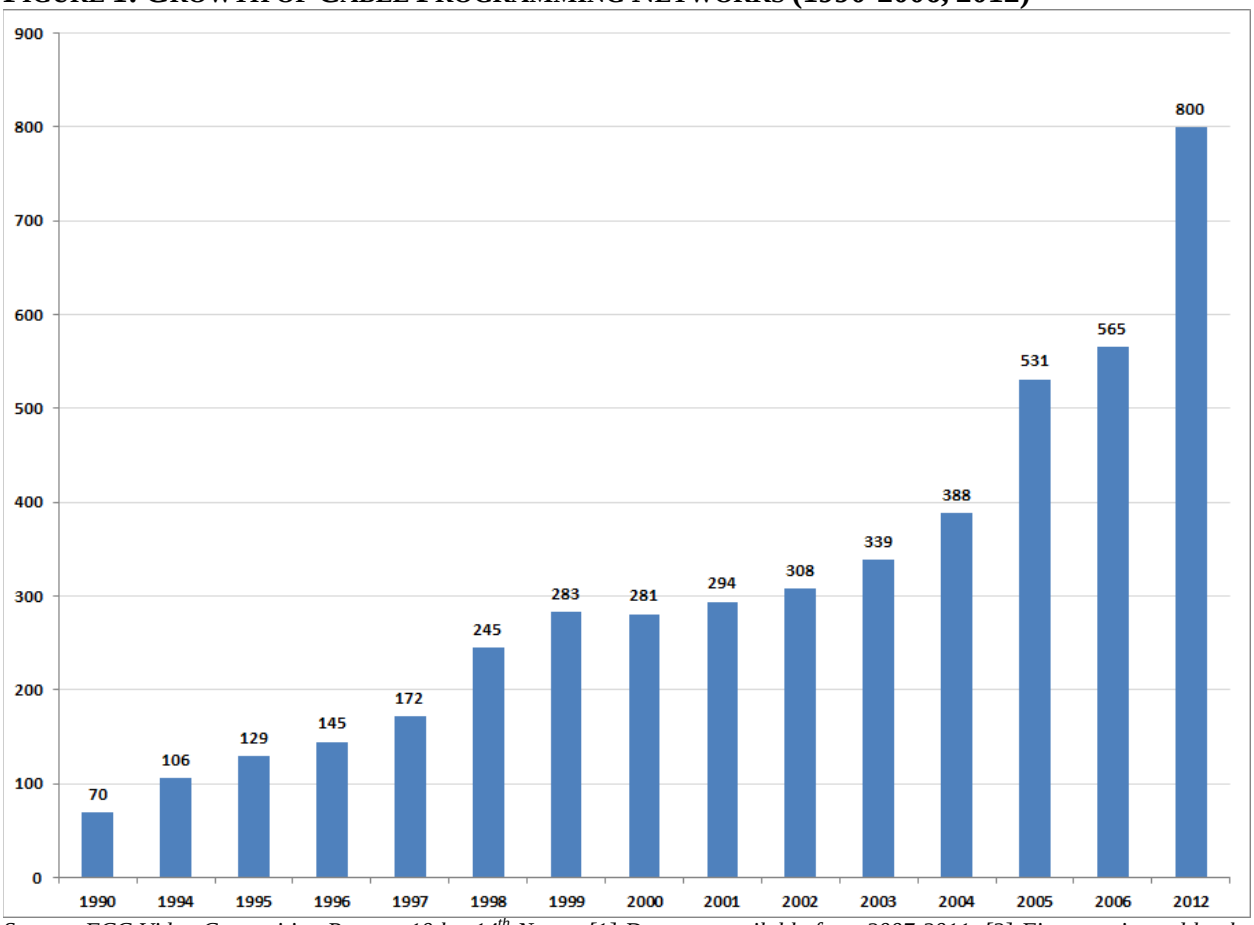
[36] See *15th MVPD Report* at ¶¶ 24-30 and Table 1.

[37] See SNL Kagan, *Multichannel Video Subscription Count Drops in 2013* (March 2014).

[38] Each cable "network" is in fact a cable channel – a single continuous stream of video programming.

Company (which owns the ABC broadcast network), CBS and Fox, though others (like the Discovery Network) are independent. As discussed below, cable networks now account for about two thirds of all television viewing in the U.S., while broadcast networks account for about a third.

FIGURE 1: GROWTH OF CABLE PROGRAMMING NETWORKS (1990-2006, 2012)



Source: FCC Video Competition Reports 10th - 14th Notes: [1] Data not available from 2007-2011. [2] Figure estimated by the FCC for 2012.

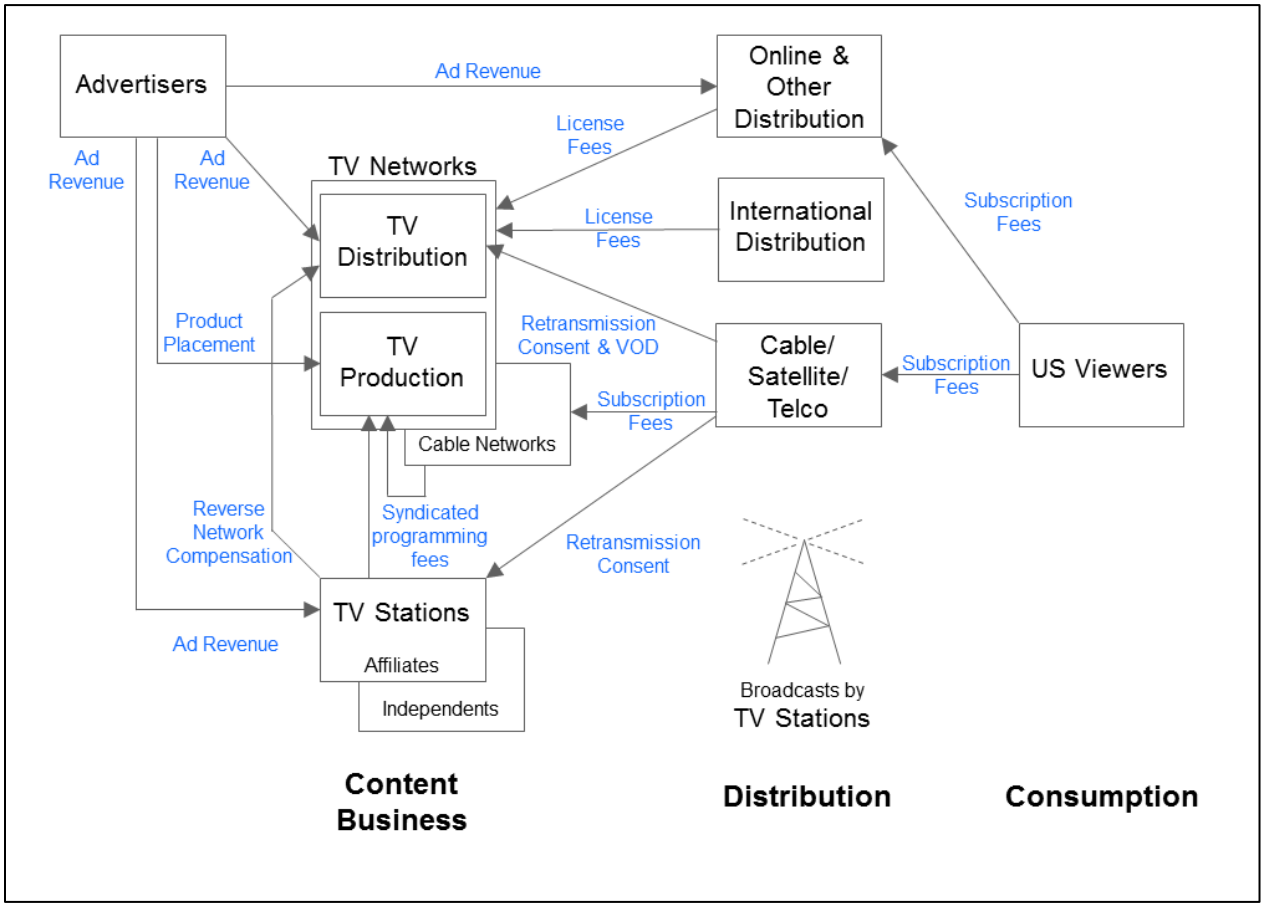
The third sector of the video distribution market is comprised of emerging OTT providers, such as Netflix, YouTube, Apple and Amazon. Such firms aggregate programming from a variety of sources, including programming produced by broadcast and cable networks, content (e.g. movies) from video production companies; they are also increasingly beginning to produce and distribute proprietary content, such as Netflix "House of Cards," a derivation of a popular British miniseries.[39] The OTT sector is growing rapidly, and is credited by many with the "cord cutting"

[39] See Julianne Pepitone, "Netflix's $100 Million Bet on Must-See TV," *money.cnn.com* (February 1, 2013) (available at http://money.cnn.com/2013/02/01/technology/innovation/netflix-house-of-cards/).

evidenced in the decline of MVPD subscribership. SNL Kagan estimates that in 2012 revenues in the combined paid and ad-supported market for online video totaled $6.42 billion, a figure that is expected to more than double to $14.2 billion by 2017.[40] However, MVPD revenues still dwarf OTT revenues at $102.4 billion in 2012.[41]

The structure of the U.S. video market is illustrated in Figure 2 below. As the figure shows, retransmission consent compensation is paid by MVPDs (cable, satellite and telco) distributors to broadcast stations; as discussed further below, a significant portion of the revenue flows through to broadcast networks. As shown in the figure, other sources of revenue supporting TV programming production include advertising, license fees received from international and online distribution, and the sale of rights to "rerun" programming (called "syndication").

FIGURE 2: BROADCAST TELEVISION INDUSTRY STRUCTURE



Source: Fitch Ratings, Credit Encyclo-Media, Volume VI, 2013-2014 at 76.

[40] See SNL Kagan, *The State of Online Video Delivery* (July 2013) at 4-5.

[41] See SNL Kagan, *Multichannel Programming Fees as a Percent of Multichannel Video Revenues* (April 28, 2014).

The U.S. video market is undergoing significant change. First, there is substantial consolidation underway in both the broadcasting and MVPD sectors. Broadcast station transactions during 2013 totaled over $8 billion, including mergers between station group owners Tribute Broadcasting and Local TV Holdings ($2.7 billion), Gannett Broadcasting and Belo Corporation ($2.2 billion), and Sinclair Broadcast Group and Allbritton Communications ($1 billion).[42] Among MVPDs, Comcast is currently seeking approval to acquire Time Warner Cable, while AT&T recently announced plans to acquire DBS provider DirecTV. All such transactions require Federal government approval.

Second, the FCC is in the process of planning an "incentive auction" which will provide broadcasters an opportunity to turn in their spectrum licenses in return for compensation to be determined through a reverse auction process, with the resulting spectrum to be auctioned to mobile broadband operators.[43] It is possible, though by no means assured, that the incentive auction will result in a significant number of broadcast stations – the National Association of Broadcasters estimates as many as 400 – relinquishing their licenses and either going off the air or "channel sharing" (i.e., combining two broadcast streams onto a single digital stream by multicasting).[44]

B. Trends in Retransmission Consent Compensation

Retransmission consent compensation totaled over $3 billion in 2013 and is expected to more than double by 2019. As noted above, however, cash retransmission consent compensation is a relatively recent phenomenon: For more than a decade, compensation took the form of in-kind payments such as agreements by MVPDs to carry cable networks owned by the broadcasters. The nature and impact of in-kind compensation is discussed in the first subsection below; the growth of cash compensation is discussed in the second subsection.

1. *In-Kind Compensation, 1992-2004*

As the FCC explained in a 2005 report, MVPDs initially refused to pay cash compensation to broadcasters:

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[42] See Pew Research Center, *Acquisitions and Content Sharing Shapes Local TV News in 2013* (March 26, 2014) (available at http://www.journalism.org/files/2014/03/Local-News-Aquisitions-and-Content-Sharing-Shapes-Local-TV-News-in-2013_Final.pdf).

[43] See FCC, *In the Matter of Expanding the Economic and Innovation Opportunities of Spectrum Through Incentive Auctions, Report and Order*, GN Docket No. 12-268 (June 15, 2014) (available at http://transition.fcc.gov/Daily_Releases/Daily_Business/2014/db0602/FCC-14-50A1.pdf).

[44] See National Association of Broadcasters, *Spectrum Impact Studies, FCC Presentation* (July 2011) (available at http://apps.fcc.gov/ecfs/document/view?id=7021699087).

