different channels of broadcast and cable programming and 56% of all homes could receive 30 or more channels.[10] As recently as 1985, the average home could receive just 19 channels, and only 19% could receive 30 or more.[11] This dramatic expansion in diversity and viewer choice reflects the proliferation of over-the-air broadcast stations, the growth of cable television and original cable program services, and the advent of other program delivery services such as MMDS and direct-to-home broadcast satellites.

The OPP Paper notes that as of the end of 1990 there were 1,093 commercial television stations, up from 883 in 1985 (OPP Paper, Table 3, p. 15). According to the FCC's broadcasting station totals as of October 31, 1991, an additional 38 stations are now on the air and the total number of commercial stations stands at 1,131.[12] Moreover, OPP failed to count educational television stations (357) and low power stations (968), which compete with commercial stations for viewers and, in the case of low power stations, for local advertising

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[10] Nielsen Television Index, "Television Audience 1990".

[11] Nielsen Television Index, "Television Audience 1986".

[12] FCC News, No. 20526, November 7, 1991.

revenue as well. These public and low power television outlets add to the diversity of choices available to viewers in hundreds of local communities.

The emergence of cable has probably caused the most profound competitive changes in the video marketplace over the past decade. According to Paul Kagan Associates, 88.4 million households (or 96% of total U.S. households) are passed by cable[13] (four percentage points more than OPP's 1990 estimate).[14] 59 million households -- or 64% of total households -- subscribe to cable.[15] In addition, 3.4 million American homes receive television and cable programming through the use of a backyard dish.[16] In short, in over two-thirds of American households, broadcasters face competition from dozens of program channels, the vast majority of which are supported by both subscription and advertising dollars.

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[13] Paul Kagan Associates, Pay TV Newsletter, May 31, 1991.

[14] OPP Paper, Table 15, p. 68.

[15] Nielsen Home Video Index. The OPP Paper estimated cable penetration at 56% in 1990 (Table 1, p. 12).

[16] The New York Times, June 23, 1991.

Another source of video choice for the consumer is the VCR, which now exists in 73% of U.S. TV households, up 4% from OPP's 1990 count.[17] Ten years ago, the home video market simply did not exist. Today it is an integral part of almost every household's television viewing.

As documented by OPP, this incredible increase in video outlets competing for viewers' attention -- over-the-air stations, cable programming services and alternative technologies like home video -- have led to audience fragmentation and a dramatic reduction in broadcasters' share of the viewing audience. As we will discuss next, this decline has continued and even accelerated since the conclusion of OPP's examination of viewing trends.

B. Broadcast Networks and Stations Are Continuing To Experience Audience Losses At An Ever-Accelerating Rate

1. Network Audience Erosion

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[17] OPP Paper, p. 106.

It is well-known that the three broadcast networks have experienced a steady decline in audience for at least the last 10 years.[18] This downward trend is the result of increased competition and viewing choices, particularly those offered by cable:

> "...[T]he declining share of broadcast viewing results both from increased cable penetration and from an increased share of cable viewing in the viewing of cable households." (OPP Paper, p.24).

The OPP Paper states that three-network prime time viewing shares have dropped from a total of 93 Nielsen share points in 1975 to a predicted 64 share points in 1990.[19]

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[18] As the Commission notes, the decline in network audience share has not been offset by the increase in television households (Notice, fn. 2; OPP Paper, Table 6, p. 26). In fact, network prime time household reach declined from 38.0 million homes in 1980 to 32.1 million homes in 1990 (based on a three network prime time rating of 34.9).

[19] OPP Paper, Table 7, p. 26. As OPP notes (OPP Paper, fn. 19), Nielsen share points do not equate to a percentage of the prime time viewing audience. Each share point represents one percent of all homes using television at any given time. In prime time, when many multi-set homes are tuned to two programs at the same time, there are more than 100 share points. Thus, to determine the networks' <u>percentage</u> of the prime time audience, one must divide their combined share points by the total number of prime time share points. In the discussion of network viewing trends in these Comments, NBC will provide both share point and percentage of viewing data. The source for all data cited is the Nielsen Television Index.

