Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

FCC 91-215
38201

In the Matter of	)	
	)	
Review of the Policy Implications of the Changing Video Marketplace	)	MM Docket No. 91-221
	)	

NOTICE OF INQUIRY

Adopted: July 11, 1991 Released: August 7, 1991

Comment Date: October 22, 1991
Reply Comment Date: November 21, 1991

By the Commission: Commissioners Quello, Barrett and Duggan issuing separate statements.

1. We initiate this proceeding in order to seek wide-ranging comments on changes in the state of the video marketplace and the public policy implications that flow from these changes. This inquiry is prompted by our general concern that some of our television rules and policies may no longer be in step with current industry circumstances and, more particularly, by a number of apparent trends described in a recent Office of Plans and Policy (OPP) staff working paper on the status of the video marketplace.[1]

2. We focus our inquiry on the implications of the findings of the OPP paper, including: 1) the increasing competition in, and fragmentation of, the video marketplace; 2) technological advances such as digital signal compression techniques; 3) the ability of some competitors to rely on revenue from direct viewer payment instead of, or in addition to, advertising; and 4) the rapid increase in the availability of national sources of programming. We believe that these changes have significant implications for core Commission goals such as localism, diversity, nationwide availability of service, and the public interest standard for broadcasters. We seek general comments concerning the staff's findings and analysis about trends and changes in the video marketplace. If commenters disagree with respect to the conclusions and projections of the staff study, we request that they offer specific evidence to support alternative conclusions. If commenters agree, we request that they provide specific evidence and analysis supporting their position and the relevant policy implications. We also ask commenters to address what steps, if any, we should take to ensure that our policies and rules continue to promote the Commission's goals of localism, diversity, nationwide availability, and broadcasting in the public interest.

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[1] Office of Plans and Policy Working Paper # 26. Broadcast Television in a Multichannel Marketplace, DA 91-817, 6 FCC Rcd 3996 (1991) ("OPP paper").

INCREASING COMPETITION IN, AND FRAGMENTATION OF, THE VIDEO MARKETPLACE

3. At the outset, we note that television broadcasting now exists in an environment significantly more competitive than in years past and likely to be even more competitive in the years ahead. The statistics in this regard are well known. In 1975, the U.S. had three commercial broadcast networks and no cable networks; cable television was largely a broadcast retransmission medium. By 1990, there were over 100 national and regional cable networks and a major new broadcast network was developing. Cable subscribership rose from 17 percent of television households in 1975 to over 56 percent in 1990; cable now passes over 90 percent of television households. The number of broadcast stations increased by 50 percent over that 15 year period, with independent stations accounting for over three-fourths of that growth. The number of off-air stations available to the median household increased from six in 1975 to ten in 1990, and by 1990, 94 percent of television households were located in markets with five or more television stations. In 1975, home videocassette recorders (VCRs) were rare and there were no home satellite dish systems; in 1990, 69 percent of television households owned VCRs and three percent had home satellite dishes.

4. This expansion in the availability of outlets and programming has markedly reduced the audience shares of the broadcast networks and their affiliates. The percentages of prime time viewing of the three major networks dropped from 73 percent in 1982-83 to 58 percent in 1989-90;[2] viewing of cable-originated programming rose from 10 to 20 percent in that period. While each broadcast network still retains a prime time audience share roughly equal to that of all cable networks combined, it appears likely that satellite services such as direct broadcast satellite (DBS), increasingly well-financed cable programming services, and greater cable television channel capacity will perpetuate these trends of the last fifteen years into the 1990s.

5. Although regulation attempts to correct market imperfections, it also serves to further public interest goals not strictly limited to purely economic forces. These dual purposes for regulation must be balanced in any review of changing market conditions. To the extent that certain Commission regulations and policies were adopted to respond to problems created by limitations on entry and concentration of control, such regulation should reflect the amount of diversity and competition that exists and any remaining barriers to entry. Accordingly, we seek comment on the implications of the growth of competition in the video marketplace for our regulatory policies, including:

(1) What is the long-term forecast for these current trends, and any

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[2] See OPP paper, p. 28, Table 8. We also note that, while the total number of television households increased from 70 million in 1975 to 93 million in 1990, over this period the number of homes reached by the three major networks in prime time declined from 36.9 million to 32.7 million. Id. at p. 26, Table 7.

identifiable countervailing trends, in viewing choices and their implications for broadcast television?

(2) What are the policy implications of a continued decline in the viewing shares of broadcast television networks? Are the effects of declining audience shares mitigated by the continued increase in the total number of television households?

(3) What impact will increased competition have on local broadcast stations, whether network affiliates or independents, and how will this affect their share of advertising revenues? Will increased competition for advertising revenues have an impact on their programming, including local programming?