> *During the first round of retransmission consent negotiations, broadcasters initially sought cash compensation in return for retransmission consent. However, most cable operators – particularly the largest multiple system operators (MSOs) – were not willing to enter into agreements for cash, and instead sought to compensate broadcasters through the purchase of advertising time, cross-promotions, and carriage of affiliated channels. Many broadcasters were able to reach agreements that involved in kind compensation by affiliating with an existing non-broadcast network or by securing carriage of their own newly-formed non-broadcast networks. Broadcast stations that insisted on cash compensation were forced to either lose cable carriage or grant extensions allowing cable operators to carry their signals at no charge until negotiations were complete.*[45]

In a 2004 regulatory filing, the Walt Disney Company stated:

> *Eventually, agreements were reached between the broadcast networks and the major cable operators that provided for the cable operators to carry various new broadcast network-owned cable programming services in return for retransmission consent rights to local broadcast station signals. Today, cable operators carrying cable networks as consideration for retransmission consent rights is a common practice.*[46]

While retransmission consent agreements were and remain confidential – meaning that information about the precise nature and extent of retransmission consent compensation must be gleaned from companies' public statements and financial reports – there is little doubt that retransmission consent facilitated the creation of many new cable networks between 1992 and 2005.

Indeed, as shown in Figure 1 above, the rate at which new cable networks were introduced increased following the adoption of retransmission consent, suggesting that both broadcasters and consumers benefited from retransmission consent despite the absence of cash compensation.[47]

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[45] See *SHVERA Report* at ¶10.

[46] See *In the Matter of Comment Requested on A La Carte and Themed Tier Programming and Pricing Options for Programming Distribution On Cable Television and Direct Broadcast Satellite Systems, Comments Of The Walt Disney Company*, MB Docket No. 04-207 (July 15, 2004) attaching, Economists Inc., "The Fair Market Value Of Local Cable Retransmission Rights For Selected ABC Owned Stations".

[47] This expansion coincided with the widespread growth of digital broadcasting, which made possible the delivery of hundreds of channels over MVPD distribution networks. As shown in Figure 1, by 2006, there were 565 cable television channels in the U.S.

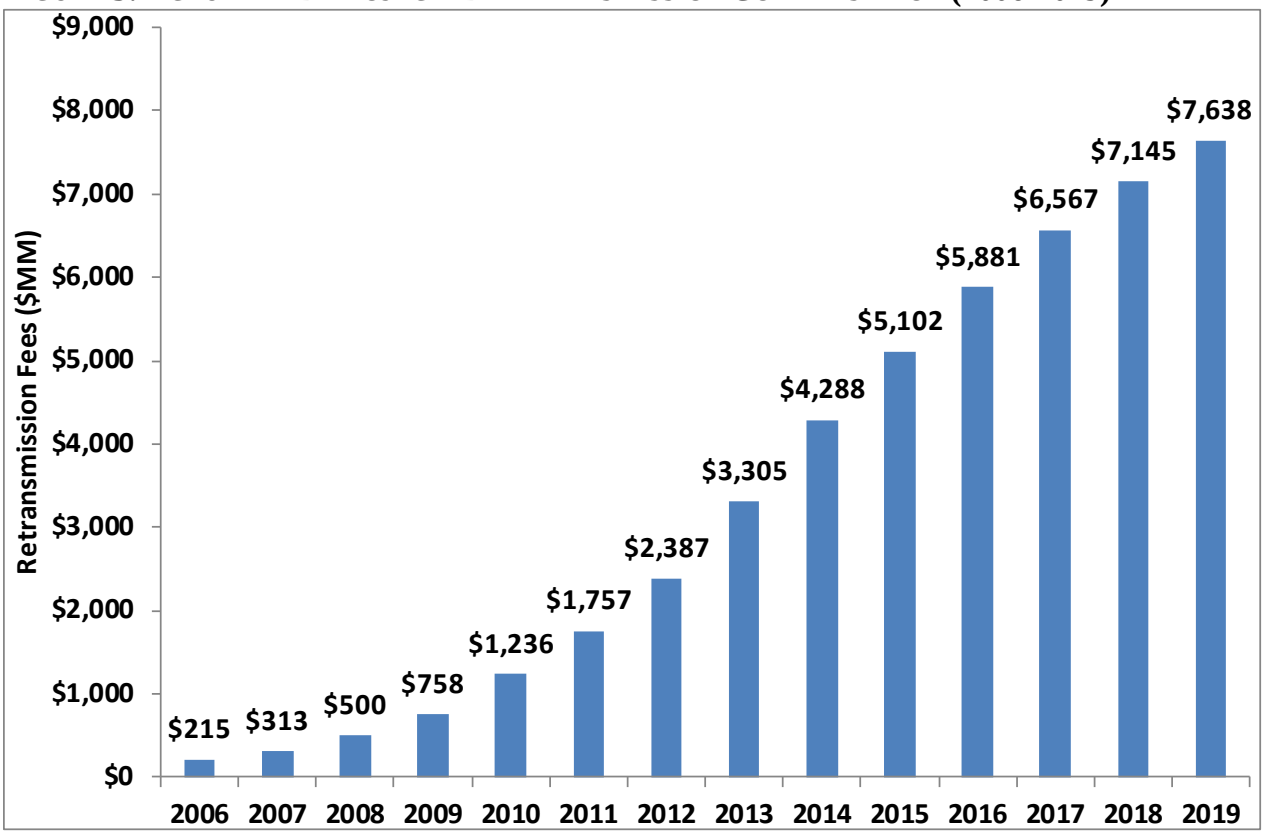
2. *Cash Compensation, 2005-Present*

The first publicly reported retransmission consent agreements that provided for cash compensation occurred in 2005. Specifically, the 2005 *Annual Report* of the Sinclair Broadcast Group reported that "[a]s the competition for programming content increases among the many cable, satellite and telecommunications companies, we are in a position to realize significant additional revenues," and added that "as these agreements come up for renewal, *we are including terms which provide us with retransmission fee revenues*."[48] Other agreements around this time also began to incorporate cash compensation. As CBS Corporation reports, it has "since 2006 … implemented a systematic process of seeking monetary consideration for its retransmission consent."[49] As mentioned earlier, many believe one reason for the shift was the emergence of satellite and telco distribution alternatives to cable TV.

SNL Kagan, a respected industry analyst firm, provides estimates of retransmission compensation from 2006 forward. As shown in Figure 3, estimated payments have increased from $215 million in 2006 to $3.3 billion in 2013, and are forecast to increase to $7.6 billion by 2019. (To be completely clear, the numbers in Figure 3 below are purely payments made to broadcasters for free to air content and do not include compensation paid, for example, to cable programming networks.) Consistent with SNL Kagan's projections, broadcasters report that they expect retransmission revenues to continue to grow. For example, 21st Century Fox president and COO Chase Carey said in the company's February 2014 earnings call that "Retransmission is also an ongoing source of growth and we continue to conclude agreements at or above our targets."[50] He had previously indicated (in 2012) that the value Fox was receiving for its stations was "clearly not close to reflecting the competitive value of … the FOX Network."[51]

[48] See Sinclair Broadcasting Group, SEC Form 10-K (December 2005) at 7 (emphasis added).
[49] See CBS Corporation, SEC Form 10-K (December 2013) at I-21.
[50] See SNL Kagan, *Economics of Broadcast TV Retransmission Revenue* (May 2014) at 10.
[51] See Deutsche Bank, *Media & Telecom Conference Transcript* (February 28, 2012) at 8-9.

FIGURE 3: ACTUAL AND PROJECTED RETRANSMISSION COMPENSATION (2006-2019)

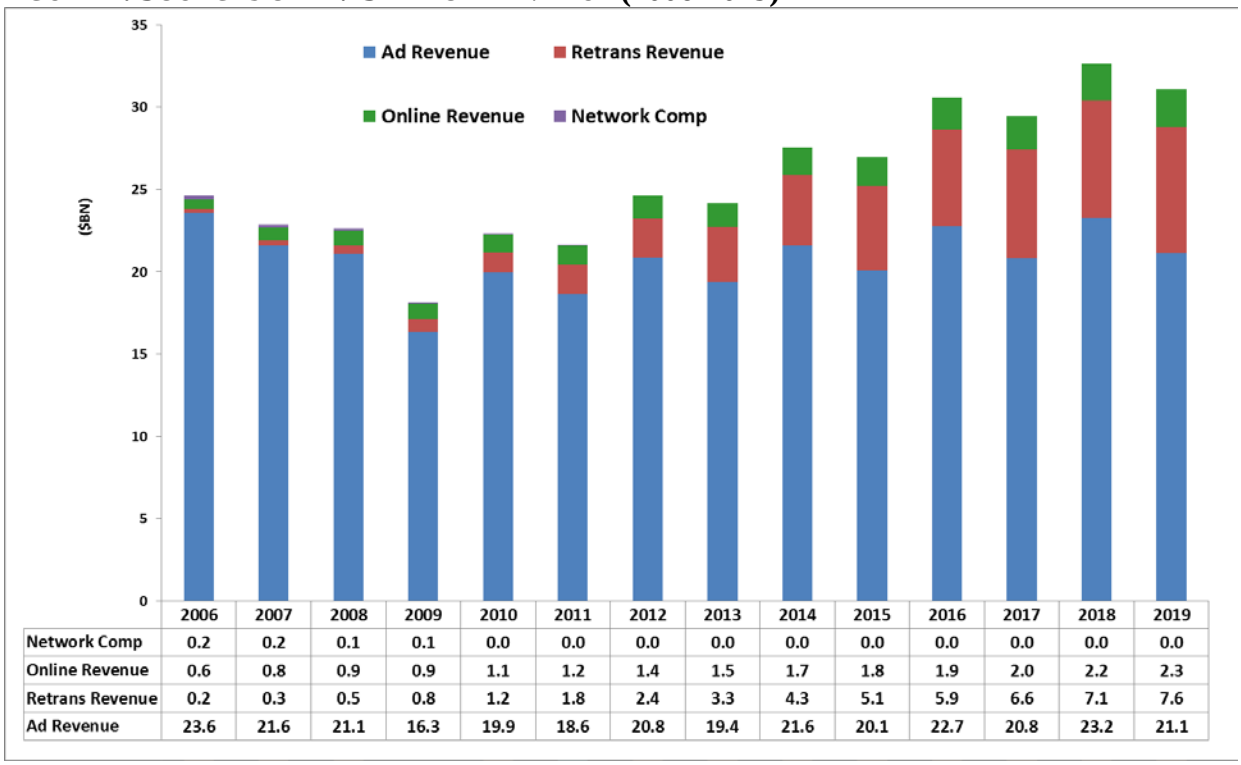


Source: SNL Kagan. (2006-2013 data is actual; 2014-2019 projected).

The effect of cash compensation for retransmission consent on the mix of broadcast station revenue has been significant, and is expected to become more so. As shown in Figure 4, SNL Kagan estimates that as of 2006, 96 percent of broadcast station revenues were from advertising, two percent from online media, and one percent from a combination of retransmission consent and payments by the networks to the stations. By 2013, the proportion accounted for by advertising had dropped to 80 percent, retransmission consent compensation had increased to 14 percent, and online revenues had risen to six percent. Retransmission consent revenues are projected to account for 25 percent of TV station revenues by 2019.[52]

[52] See R. Flynn, *The Complete Picture of TV Station Industry Revenues 2006-2019*, SNL Kagan (February 14, 2014).

FIGURE 4: SOURCES OF TV STATION REVENUE (2006-2019)



	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Network Comp	0.2	0.2	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Online Revenue	0.6	0.8	0.9	0.9	1.1	1.2	1.4	1.5	1.7	1.8	1.9	2.0	2.2	2.3
Retrans Revenue	0.2	0.3	0.5	0.8	1.2	1.8	2.4	3.3	4.3	5.1	5.9	6.6	7.1	7.6
Ad Revenue	23.6	21.6	21.1	16.3	19.9	18.6	20.8	19.4	21.6	20.1	22.7	20.8	23.2	21.1

Source: SNL Kagan, Total TV Station Industry Revenue Projections, February 2014. (2006-2013 data is actual; 2014-2019 projected).

C. Economic Impact of Retransmission Consent

Retransmission consent compensation has contributed to the economic vitality of the broadcast television sector in the U.S. and will continue to do so in the future. In the face of increasing competition for advertising, the ability of broadcasters to implement a two-sided business model has given both television station owners and the broadcast networks with which they are affiliated the ability to upgrade facilities, increase the quantity of programming provided (through multi-casting), improve the quality of their signals (through the provision of high-definition channels), and increase the quantity and quality of programming (including news and public affairs programming, as well as national and international sporting events).