Unfortunately, the OPP was overly optimistic in its forecast. In fact, the three-network prime time shares in 1990 totalled only 61, constituting 57% of the viewing audience, and each network attracted, on average, only 19% of prime time viewers. This was a three share point and two percentage point drop from the networks' 1989 prime time viewing level (a 64 share; 59% of the audience).

Thus, in 1990 the three-network viewing had already fallen to the level which OPP predicted it would reach in 1994![20]

The trend toward increased competition for the prime time viewer has continued unabated in 1991.

This Fall, one or more of the original networks is regularly losing the prime time ratings race to relatively new program services. On Thursday nights at 8 pm, CBS and ABC routinely come in third and fourth, respectively, behind NBC and Fox. NBC typically finds itself ranked fourth behind CBS, ABC and Fox on Sunday nights at 8 pm. (Wall Street Journal,

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[20] OPP Paper, Table 7, p. 26.

October 10, 1991). On one Sunday night during the third week of the new season, NBC found itself ranked fifth, behind CBS, ABC, Fox and HBO. (New York Times, October 9, 1991).

Given this record of performance so far this year, NBC now projects a three-network 1991 prime time viewing share of 59 -- below 60 share points for the first time in history -- which translates to 54.6% of the prime time viewing audience -- another historic low.

In the top 10 markets, where there are more video outlets and competition for viewer attention is most fierce, the decline in network audiences has been most pronounced. During the 1990/91 season, network affiliates in these markets attracted only 51% of the audience during prime time. This contrasts with the viewing level of 79% they enjoyed in 1980/81.

Network viewing has also dropped precipitously in other dayparts. For example, in daytime the viewing of the three networks has fallen from 76% of the audience during the 1980/81 season to 51% in the 1990/91 season -- two percentage

points lower than in the previous 1989/90 season.[21]

2. Local Station Audience Erosion

Of course, the viewing of networks represents little more than the sum total of the audiences of their affiliated stations across the country during network broadcasts. Thus, local affiliates have suffered the effects of these audience losses along with their network program suppliers. And affiliates are not just losing audience during network programming periods, but during local programming time as well. The OPP Paper reports that during non-network dayparts, network affiliate viewing declined from 22% of the audience in 1984/85 to 17% of the audience in 1989/90. In pay cable households, affiliate viewing declined from 19% of the audience to a scant 12% over this period. (OPP Paper, Table 9, p.30).

Affiliates' loss of viewers has also been felt during local news broadcasts, which embody the principle of localism

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[21] Since multi-set usage is uncommon in dayparts other than prime time, the network share points in daytime are virtually the same as their percentage of viewing.

and service in the public interest envisioned by the Communications Act. During the May, 1980 Sweep, network affiliates enjoyed a 70-71 share of television households during the time periods when most affiliates carry their late afternoon news programs, as well as revenue-producing syndicated shows (e.g., 4:30 - 8:00 pm).[22] By May, 1991, affiliates were achieving only a 63 share from 4:00 to 6:00 PM and a 66 share from 6:00 to 8:00 PM -- an audience share loss of 10% and 7%, respectively. In the three largest television markets, network affiliate shares during their 6:00 PM local newscasts are, in two out of the three markets, considerably lower than they were ten years ago:

Network Affiliate Household Shares
6:00 PM Early Evening News

	1980/81	1990/91
New York	54	46
Los Angeles	47	35
Chicago	49	49

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[22] All station ratings data is from the Nielsen Station Index

3. Cable Audience Grows

As the OPP Paper notes, broadcasters' loss of viewing has been cable's gain. In prime time, basic and pay cable network viewing levels have risen from 10% in 1982/83 (OPP Paper, Table 8, p. 28) to 22% in 1990/91 -- an increase of 2 percentage points over what OPP reported for 1989/90. On an all-day basis, the percentage of viewing attained by cable program services climbed from 23% in 1984/85 (Id. at Table 6, p. 23) to 34% in 1990/91, again up 2 percentage points from OPP's analysis of the previous season. If the universe examined is limited to cable households, however, cable programmers' all-day viewing levels were as high as 45% in 1989/90 and 48% in 1990/91, presaging the continued shift of viewers from over-the-air broadcasting to cable services as more homes subscribe.[23] As noted above, affiliates' percentage of viewing in locally programmed dayparts has declined most precipitously in cable and pay cable homes.