(4) Which Commission policies and regulations, if any, hamper the ability of the networks, their affiliates, or independents to compete with multichannel delivery systems?

(5) Do our ownership rules, for example, prevent realization of economies of scale and limit program investment which might otherwise promote the vitality of local stations?

(6) To what extent should the number of competing programming choices provided by cable television and satellite services affect our broadcast multiple ownership policies, consistent with diversity and other public interest goals?

(7) If changes are proposed to the broadcast multiple ownership or cross-ownership rules, what effect will such proposals have on the traditional concerns for diversity embodied in the Commission's public interest mandate?

(8) To what extent, if any, might changes in ownership rules permit broadcasters to increase investments in programming that would increase diversity?

TECHNOLOGY

6. Technology and economics have combined in recent years to change the face of video distribution in the United States. The principal changes that have taken place involve expansion in the availability and channel capacity of multichannel video service providers, in particular increases in cable availability and channel capacity and the development of a market for direct-to-home satellite service. Other important developments include widespread ownership and use of home video recording and playback systems, and use of hand-held television remote control devices.

7. Other technological changes, in particular the development and refinement of digital video compression technologies, could be even more revolutionary in their consequences in the years ahead. Compression systems, which are likely to be used first in conjunction with satellite program delivery and then on cable systems, also hold the potential for increasing the channel capacity of terrestrial broadcasting systems. Dramatic increases in channel capacity will be possible through the implementation of this

technology. In addition, increased use of currently available technologies, including addressability and interactivity, which allow viewers to select specific programming or send messages for transactions such as home shopping and banking, could permit enhanced service offerings.

8. With respect to these and other new technological changes, we ask:

(1) At what point will technologies with compression capabilities become a competitive factor in the marketplace? What type of market penetration is projected for such video services?

(2) Are any existing Commission technical, ownership or other regulations likely to have a negative effect on the development and widespread use of these technologies? Are there technical rules that could be modified to increase the competitiveness of broadcast television stations vis-a-vis multichannel providers?

(3) Do the combination of these ongoing technological developments plus existing Commission regulations have any positive or negative implications for the widespread availability of video service? For example, what will be the impact on broadcast television if video compression techniques are introduced first by satellite and cable systems, as expected?

(4) What are the implications, if any, of these technological changes for the diversity of video programming and editorial viewpoints?

(5) What are the implications of these technological changes for provision of locally produced or originated versus nationally produced service to viewers?

(6) To what extent will broadcast licensees, particularly those who own a single or small group of stations, be able to participate in these technological changes and enhance their local service? How do such changes implicate the Commission goal of localism embodied in Section 307(b) of the Communications Act?

(7) More generally, in what ways, if any, will these changes affect the ability of the Commission to carry out its mandate to regulate broadcasting and other ancillary services "in the public interest?"

RELIANCE ON DUAL REVENUE STREAMS

9. One of the most significant trends in the economics of video distribution in recent years is the change from advertising as virtually the sole revenue source for distributors to an environment in which a significant portion of distributors receive both advertising and direct consumer revenues. The primary example of this phenomenon, the cable industry, derives revenues from both subscription fees and advertising sales. Indeed, pay and pay-per-view services derive their revenues solely from viewer payment. A satellite DBS provider would also be able to capture these dual revenue sources. The television broadcasting industry, on the other hand, has almost uniformly derived revenue solely from advertising sales, directly or through network compensation.

10. We seek comment on the implications of this development for our regulatory policies:

(1) What are the implications of increased specialization as a competitive programming strategy for the single-channel broadcaster? What practical and legal impediments would affect the ability of a broadcaster to follow a niche programming strategy?

(2) Is multichannel transmission capability or the ability to deliver a specialized program service the only means to attain dual revenue streams?

(3) What are the projections for advertising revenue growth during the next decade? Will local broadcasters experience a net growth or net loss in advertising revenue during this same period? To what extent do underlying economic conditions in the national and local market affect this analysis?

(4) To what extent would the loss of advertising revenues to competitive media services affect a broadcast licensee's ability to provide local service? To the extent local broadcast service is diminished, what are the implications for local services provided by other competitive media outlets? What are the implications for the system of local stations fostered by Commission policies and Section 307(b) of the Communications Act?

(5) Would repeal of the compulsory license for cable television and/or implementation of a scheme of retransmission consent enable local stations to compete more effectively?[3]

(6) Does viewer payment for programming affect the diversity of voices, both broadcast and non-broadcast, available in local video markets? How are broadcast viewers who do not pay directly for programming affected by the growth of pay program services? What are the implications for our current regulatory framework for over-the-air broadcasting?