1. *Significance of Retransmission Consent to Broadcast Revenues*

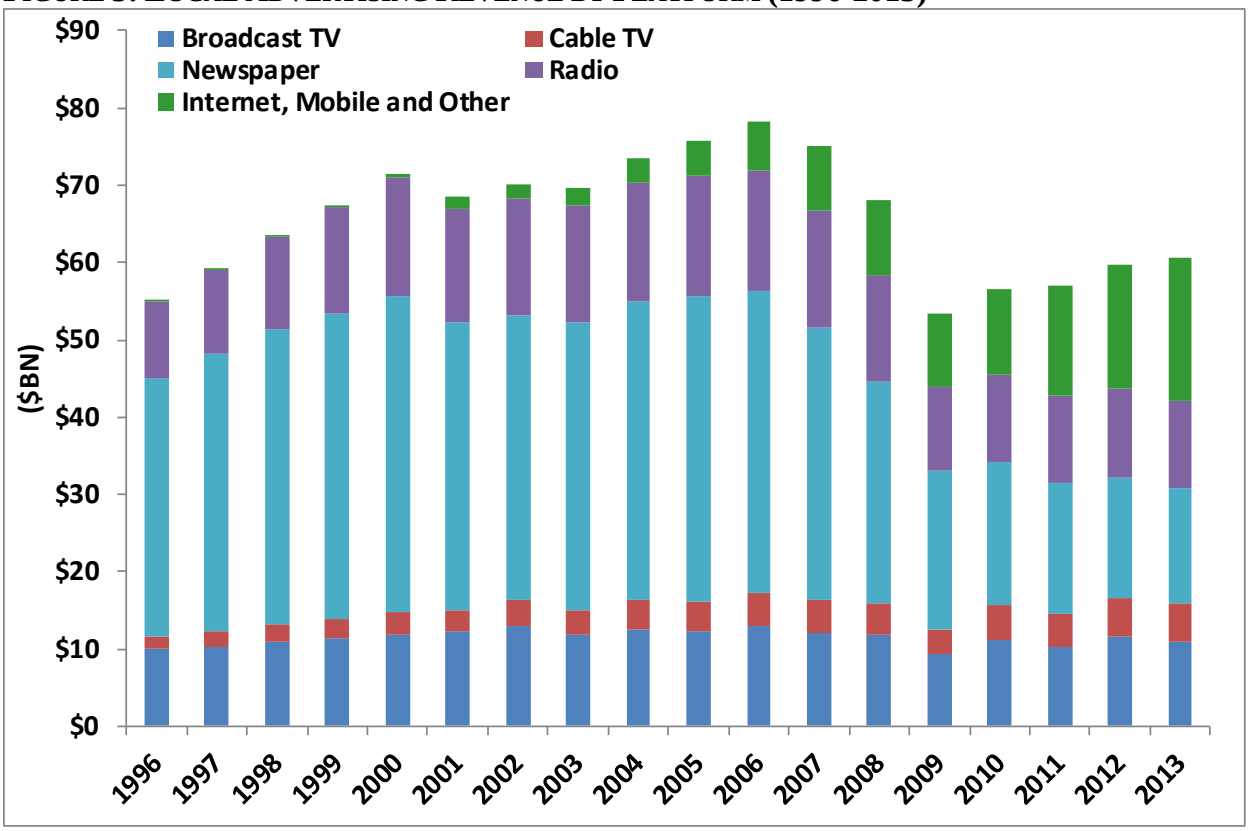
Television stations traditionally have been primarily supported by both local and national advertising,[53] with competition coming from other media such as radio and print. Competition in

[53] See *15th MVPD Report* at ¶¶ 203-206.

both the local and national markets has been intensified by the rise of new advertising vehicles, including the Internet, cable networks, and, most recently, mobile.

As shown in Figure 5, as recently as 2010 broadcast television was the third largest form of local advertising, but has since been surpassed by Internet and mobile advertising, which are growing rapidly.

FIGURE 5: LOCAL ADVERTISING REVENUE BY PLATFORM (1996-2013)

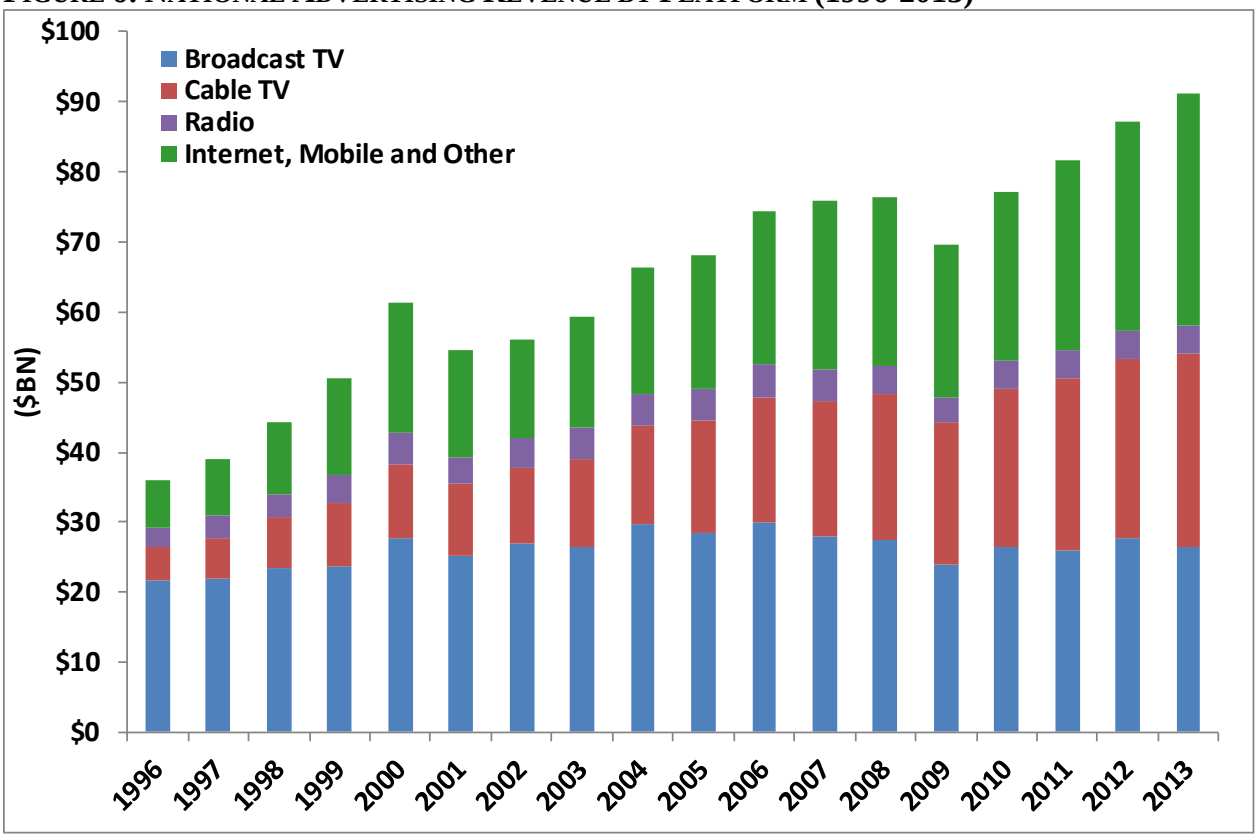


Source: SNL Kagan.

The data in Figure 5 also illustrate the impact of increasing competition on TV stations' local advertising revenues (represented by the dark blue portions of each bar). While local Internet and mobile advertising has grown rapidly since the end of the recession, rising from $10 billion in 2008 to $18 billion in 2013, local TV ad revenues actually declined over the same period, from $12 billion to $11 billion.

Figure 6 presents comparable data for national advertising, and tells a very similar story. Advertising revenues for Internet and mobile media, and for national cable TV networks, are increasing rapidly, while broadcast TV ad revenues remain at the same levels in 2013 as a decade earlier.

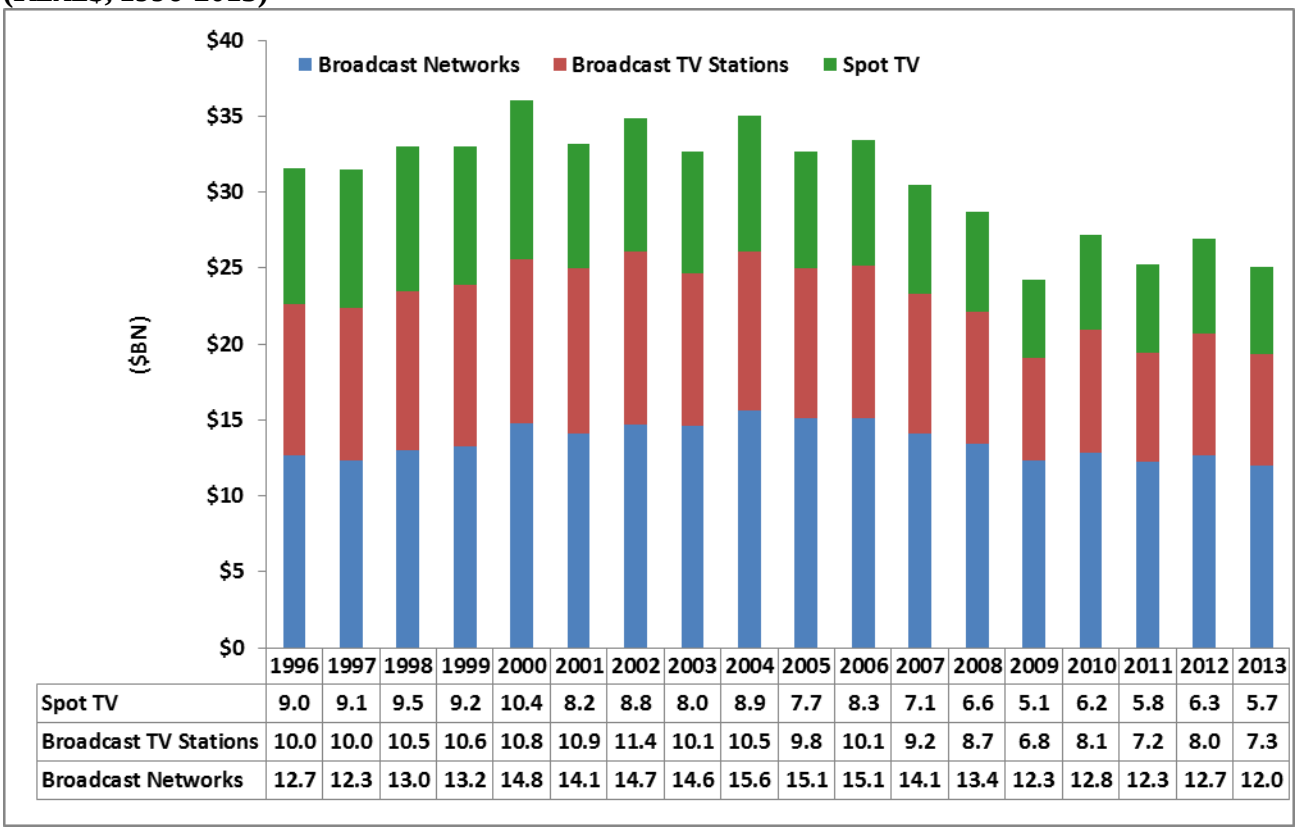
FIGURE 6: NATIONAL ADVERTISING REVENUE BY PLATFORM (1996-2013)



Source: SNL Kagan.

The data reported in Figures 5 and 6 are in nominal dollars, not adjusted for inflation. Figure 7 shows total TV advertising revenues for the same period in real terms. As the data show, television advertising revenues overall decline by more than 20 percent in real terms during this period, from $31.7 billion in 1996 to $25.0 billion in 2013.

FIGURE 7: NATIONAL AND LOCAL BROADCAST TELEVISION ADVERTISING REVENUES (REAL$, 1996-2013) [54]



	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Spot TV	9.0	9.1	9.5	9.2	10.4	8.2	8.8	8.0	8.9	7.7	8.3	7.1	6.6	5.1	6.2	5.8	6.3	5.7
Broadcast TV Stations	10.0	10.0	10.5	10.6	10.8	10.9	11.4	10.1	10.5	9.8	10.1	9.2	8.7	6.8	8.1	7.2	8.0	7.3
Broadcast Networks	12.7	12.3	13.0	13.2	14.8	14.1	14.7	14.6	15.6	15.1	15.1	14.1	13.4	12.3	12.8	12.3	12.7	12.0

Source: SNL Kagan; NERA Economic Consulting.

The data shown in Figures 5-7 helps to explain why the availability of retransmission consent has played such a crucial role in the economics of the over-the-air television industry in recent years, accounting for a large and growing proportion of broadcasters' revenues. Indeed, as shown in Table 2, retransmission consent revenues now make up nearly a quarter of all revenues for some publicly traded station groups.