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[23] OPP predicts cable penetration will reach 65.7% if TV households by 1999, but, according to the Nielsen Home Video Index, cable penetration already stands at 64%. Kagan predicts penetration will reach 69% by the end of the decade. Paul Kagan, Cable TV Investor, July 29, 1991, p. 6.

Clearly, because of competition from cable and other video choices, broadcast stations and networks are not able to command the audiences they enjoyed in a far less competitive era. The number of viewing choices is likely to increase, not diminish over time. And as these proliferating viewing alternatives achieve the economic strength to offer viewers more attractive and compelling programs, the size of their audiences will grow at the expense of local stations and national broadcast networks. The bottom line is this: unless broadcasters can compete on an equal footing with these alternatives, the decline of station and network audiences, and thereby broadcast industry economics, will most certainly continue.

C. Declining Broadcast Revenues

Since the business of broadcasting involves selling audiences to advertisers, it should come as no surprise that station and network loss of viewers has seriously affected their revenue base and profitability. The OPP Paper states:

> "The rapid growth of the video advertising market appears to have ended. The share of the networks in that market has been falling for a decade, and the share of cable has been growing. Since the mid-1980's real advertising revenues of the networks, and per-station real advertising revenues of broadcasters, have been falling. Network revenues have fallen less rapidly than audiences, but as audiences continue to decline, and as cable advertising becomes a better substitute for network

> advertising, the decline can be expected to worsen. Cable now has a much smaller share of advertising revenues than of viewership of channels carrying advertising, so cable advertising has great potential for growth. (OPP Paper, p. 134).

This description is accurate but fails fully to convey the severity of the economic strain broadcasters face today. The recessionary economy is clearly in part responsible for broadcasters' current economic plight, but there are few in the broadcast industry who believe these difficulties are cyclical. The downward trend in network and station revenues is primarily due to fundamental changes in the underlying advertising market and the competitive environment that may signal that slow growth in television advertising is a permanent phenomenon. The revenue declines networks and stations have suffered in the last one or two years are unprecedented, have never occurred on this scale in the previous six recessions over the past 20 years. If the television advertising marketplace is unlikely to rebound to any significant extent, and if, as OPP predicts, advertising dollars continue to shift to cable program channels, it will be much more difficult for networks to compete against cable for programming and for individual stations to sustain their service to local communities.

Outdated government regulations currently prevent broadcasters from expanding their sources of revenue and

business relationships. This regulatory underbrush must be swept aside so that broadcasters can continue to have the financial wherewithal to provide local and national audiences with high quality entertainment and informational programming.

1. Broadcasters' Revenue Decline Is Unprecedented And Cannot Be Attributed To The Recession Alone

The OPP Paper contains data that show how network and station advertising revenues have declined in real terms since 1985 and 1988, respectively, after increasing in virtually every preceding year.[24] Thus the downward trend in broadcast revenues, particularly in the case of networks, predates the current recession by several years. In the past, network television was deemed "recession proof," and the network revenue growth outperformed the economy in every other recession since 1970. In 1991, however, after adjusting for

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[24] OPP Paper, Table 25, p. 121. OPP notes that because the number of stations has increased, the growth rate of advertising revenues for individual stations is lower than the growth registered by the aggregate of all stations. The average station has therefore experienced a revenue decline of 4% per year since 1987 (OPP Paper, p. 128).

inflation, the three networks are projected to underperform the economy by an unprecedented 6%. (See Chart)