<u>CHANGES IN DISTRIBUTION AND SUPPLY OF VIDEO PROGRAMMING AT THE NATIONAL LEVEL</u>

11. As the number of local video programming outlets has increased, so have the sources of and distributors of national television programming. As space satellite relay systems have replaced microwave routes as the principal technology for delivery of programming to local broadcast stations, programs increasingly are available nationwide rather than on a local or regional basis. Starting in 1975, programmers to the cable television industry began using satellite relay systems to deliver programming for cable use. Today satellites are used not only to relay numerous channels of video programming to cable systems within the U.S. (and around the world) but to deliver network and syndicated programming to both regular and low power television stations.

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[3] The related issue of must carry is the subject of the <u>Report and Order and Second Further Notice of Proposed Rule Making</u> in MM Docket Nos. 90-4 and 84-1296, FCC 91-184, 56 FR 33387, 33414 (July 22, 1991).

12. In terms of audience, each of the three major broadcast networks still attract larger audiences than any other individual source. Nevertheless, the sources of supply to local video outlets are becoming increasingly competitive; new broadcast and cable networks are developing and new sources of news and syndicated programming have come into being. These developments, in conjunction with other changes in the marketplace, will affect our understanding of how the video marketplace functions and the rules and policies that should apply to the various participants. We seek to explore and obtain comment on these consequences through this proceeding.

13. In particular, we seek comment on:

(1) What changes can be anticipated in the sources and supply of video programming at the national level?

(2) To what extent will competition to broadcast television, particularly by cable networks and their cable system affiliates, change the relationships between suppliers of broadcast programming and local television broadcast stations? Will new sources of supply and competition loosen the relationship between networks and their affiliates or will it create pressure for a closer partnership between them?

OTHER ISSUES

14. In addition to comments on the changing video marketplace structure and the Commission policies and rules specifically raised in this notice, we welcome comment on any other events, policies, or rules that may be implicated by our general inquiry into the future of the video marketplace. In this regard, commenters may also wish to address whether changing the multiple ownership rules impacts any prior Commission decisions that deleted or modified rules or policies which were based upon the principles of diversity, localism, or the number of broadcast television outlets in the market.

PROCEDURAL MATTERS

A. Ex Parte Rules - Exempt Proceeding

15. This proceeding is exempt from the *ex parte* requirements pursuant to 47 C.F.R. § 1.1204(a)(4).

B. Comment Dates

16. Pursuant to applicable procedures set forth in Sections 1.415 and 1.419 of the Commission's Rules, 47 C.F.R. §§ 1.415 and 1.419, interested parties may file comments on or before October 22, 1991, and reply comments on or before November 21, 1991. To file formally in this proceeding, you must file an original and five copies of all comments, reply comments, and supporting comments. If you want each Commissioner to receive a personal copy of your comments, you must file an original plus nine copies. You should send comments and reply comments to the Office of the Secretary, Federal Communications Commission, Washington, D.C. 20554. Comments and reply

comments will be available for public inspection during regular business hours in the Dockets Reference Room of the Federal Communications Commission, 1919 M Street, N. W., Washington, D.C. 20554.

C. Additional Information

17. For additional information on this proceeding, contact Beverly McKittrick, Mass Media Bureau, (202) 632-5414.

FEDERAL COMMUNICATIONS COMMISSION

Donna R. Searcy
Secretary

STATEMENT OF COMMISSIONER JAMES H. QUELLO ON
REVIEW OF THE POLICY IMPLICATIONS OF THE CHANGING VIDEO MARKETPLACE

They say that in life timing is everything, and I think it is a particularly appropriate time right now to take a comprehensive look at our policies relating to television. The video marketplace is going through changes as significant as any in its history, and it is incumbent upon the Commission, as the expert agency, to monitor these changes and adjust its policies accordingly.

First, I want to congratulate the staff of the Office of Plans and Policy for their most impressive effort in producing a thought-provoking study on which many of the NOI questions are based. This study is an excellent starting point for our inquiry.

I want to emphasize, however, that the study is just that — a starting point. It has not yet been adopted by the Commission or tested by the adversarial give and take that we expect from the commenters in this proceeding. Consequently, any interpretations in the popular press about the FCC predicting the demise of broadcasting are more than a little premature. We are just beginning the inquiry.

But you don't have to predict the end of broadcasting as we know it to understand that some of our rules no longer relate to the reality of the video marketplace. I believe I made my feelings on this point clear in my dissenting statement in the financial interest and syndication rules proceeding. *Evaluation of the Syndication and Financial Interest Rules*, FCC 91-114 (released May 29, 1991) (dissenting statement). The finsyn rules were adopted during a time of near-absolute network dominance — a fact that has changed drastically during the intervening two decades. In my mind, there can be no justification for retaining rules long after their policy purposes have vanished, especially if the rules hamper the viability of a competitor in the video marketplace. In particular, I think it is time to review the effect of cross-ownership rules on free over-the-air television.