[54] Spot television advertising represents national ads that are broadcast to select local TV markets, i.e., they are "spotted" to certain areas.

TABLE 2: RETRANSMISSION REVENUE FOR MAJOR STATION GROUPS (2012-2013)

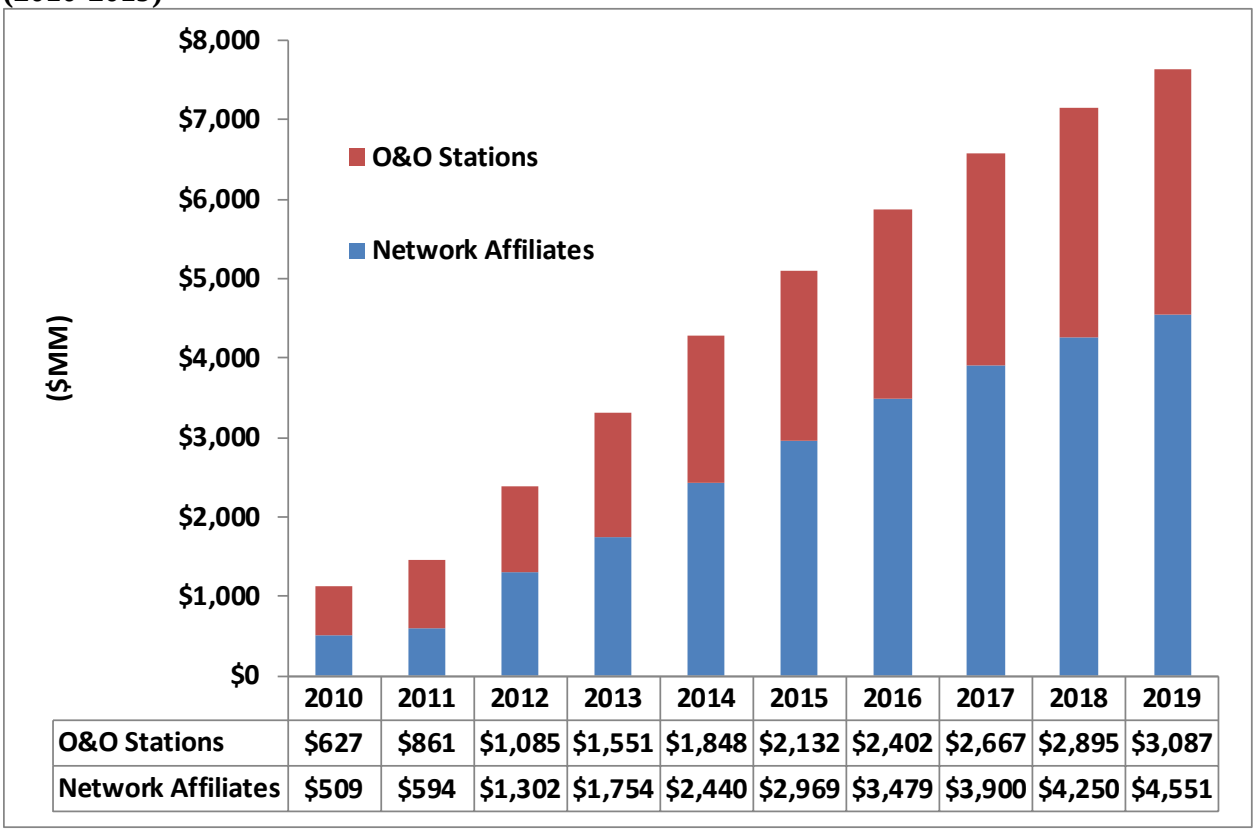
		Retrans Revenue ($MM)		Retrans % of TV Rev.	
Rank	**Company**	**2012**	**2013**	**2012**	**2013**
1	Univision (UNI & TEL)	358	431	18%	19%
2	21st Century (FOX & MNT)	308	429	16%	22%
3	CBS Corp. (CBS & CW)	250	324	17%	23%
4	Sinclair	198	313	20%	24%
5	Comcast (NBC & TEL)	40	202	3%	14%
6	Walt Disney (ABC)	122	165	12%	17%
7	Gannett	97	148	11%	18%
8	LIN Media LLC	92	130	17%	20%
9	Tribune	85	103	7%	10%
10	Nexstar	61	101	16%	20%
11	Media General	65	94	11%	17%
12	Meredith Corp	48	91	15%	24%
13	Allbritton	34	43	14%	20%
14	E.W. Scripps	31	43	6%	10%
15	Gray TV.	34	40	8%	12%
16	Entravision	20	22	13%	14%
17	Journal	10	22	7%	13%
18	Saga	2	2	10%	12%
	Total	1,855	2,704	12%	19%

Source: SNL Kagan.

Retransmission consent is important both to the owners of local television stations (i.e., the station groups listed in Table 2) and to the television broadcast networks that produce over-the-air programming, who also share in retransmission consent revenue in two ways. First, as noted above, the networks (or their parent companies) own and operate ("O&O) local broadcast stations, which receive retransmission consent revenues directly. Figure 8 shows the division of retransmission consent fees between O&O stations, on the one hand, and network affiliates, on the other.[55] As the figure shows, in 2013, O&O stations received about $1.5 billion in compensation, compared with $1.7 billion for network affiliates.

[55] Retransmission consent fees received by independent stations are not shown, but based on the small proportion of viewing hours accounted for by independent stations they are expected to account for only a small proportion of the total.

FIGURE 8: GROSS RETRANSMISSION FEES, O&O STATIONS AND NETWORK AFFILIATES (2010-2019)



	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
O&O Stations	$627	$861	$1,085	$1,551	$1,848	$2,132	$2,402	$2,667	$2,895	$3,087
Network Affiliates	$509	$594	$1,302	$1,754	$2,440	$2,969	$3,479	$3,900	$4,250	$4,551

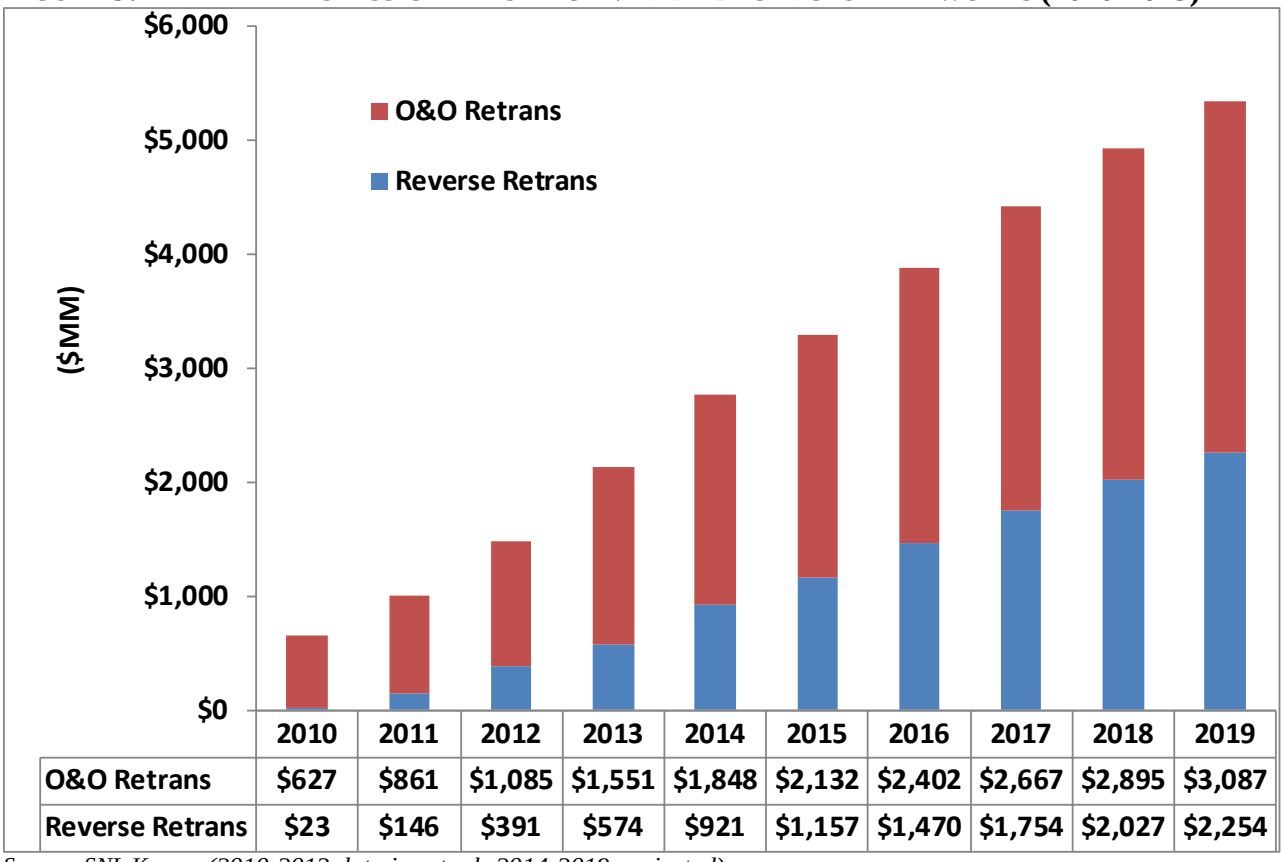
Source: SNL Kagan. (2010-2013 data is actual; 2014-2019 projected).

The second way networks benefit from retransmission consent is through payments from their affiliates. Beginning around 2010, networks began negotiating agreements with network affiliates under which the affiliate stations share a portion of their retransmission consent revenues with the network, a form of payment known as "reverse compensation" or "reverse retrans." These reverse compensation payments reflect the value of the programming provided by the networks to the station and increasing ability of the stations, through retransmission consent, to monetize that value. As seen in Figure 9 reverse compensation is expected to grow from $391 million in 2012 to $2.3 billion by 2019.

Figure 9 shows the total retransmission consent revenues received by broadcast networks, including payments to O&O stations and reverse retrans payments from affiliates. As the figure shows, broadcast networks received over $2 billion in total retransmission consent payments in 2013, comprising 13 percent of their Net Operating Revenue.[56]

[56] See SNL Kagan, *TV Network Industry Benchmarks* (accessed May 27, 2014).

FIGURE 9: NET RETRANSMISSION FEES RECEIVED BY BROADCAST NETWORKS (2010-2019)

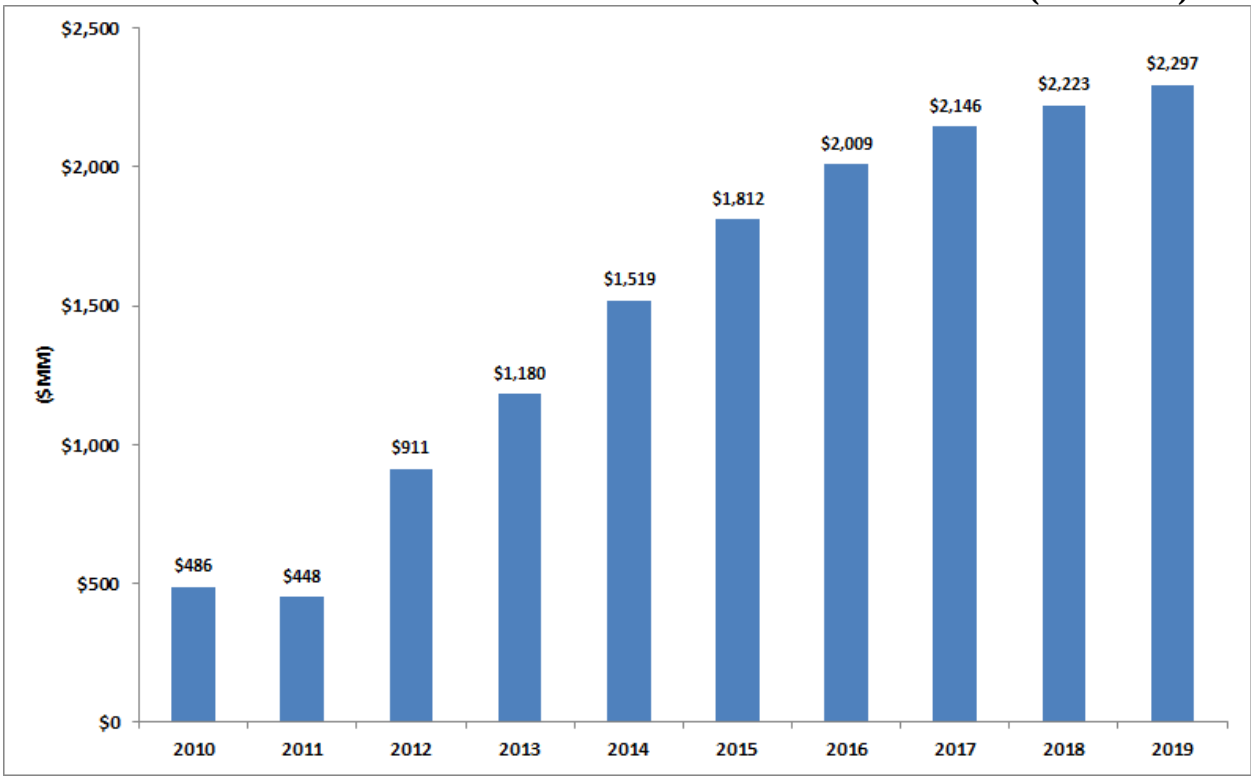


	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
O&O Retrans	$627	$861	$1,085	$1,551	$1,848	$2,132	$2,402	$2,667	$2,895	$3,087
Reverse Retrans	$23	$146	$391	$574	$921	$1,157	$1,470	$1,754	$2,027	$2,254

Source: SNL Kagan. (2010-2013 data is actual; 2014-2019 projected).