In this regard, the present inquiry presents a much needed opportunity to look at a broad range of policies to determine which ones are still needed, which ones are not, and which ones are counterproductive in terms of the public interest. I am looking forward to reading the comments in this most important proceeding.

SEPARATE STATEMENT
OF
COMMISSIONER ANDREW C. BARRETT

RE: REVIEW OF THE POLICY IMPLICATIONS OF THE CHANGING VIDEO MARKETPLACE

I look forward to reviewing the comments which will be filed in response to issues raised in this Notice of Inquiry. As I have stated before with respect to our radio "attic to basement" review, periodically the Commission should examine its rules to ensure that they comport with marketplace realities. However, I wish to emphasize, that such reviews must be taken in a balanced manner. In the media area, I believe our regulations exist not only to address market imbalances, but also to address public interest concerns that may or may not be in the best economic self-interest of broadcast licensees. These dual purposes for regulation in the media area should be addressed when analyzing changing market conditions. To the extent that certain Commission regulations and policies were adopted to respond to problems of limitation on entry or concentration of control, I believe such regulations should continue to bear some relationship to: (1) the amount of competition that exists; (2) the remaining barriers to entry; and, (3) the relative diversification of control within segments of the marketplace. To the extent certain Commission regulations were adopted to respond to overarching public interest concerns, I believe that a review of changing market conditions or technologies must also address the implications for these concerns.

In this Notice of Inquiry, I encourage industry members, trade associations, and public interest groups to address the implications of changing technologies on the future of local broadcast stations. I particularly look forward to reviewing comments with respect to the implications of any proposed multiple ownership rule changes on our traditional concerns for diversity and localism. In this regard, I hope that commenters not only address the implications of such changes on traditional First Amendment or diversity concerns, but also comment on the extent to which such changes impact upon the rationale for prior Commission decisions to abolish the Fairness Doctrine or community ascertainment requirements. Finally, I look forward to comments from those who own a single station or a small group of stations as to their ability to participate in future technological and economic changes projected in the OPP working paper.[1]

[1] F. Setzer & J. Levy, OPP Working Paper 26, Broadcast Television in a Multichannel Marketplace (FCC June 1991). I also desire additional input on the economic projections provided in the OPP paper. As I have stated before, the OPP paper is one of several inputs I will look at in making any decisions in this docket.

Separate Statement
of
Commissioner Ervin S. Duggan

In Re: Notice of Inquiry -- Review of the Policy Implications of the Changing Video Marketplace

As I have said in the past, I fully support reviewing the Commission's television rules and policies in light of new realities. Such a review seems to me well-founded, in view of the Staff Working Paper produced by the Office of Plans and Policy; the most thorough recent analysis of the video marketplace.

I fervently hope that the gloomy predictions offered by this paper turn out to be wrong. If we hope to prove them wrong, however, and to shape a happier future for broadcast television, we need to remember one important fact: the fate of the broadcast industry will not be shaped at 20th and M Streets. Regulation is important, but the greatest power to shape the destiny of broadcasting is in the hands of broadcasters themselves: in their courage, their imagination, their agility, their shrewdness. It is far more important, in my judgment, that broadcasters respond vigorously to the change in the marketplace than for the FCC merely to put more stations in the hands of a few owners.

Broadcasters need to invent a whole new future. They need, as never before, to innovate: to launch a new era of research, technical innovation, and imaginative programming. Broadcasters should be creating new services and forging new alliances that will expand their channel capacity and energize their programming. Where, for example, are broadcasters when it comes to exploiting the tantalizing possibilities of interactive television?

It has become a truism that the future belongs to those who know how to produce great programming. Surely the worst thing that could happen now is for broadcasters to respond to new challenges by cutting back drastically on high quality entertainment and local programming, the very thing that has distinguished the broadcast medium in the past.

I was struck by two themes that emerged, again and again, in the recent obituaries of actor-producer Michael Landon. One was that every show he was involved with turned out to be a hit. The other was that every show he was involved with was one that parents and children could sit down and enjoy together. Perhaps this connection is no accident. What does it profit broadcasters to seek "breakthrough" concepts in programming--- if the breakthroughs are to the lowest common denominator of taste and values?

Ever since joining the Commission, I have been troubled by the asymmetry between our regulation of broadcasting and multichannel video industries. We expect broadcasters to continue serving the public interest while competing for ever more scarce advertising revenues. Broadcasters' competitors, on the other hand, are not so constrained when it comes to regulation, to revenue streams, or to channel capacity.

In light of broadcasters' long history of public service, I want to do all that I can to help broadcasters compete in the future video world. I am eager to remove old regulatory barriers, if they prove to be unnecessary. But broadcasters' ultimate fate, I am convinced, lies in their own hands and minds. So I will be interested, as we examine what we must do for broadcasting, to see what broadcasting is doing for itself.

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