Figure 10 shows the amount of retransmission consent revenues that remain with local broadcast stations, net of reverse compensation. As the figure shows, net retransmission consent revenues for local broadcasters totaled roughly $1.2 billion in 2013.

FIGURE 10: NET RETRANSMISSION FEES ACCRUED BY NETWORK AFFILIATES (2010-2019)



Source: SNL Kagan. (2010-2013 data is actual; 2014-2019 projected).

2. *The Impact of Retransmission Consent on Broadcast Finances*

As the above data suggests, retransmission consent compensation has had a significant impact on the financial viability of the U.S. broadcast television industry, and that impact is expected to grow over time.

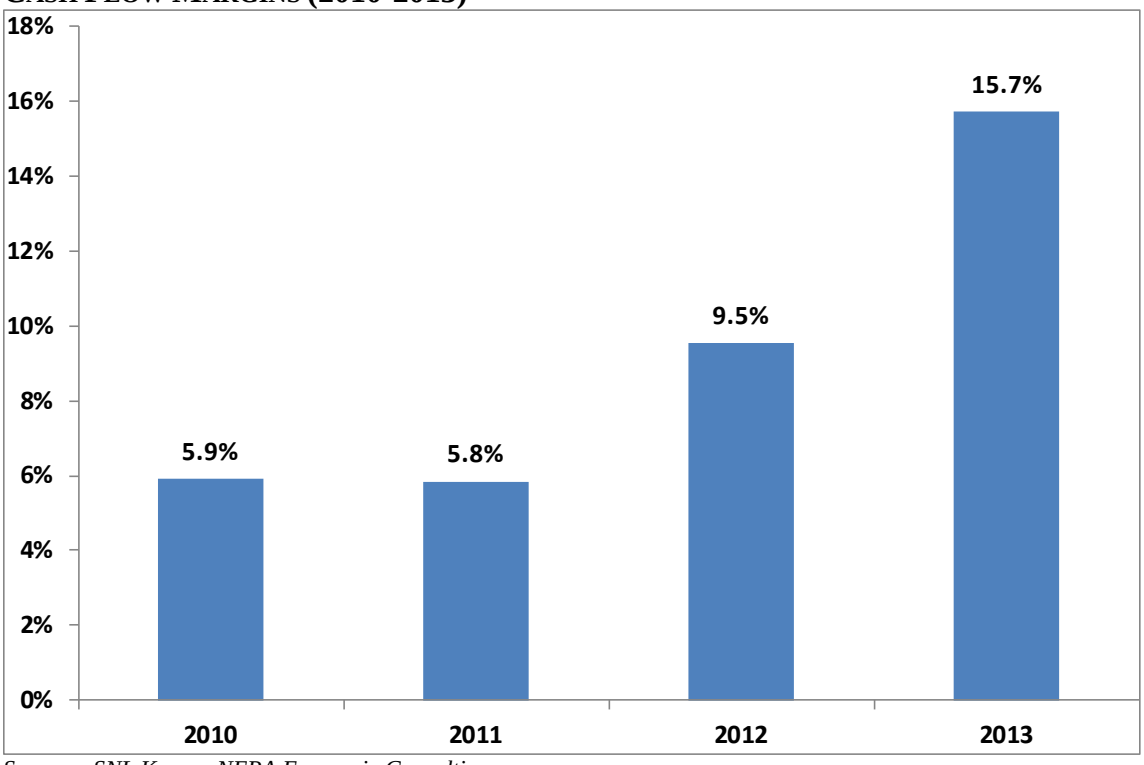
As in other countries, the global recession of 2007-2009 had a significant impact on the profitability of U.S. broadcasters, and that impact was magnified by the emergence of increased competition for advertising, as detailed above. The profitability of U.S. broadcasters declined precipitously as a result,[57] and eleven U.S. broadcasters – including the Tribune Company, Ion Media Networks and Young Broadcasting – filed for bankruptcy protection between 2008 and 2010.[58] The emergence of retransmission consent compensation thus came at an important moment for the industry.

[57] See Sam Schechner and Rebecca Dana, "Local TV Stations Face a Fuzzy Future," *The Wall Street Journal* (February 10, 2009).

[58] See Eisenach and Caves (2011) at 25.

As shown in Figure 11, *net* retransmission consent compensation (after paying reverse compensation to the networks) accounted for 16 percent of broadcast station cash flow margins in 2013, up from just six percent in 2010.[59]

FIGURE 11: TELEVISION STATION NET RETRANSMISSION FEES AS A PERCENTAGE OF CASH FLOW MARGINS (2010-2013)



Sources: SNL Kagan, NERA Economic Consulting.

The figures above need to be considered in light of the strong economies of scale inherent in broadcasting – i.e., the fact that an increase in revenues does not result in significantly higher costs, but instead flows through to the bottom line. A recent analysis of the impact of retransmission consent on broadcaster profitability in the U.S. found that the elimination of retransmission consent revenues would reduce the average profit margins of broadcast television stations by nearly 80 percent, from 14.8 percent to 3.1 percent, resulting in long-run economic losses that ultimately would force many broadcasters to exit the industry.[60]

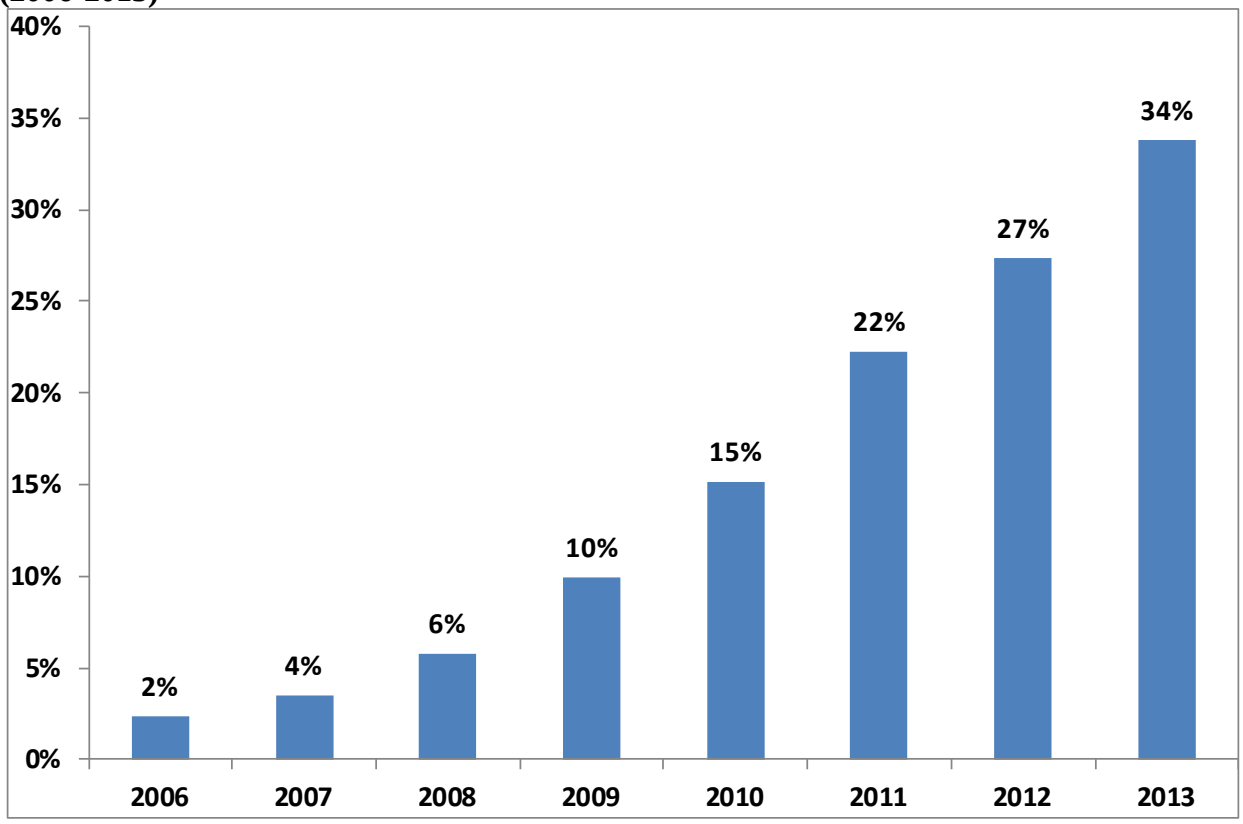
[59] Operating cash flow equals the difference between cash received from customers and cash paid to suppliers less categories such as interest, taxes and dividends.

[60] See Eisenach and Caves (2011) at 37-38.

3. *Retransmission Consent's Impact on the Quantity and Quality of Programming and Distribution*

The improved financial situation occasioned by the retransmission consent regime has been accompanied by increases in the quantity and quality of broadcast programming and in broadcasters' ability to invest in improved facilities and new technologies. As shown in Figure 12, the $3.3 billion television stations received in retransmission consent revenues in 2013 accounted for 34 percent of their spending on programming; put differently, holding profits constant, in the absence of retransmission consent compensation broadcasters would have had to reduce the amount they spend producing content by more than a third.[61]

FIGURE 12: GROSS RETRANSMISSION FEES AS A PERCENTAGE OF PROGRAMMING EXPENSES (2006-2013)



Source: SNL Kagan.

[61] In a dynamically competitive industry with free entry, such as television broadcasting, firms do not earn excess returns. Rather, competition forces suppliers to invest increased revenues in improved quality or expanded capacity.

Retransmission consent has also allowed broadcasters to retain (or regain) rights to programming, especially sports programming, that would not otherwise have been available on free over-the-air television. Historically, most sports programming, including both national and local sports broadcasts,[62] was available on over-the-air television. Over the years much of this programming moved to cable networks, who were able to offer higher compensation as a result of their access to multiple revenue streams (e.g., including both advertising and monthly subscription fees). Thus, for example, a portion of American football (NFL) games moved from a broadcast network to ESPN, a cable network, in 2006. As Fox Networks explained in a 2010 filing at the FCC:

> *Today, the broadcast business is facing new challenges and it is apparent that without creating a second revenue stream, broadcasters will no longer be able to acquire major sports events and the popular entertainment programming.*[63]

Indeed, retransmission consent has provided broadcasters the wherewithal to both retain and regain broadcast rights to NFL games, as it recently won back the right to broadcast some games that had gone to a cable network by creating a second source of revenue.[64] Sports programming is not the only beneficiary. Indeed, there is widespread agreement that the quality of American television is at an all-time high, leading many to refer to the present as the "Golden Age of Television."[65] As FCC Commissioner Ajit Pai stated in July 2013:

> *American consumers are reaping the benefits of competition and innovation in the video marketplace. While many fondly refer to the period between 1948 and 1959 as the Golden Age of Television, there is no time like the present for those who savor quality content.*[66]

More recently, in March 2014, *New York Times* media and culture reporter David Carr wrote that:

> *The vast wasteland of television has been replaced by an excess of excellence that is fundamentally altering my media diet and threatening to consume my waking life in the process.*[67]

Another positive effect of retransmission consent has been on the production of local news. As noted above, the relationship between local news production and station revenues is well documented, and the growth of retransmission consent has led to increases in local television

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[62] In the U.S., teams in most professional sports broadcast games locally separate from games broadcast nationally.

[63] See *Fox Letter to FCC*.

[64] See M. Ilas, "CBS to Air NFL's Thursday games," *SNL Kagan* (February 5, 2014).

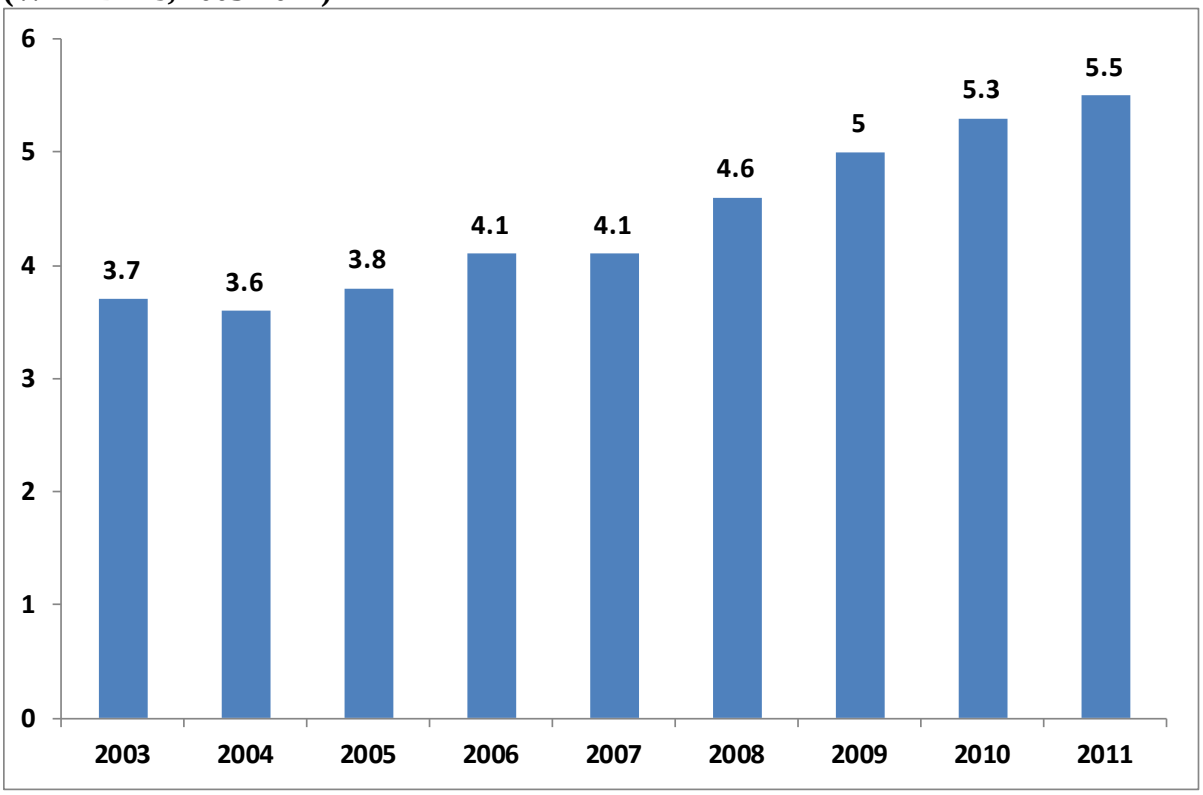
[65] See e.g., Jeff Bewkes, "The Coming Golden Age of Television," *The Wall Street Journal* (October 6, 2010).

[66] See *15th MVPD Report*, Separate Statement of Commissioner Ajit Pai.

[67] See David Carr, "Barely Keeping Up in TV's New Golden Age," *The New York Times* (March 9, 2014).

news and public affairs programming. As shown in Figure 13, the emergence of retransmission consent compensation coincided with a significant increase local news production by commercial broadcasters, from under four hours per weekday to 5.5 hours in 2011. A recent study found that retransmission consent revenues are directly responsible for increasing news output by an average of 11 minutes per week for each of the approximately 1,300 commercial television stations in the U.S.[68]

FIGURE 13: AVERAGE HOURS OF LOCAL TV NEWS PER LOCAL STATION (WEEKDAYS, 2003-2011)

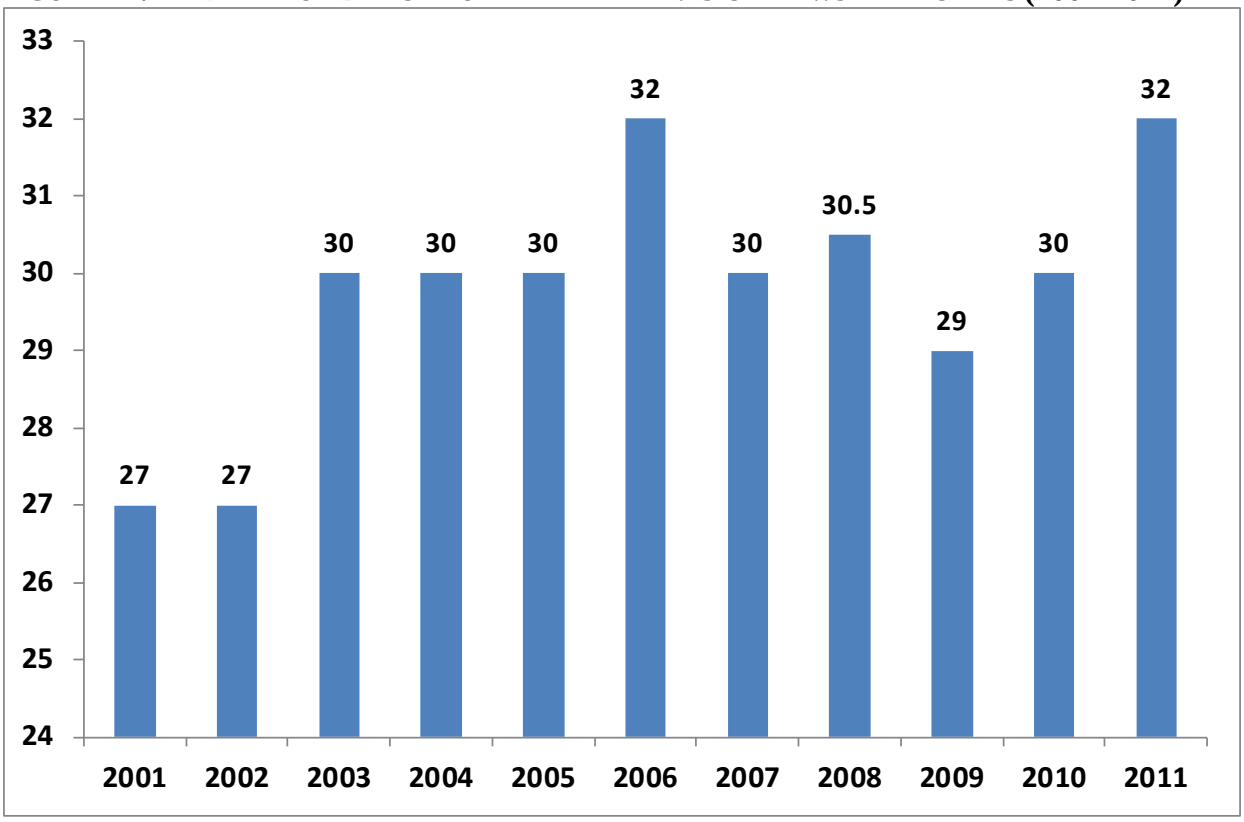


Source: RTDNA, Pew Research Center.

Additional news production has also led to increased employment by broadcast stations. As shown in Figure 14, the median number of news programming related employees in television stations has increased nearly 20 percent, from 27 in 2001 to 32 in 2011.[69]

[68] See Eisenach and Caves (2011) at 46-47.
[69] Staffing fell during the 2008-9 recession but recovered in 2010 and 2011.

FIGURE 14: MEDIAN NUMBER OF FULL-TIME TELEVISION NEWS EMPLOYEES (2001-2011)



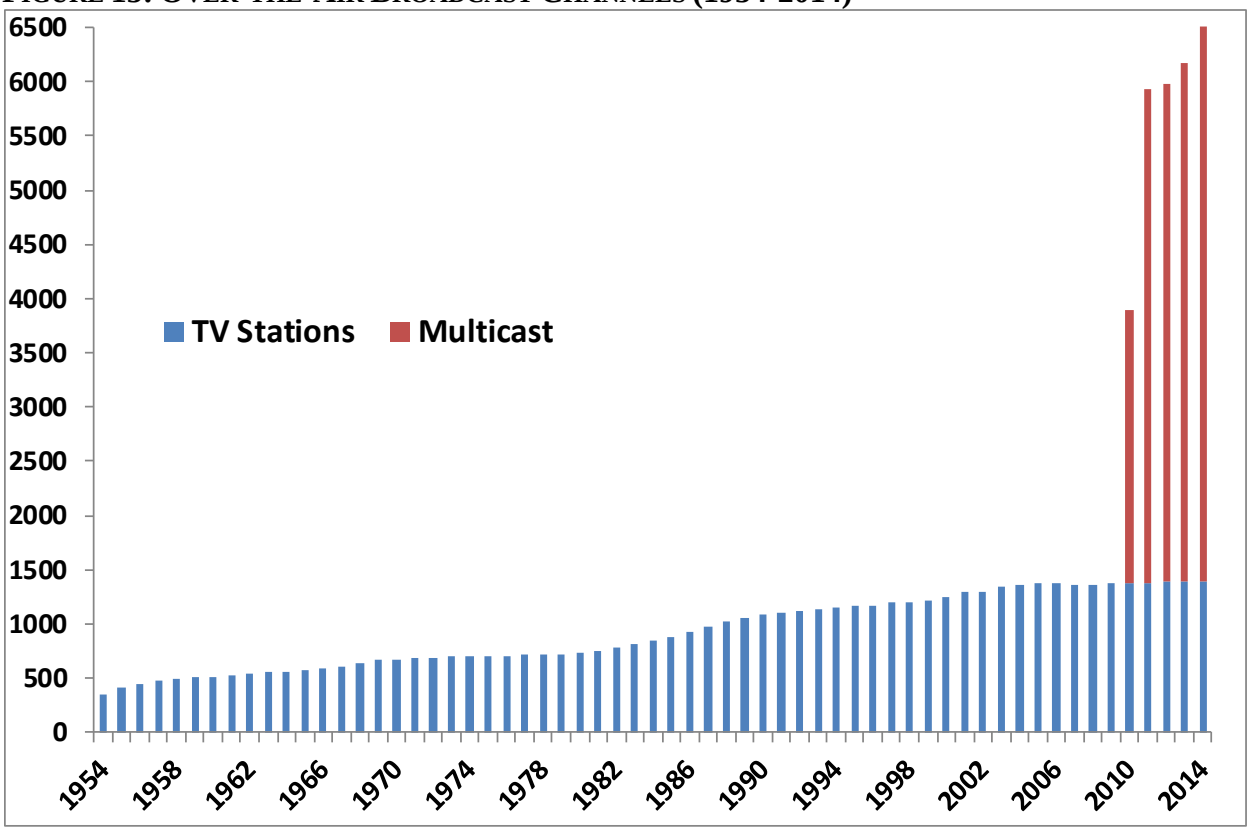
Source: RTNDA.

Retransmission consent compensation has also enabled broadcasters to invest in digital multicasting, the impact of which is seen in Figure 15.[70] The National Association of Broadcasters reports that "Today, the total number of live over-the-air broadcast channels aired by full-power, Class A and low power television stations is an estimated 5,511 channels – up from 4,552 channels in 2012, and only 2,518 channels at year-end 2010."[71]

[70] A digital signal allows for the broadcast of the original station's signal as well as about two additional signals. These additional signals are the digital multicasts. The U. S. fully switched to digital broadcasting in June 2009.

[71] See Comments of the National Association of Broadcasters in MB Docket No. 14-16, *In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming* (March 21, 2014) at 11 (citing Kagan Multiplatform Analysis 2014).

FIGURE 15: OVER-THE-AIR BROADCAST CHANNELS (1954-2014)



Sources: Warren Communications, Federal Communications Commission, SNL Kagan, NERA Economic Consulting.

These additional signals cover a range of programming genres, including ethnically-focused channels broadcast in Spanish and other languages, religious channels and a variety of other programming focused on particular audiences. Thus the growth in the number of broadcast video streams has been accompanied by increases in program diversity. [72]

Finally, retransmission consent has also helped to finance the U.S. transition to high definition (HD) broadcasting. By 2009 the majority of national primetime programming and major sports

[72] In addition to multicasting, most broadcast network programming is now available for free on broadcaster-owned websites for four weeks subsequent to its initial air date. For example, ABC's programming can be viewed on the Internet website abc.com. In the fourth quarter of 2013, the abc.com website had almost 10 million unique viewers, and abc.com viewers average 2.5 hours of viewing. Broadcasters are also increasingly making their programs available through third-party sites. In the fourth quarter of 2013, Hulu – a video distribution web site which is a joint venture of several major broadcast networks – had 14.4 million unique viewers who averaged 4.2 hours of viewing. While retransmission consent is not directly implicated in online distribution, it is largely responsible for giving broadcasters the financial capacity to invest in high quality programming and in new business ventures. See SNL Kagan, "Broadcast Nets See Big Gains In Q4'13 Online Views" (February 19, 2014).

events were broadcast in HD[73] and proportion of stations broadcasting local news in HD rose from 33 percent in 2010 to 40 percent in 2011 and 60 percent in 2012.[74] By 2014, 85.7 percent of full power commercial stations were broadcasting in HD, including nearly all of network affiliates.[75] Since the stations providing news broadcast in HD are concentrated in the larger metropolitan areas and network affiliates are present in every DMA, virtually all television households could receive these HD broadcasts.

The availability of HD programming has in turn led households to upgrade their television sets: In 2008, only 25 percent of television households had HD TV sets, of which 56 percent were receiving HD signals; by 2012 70 percent of households had HD sets, and 96 percent of those were receiving HD signals.[76]

4. *Retransmission Consent's Impact on Competition*

The investments television broadcasters have made in better programming and distribution capabilities have allowed them to stabilize their viewing audiences, as shown in Figure 16, following a long period of audience decline.

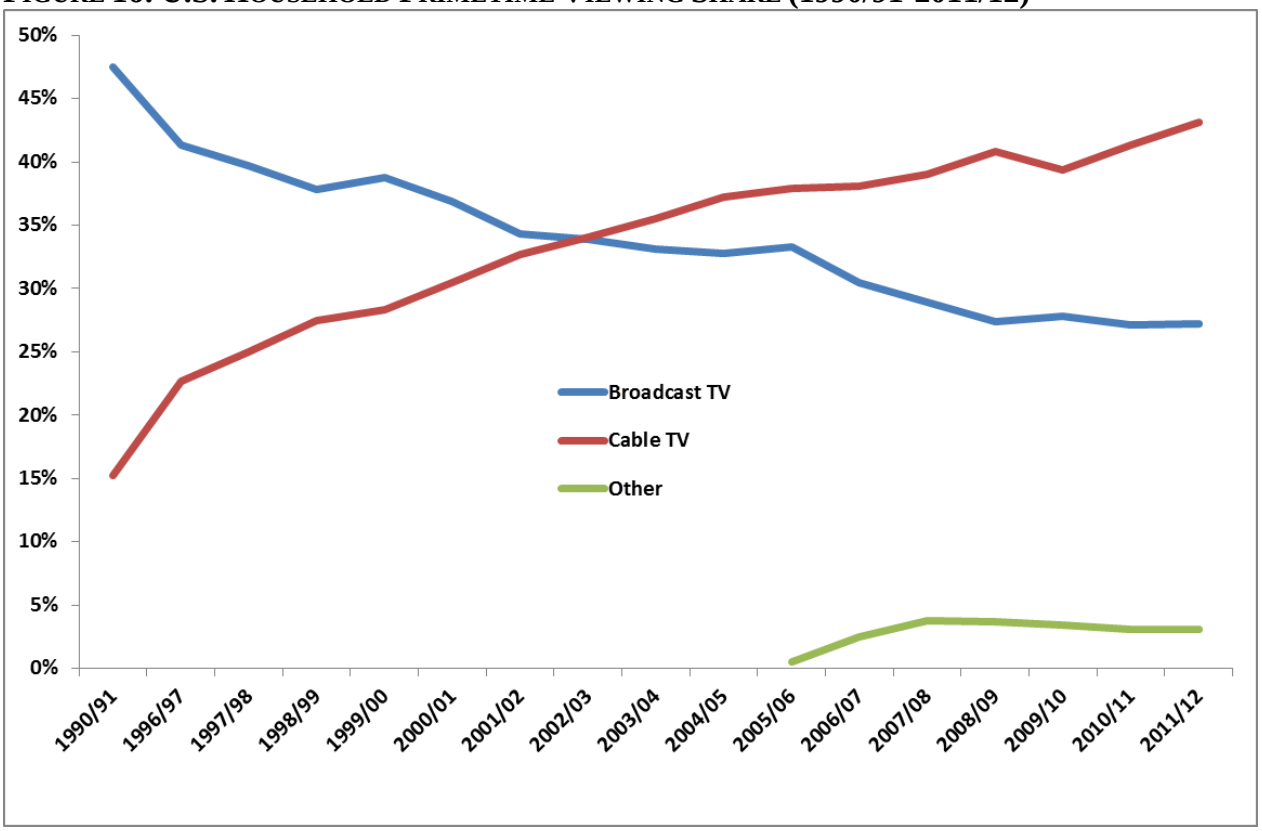
[73] See Comments of the National Association of Broadcasters, *In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming,* MB Docket No. 07-269 (July 29, 2009) at 5.

[74] See Radio Television Digital News Association (RTDNA), TV and Radio News Staffing and Profitability Survey (2012) (available at http://www.rtdna.org/article/2012_tv_and_radio_news_staffing_and_profitability_survey#.U7MHhxAabzA).

[75] See SNL Kagan, *Multiplatform Analysis* (March 12, 2014).

[76] See Nielsen, *Television Audience, 2010 & 2011* at 4.

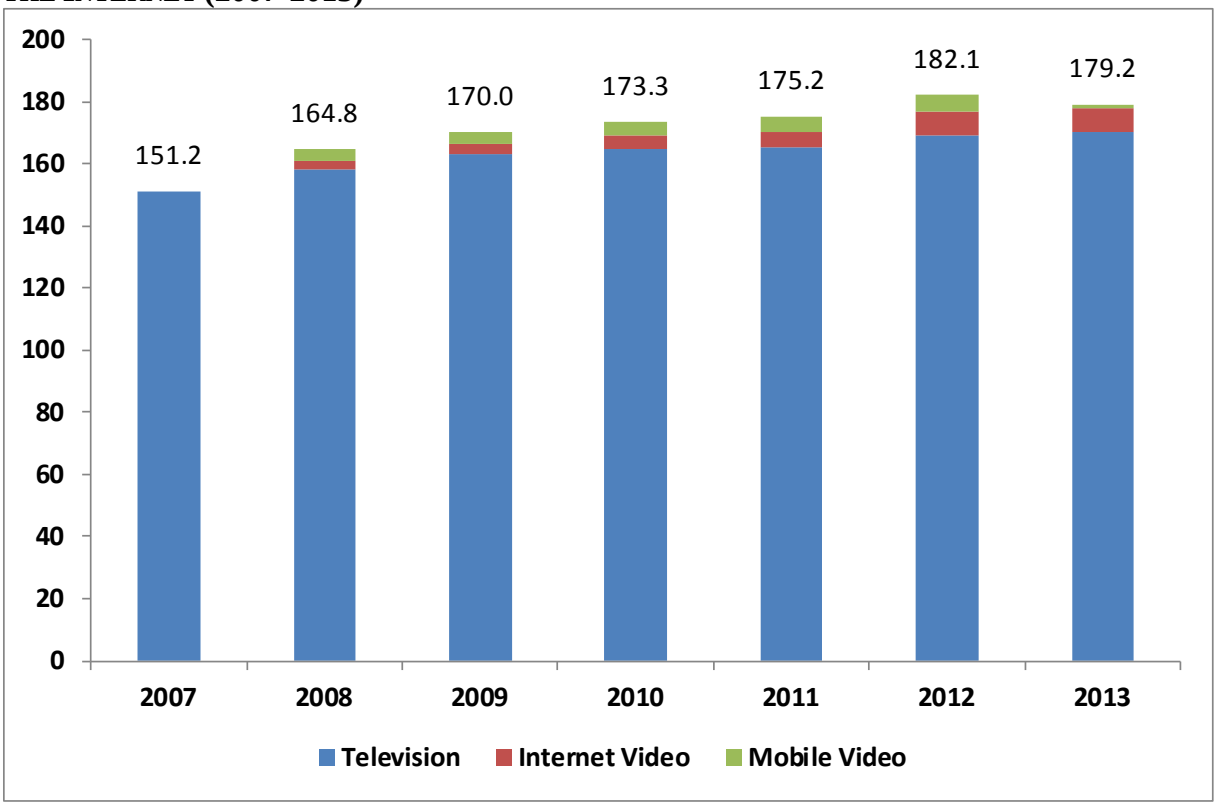
FIGURE 16: U.S. HOUSEHOLD PRIMETIME VIEWING SHARE (1990/91-2011/12)



Source: Cabletelevision Advertising Bureau. Broadcast includes broadcast TV network and local programming; cable TV includes cable network programming; other includes viewing of programming that cannot be assigned to a specific distributor.

Competition between broadcast, cable and other forms of video programming has been good for consumers who continue to watch traditional television even as their viewing of newer video distribution formats is increasing. As shown in Figure 17, the proliferation of programming outlets has led to increased overall viewing, as traditional television has retained its audience and viewing through the Internet has increased.

FIGURE 17: AVERAGE MONTHLY TIME (HOURS) SPENT VIEWING TELEVISION AND VIDEO ON THE INTERNET (2007-2013)



Source: Nielsen.

The improvements in the variety and quality of broadcast television programming described above are also important because in the U.S. an increasing number of households either receive only television broadcast signals or have them as the primary programming source. As of May 2014, 10.2 percent of television households received over-the-air signals only (i.e., they did not subscribe to cable, DBS or telco video), up from 9.6 percent in February 2012.[77] Approximately an additional 15 percent of MVPD subscribers subscribed to a service level, called "entry-level basic service," that includes mainly local TV stations.[78] Overall this means that some 25 percent of U.S. television households are fully or largely reliant on television broadcast programming. In the U.S., households relying solely on over-the-air television tend to have lower incomes than those subscribing to MVPDs.[79]

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[77] See Nielsen, National ADS, *Wired-Cable & Over-The-Air Penetration Trends*, reported by the Television Bureau of Advertising (available at http://www.tvb.org/research/media_comparisons/4729/72512).

[78] See FCC, *Report on Cable Industry Prices, In the Matter of Statistical Report on Average Rates for Basic Service, Cable Programming Service, and Equipment*, MM Docket No. 92-266 (June 7, 2013) at ¶11.

[79] They are also composed of relatively larger numbers of racial/ethnic minorities (i.e., Asian-American, Hispanic-American or African-American). See GfK, *Home Technology Monitor 2013 Ownership Survey and Trend Report* (cited in in , *In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery*

D. International Benchmarks

The U.S. market for video content is distinguished from markets in other countries by a variety of characteristics, only some of which are related to the ability of broadcasters to obtain compensation from MVPDs for retransmission of their signals. Nevertheless, it is appropriate to note that the U.S. system has produced very desirable results by international standards.

As shown in Table 3, the U.S. has the highest amount of television viewing per person per day as well as the highest television revenue per capita. The U.S. also has a high rate of subscription (pay TV) take up, with 87 percent of television households subscribing.[80] Viewing in the U.S. is highly dispersed, with the number one rated channel only receiving a seven percent share of total viewing. This diversity contrasts with European countries and Australia where the leading channel garners about a 20 percent share of total viewing.[81]

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of Video Programming, MB Docket No. 14-16 *Comments of the National Association of Broadcasters* (March 21, 2014), at 3-4.

[80] The characteristics of subscription services differ between countries. According to Ofcom, "[i]n the US and Canada, pay-TV services are similar to those in the UK (providing access to a large number of additional TV channels in exchange for payment). But the pay-TV fee for some cable packages in the Netherlands and Sweden is more akin to an 'access charge'; in return for which consumers receive a limited number of television channels." See Ofcom, *International Communications Market Report* (2013) at 166 (hereafter *Ofcom Report*).

[81] See *Ofcom Report* at Figure 3.1 and 166.

TABLE 3: TELEVISION METRICS BY COUNTRY (2012)

	USA	UK	FRA	GER	ITA	CAN	JPN	AUS	ESP	NED	SWE	IRL
TV Revenue (bn)	103.6	11.7	9.6	11.0	6.7	4.5	32.7	5.5	4.4	2.6	1.8	0.8
Revenue per Capita	329	185	145	136	108	130	257	249	93	152	200	169
from advertising	125	56	41	41	52	63	116	117	33	46	62	32
from subscriptions	203	86	74	47	34	48	97	95	25	67	96	100
from public funds	1	44	33	51	24	18	42	34	39	40	41	34
% from advertising	0.38	0.30	0.28	0.29	0.47	0.49	0.45	0.48	0.34	0.30	0.31	0.19
% from subscriptions	0.62	0.46	0.50	0.34	0.31	0.37	0.38	0.39	0.26	0.44	0.48	0.60
% from public funds	0.00	0.24	0.22	0.37	0.22	0.14	0.16	0.14	0.40	0.26	0.21	0.20
TV License Fee	-	145	102	176	91	-	108	-	-	-	194	130
Largest TV Platform												
Platform	Dcab	Dsat	IPTV	Dsat	DTT	Dcab	Dcab	DTT	DTT	Dcab	Acab	Dsat
% of Homes	40%	47%	32%	41%	51%	58%	32%	61%	71%	53%	32%	53%
TV Viewing per Day (mins)	293	241	230	222	255	238	n/a	186	246	196	164	203
No. 1 Channel Share	7%	21%	23%	13%	18%	9%	n/a	17%	14%	21%	24%	20%
DTV take-up %	91%	100%	97%	75%	100%	94%	80%	93%	100%	85%	68%	96%
Pay TV take-up %	87%	54%	64%	64%	33%	95%	66%	31%	24%	99%	95%	73%

Source: Ofcom. The TV License fee refers to the fee charged to television viewers as a form of public funding.

As shown in Table 4, U.S. television industry revenues have grown since 2005 in absolute terms but also relative to Europe/Canada and Japan/Australia. For example, in 2005 Europe/Canada generated about 65 percent as much television revenue as the United States; by 2012 the proportion had fallen to about 53 percent.

TABLE 4: TELEVISION INDUSTRY REVENUE BY AREA (£BILLIONS, 2005-2012)

	2005	2006	2007	2008	2009	2010	2011	2012
USA	71	77	84	87	87	91	100	104
Europe/Canada	46	48	51	51	51	55	56	55
Japan/Australia	34	35	35	35	34	36	37	38
Relative to the U.S.								
Europe/Canada	65%	62%	61%	59%	59%	60%	56%	53%
Japan/Australia	48%	45%	42%	40%	39%	40%	37%	37%

Source: Ofcom. Notes: [1] Revenues include advertising, subscriptions and public funding. [2] Europe includes UK, France, Germany, Italy, Spain, Netherlands, Sweden, Republic of Ireland and Poland.

Thus, to summarize, the growth of retransmission consent compensation has U.S. has allowed broadcasters to invest in improved programming and increased distribution capacities, thus competing more effectively with pay TV operators for both advertising and audiences. Overall, the U.S. television industry is performing well both in absolute terms and relative to other countries.

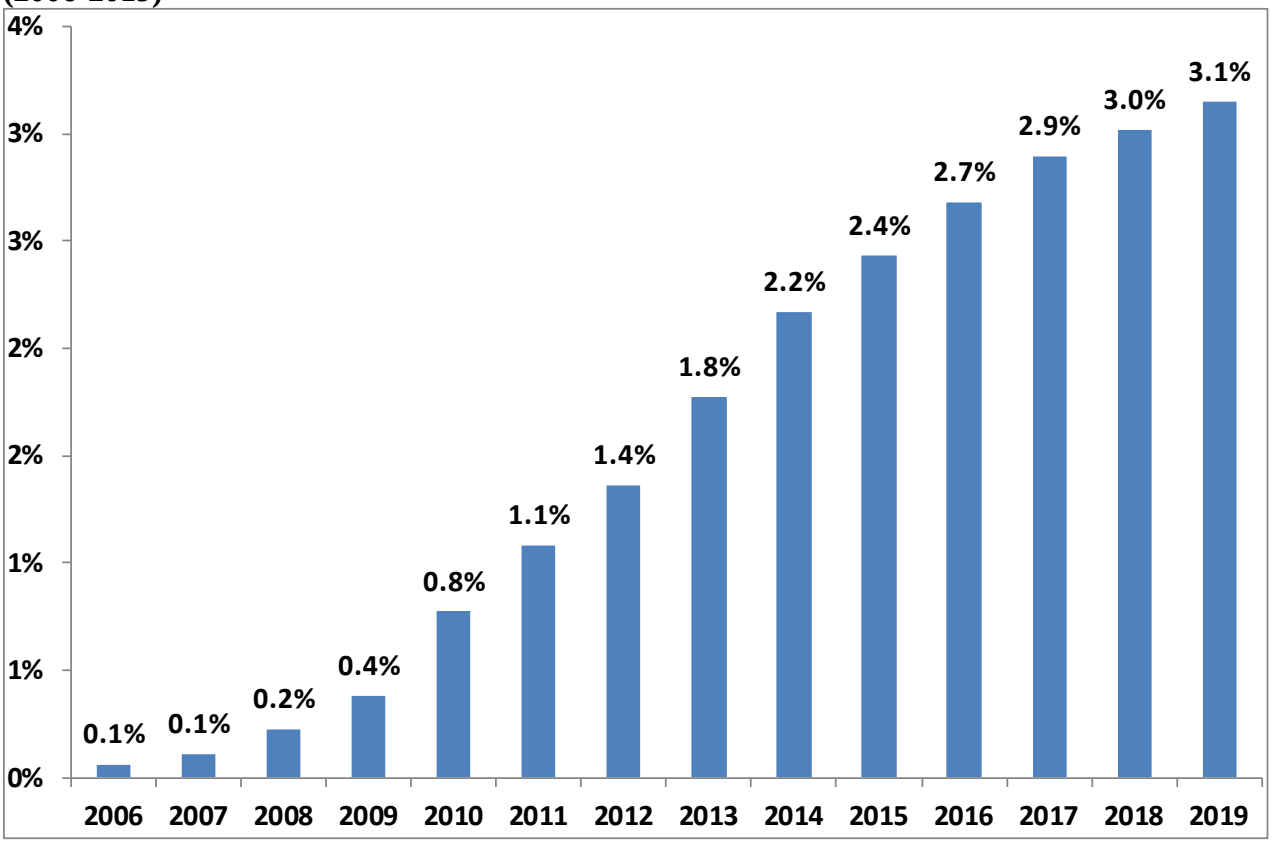
V. Criticisms of Retransmission Consent by MVPD Operators

For obvious reasons, MVPDs opposed the creation of retransmission consent (and the re-imposition of must-carry), and they have continued to advance various criticisms over the course of the two decades the system has been in place. In general, MVPDs argue that retransmission consent has raised their input prices, and thus forced them to raise the prices MVPDs charge consumers. MVPDs have also pointed to the occasional negotiating impasses that have arisen in recent years as evidence of some sort of market failure. While a complete rebuttal of these charges is beyond the scope of this paper, it is important to note that these criticisms are misplaced.

First, while the monthly fees paid by consumers for pay TV services have increased faster than inflation for most of the past decade, the amount – and quality – of programming offered has increased even faster. Thus, when measured on either a price-per-channel basis or on the basis of price per viewing hour, pay TV prices have actually declined. For example, according to the FCC, the average monthly price per channel for expanded basic cable service – the most commonly subscribed pay TV package – fell from $0.65 cents per channel to $0.51 between 2006 and 2012, even as retransmission consent compensation increased.

Moreover, and importantly, while retransmission consent compensation comprises a significant proportion of broadcast stations' revenues, it is a much smaller proportion of costs for the much larger MVPD sector. As shown in Figure 18, retransmission consent compensation in 2013 accounted for less than two percent of cable operators' revenues, and is projected to level off at less than three percent of revenues in by the end of the decade.

FIGURE 18: CABLE RETRANSMISSION COMPENSATION AS A PERCENTAGE OF CABLE REVENUE (2006-2019)



Source: SNL Kagan. (2006-2013 actual; 2014-2019 projected).

Thus, while the amount U.S. consumers spend on pay TV has increased faster than inflation in recent years, at least by some metrics, those increases cannot be attributed to retransmission consent compensation. In fact, the evidence demonstrates that television programming costs in the U.S. are rising slower than MVPD revenues, slower than other components of MVPD costs, and slower than MVPD profits.[82]

Second, retransmission consent negotiations very seldom lead to bargaining impasses, and those that do occur typically are short-lived and affect relatively few consumers. In 2012 and 2013 there were approximately 1,390 licensed commercial television stations in the U.S.[83] During these years SNL Kagan reported a total of 21 instances of carriage interruption in 2012 and 17 instances in 2013, of which twenty-six of these involved a DBS operator (DirecTV or DISH Network), five involved Time Warner Cable and the other seven involved other cable

[82] See Jeffrey A. Eisenach and Kevin W. Caves, "Retransmission Consent and Economic Welfare," Navigant Economics (April 2010) (showing that U.S. programming costs are rising more slowly than MVPD revenues, MVPD costs and MVPD profits).

[83] See FCC, *Broadcast Station Totals* as of June 30, 2012 and as of June 30, 2013.

companies.[84] The number of stations involved ranged from as few as one to as many as 40, while the duration of the interruption ranged from as few as two days to as many as 187. The simple average duration of the disputes was 41 days, but this average is heavily affected by a few single-station disputes in 2012. The average duration when weighted by affected subscribers was approximately 25 days.

One way to measure the impact of retransmission disputes is to compare the weighted average number of subscriber days lost to the total number of subscriber days.[85] In 2012, only 0.7 percent of total subscriber days were affected, and in 2013 the percentage fell to 0.6 percent.[86] However, even these figures substantially overstate the impact on viewers, since only the viewers who would have been watching the channels affected by an impasse are actually affected by its absence. For example, accounting for the fact that ABC's share of total viewing is only about six percent would reduce the affected proportion of subscriber days to about 0.05 percent.[87]

In general, retransmission consent negotiations almost always result in agreements on mutually acceptable terms. As SNL Kagan reported recently:

> *Although signal disruptions (i.e., blackouts) have become more common over the past three years, they have involved a relatively small number of publicly declared retrans deals. Untold hundreds of retrans deals have been inked without any public announcement.*[88]

MVPDs would prefer to return to situation prior to 1992, in which they had the ability to profit from carrying broadcasters' signals without permission and without compensation, and they have lobbied hard to achieve that goal, most recently in the context of Congressional efforts to renew the Satellite Television Extension and Localism Act of 2010 (STELA), which is set to expire at the end of 2014. Despite these efforts, the version of the legislation that passed the primary committee of jurisdiction in the U.S. House of Representatives with broad bi-partisan support contains only minor changes to retransmission consent (relating to the circumstances under which otherwise unaffiliated broadcasters can join together to negotiate retransmission consent

[84] See SNL Kagan, *Publicized Retransmission Blackouts 2000-2014 YTD* (2014).

[85] Data from SNL Kagan, *U.S. Cable Industry Benchmarks*.

[86] This assumes that all subscribers in a television market watched the blacked out station. It also assumes that only one station in each television market was affected. On average 1.4 stations per market were affected.

[87] See Nielsen data in Cabletelevision Advertising Bureau, *TV Facts* (2013) at 30-33 for ABC primetime share in 2010-11.

[88] SNL Kagan, *Economics of Retransmission Consent* (May 2014) at 2.

agreements with MVPDs);[89] and, as this is written, it appears likely that a similar bill will pass the Senate, also with bi-partisan support.[90]

Thus, both U.S. political and both Houses of Congress appear to agree that retransmission consent continues to serve its purpose. As Representative Greg Walden, Chairman of the House Telecommunications Subcommittee, put it in a December 2013 speech:

> *Americans enjoy quality and choice in video programming that is the envy of consumers in the rest of the world. At the heart of this volume of video programming and choice lies retransmission consent: a recognition of the value of video programming.*[91]

While details of the U.S. retransmission consent regime may change over time, the basic principle – that television broadcasters should be permitted to charge cable TV operators and other TV distributors for retransmitting their signals – appears to be firmly embedded in U.S. policy.

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[89] See "U.S. House Panel Advances Satellite TV Law Reauthorization," *Reuters* (May 8, 2014) (available at http://www.reuters.com/article/2014/05/08/us-usa-television-congress-idUSBREA470R820140508).

[90] See John Eggerton, "Senate Judiciary Leaders Introduce STELA Bill," *Broadcasting & Cable* (June 10, 2014) (available at http://www.broadcastingcable.com/news/washington/senate-judiciary-leaders-introduce-stela-bill/131676).

[91] See Halonen (2013).

VI. Conclusion

Based on the results reported above, it is clear that retransmission consent has contributed positively to the development of a robust, innovative video content ecosystem in the U.S. By allowing television broadcasters to compete on a level playing field with pay TV distributors and, more recently, with new Internet-based services, it has increased competition in the market for digital video programming and distribution. U.S. consumers have benefited from better programming, including more news and other public interest programming, and from the ability to receive free over-the-air programming for which they would otherwise have to pay.

The success of the U.S. retransmission consent regime provides a useful example for other nations in which television broadcasting faces increasing competition from pay TV, Internet-based distributors, and other media. While the details of any such regime should be carefully tailored to reflect local realities, such as market structures and the balance of bargaining power between broadcasters and distributors, the U.S. example demonstrates that allowing broadcasters to be compensated for the value of their programming is good public policy.

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