Moreover, to blame broadcast station and network financial woes solely on current economic conditions ignores the fact that cable and barter syndication have been relatively unaffected by the current recession. Cable advertising revenues are expected to increase by 12% this year, and barter syndication revenues by 20%.[25]

In contrast, the extent of the revenue declines that have been experienced by stations and networks in 1991 are severe and without precedent. According to a survey by the Television Bureau of Advertising (TvB), for the first half of 1991, three-network revenues declined by 7.1%, national spot by 8.4% and local ad revenue by 4.9%.[26] The predictions for full-year 1991 are particularly gloomy, even as compared to the minimal growth in advertising expenditures achieved in 1990:

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[25] McCann-Erickson, "Insider's Report," Number 23, June, 1991.

[26] Broadcasting magazine, September 9, 1991.

THE RECESSION ALONE CANNOT EXPLAIN THE NETWORKS' ECONOMIC PLIGHT

TV Networks have outperformed the economy in every recession in the last 20 years --- except the recession of 1991

Recessionary Years	Infl. Adj. GNP	Infl. Adj. Network Revenue Growth	Network Revenue +/- GNP
1974	-0.5%	1.1%	1.6%
1975	-1.3%	-0.4%	0.9%
1980	-0.2%	2.1%	2.3%
1982	-2.5%	4.4%	6.9%
1991	-4.4%	-10.5%	-6.1%

Projected 1991 Television Advertising Growth Rates[27]

	1991	1990
Network	1.5%	5.0%
Nat'l Spot	1.0%	7.5%
Local	1.0%	3.5%

When surveyed, television stations themselves offered an even more pessimistic 1991 forecast, and predicted that this year spot revenue will decline by 7% and local by 2% -- the first such declines since 1971, the year cigarette advertisements were banned from television.[28] Through the third quarter of 1991, three network revenues were down 5.6%[29], and NBC predicts three-network full year revenues will dip by 6% -- the third consecutive year of network revenue declines.

In sum, the revenue losses suffered by television stations and networks over the past several years are without precedent and cannot be explained solely by reference to the state of the economy or the cyclicality of the television business. Instead, they signal fundamental changes in the marketplace and in the competitive environment.

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[27] McCann-Erickson, "Insider's Report," supra.

[28] Electronic Media, September 16, 1991.

[29] Electronic Media, November 11, 1991.

2. Fundamental Structural Changes In The Advertising Market May Permanently Diminish The Role Of Media Advertising

For many years, mass media advertising has been the primary method for marketing goods and services in this country. Recently, however, paid advertising, particularly in mass media, has been of declining importance, both in general and relative to other marketing techniques.[30] Today's technology makes possible pinpointed marketing to a company's most likely customers, and companies have been shifting their marketing dollars out of paid advertising and using other, more targeted marketing strategies, such as promotions, contests, direct marketing and couponing. The corporate debt load created by the mega-mergers of the 1980's has put pressure on managers to pursue these marketing techniques, which boost quarterly sales, rather than establish long-term brand identity. Thus, in 1985, 37% of total U.S. marketing expenditures were devoted to media advertising and 43% to promotional activities. By 1990, media advertising

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[30] See, "What Happened To Advertising?", Business Week, September 23, 1991.

represented only 34% of marketing expenditures, and promotion had climbed to 45%.[31]

In addition to this trend toward promotion and away from paid advertising, there has been tremendous consolidation among traditional mass media advertisers, such as airlines, banks and retailers. This has resulted in fewer purchasers of, and less competition for, advertising time. In a marketplace governed by the laws of supply and demand, this reduction in competition has held down the price of television advertising and will continue to do so.

These developments may signal fundamental shifts in the advertising marketplace and in marketing philosophy. They may indicate that media advertising, including broadcast television, will never again experience the growth it enjoyed throughout the 1970's and 1980's. Moreover, even where paid advertising is used, traditional mass media, such as network and station broadcasting, are finding their share of the advertising pie eroded by other media that can more narrowly

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[31] The Veronis, Suhler & Associates Communications Industry Forecast, June, 1991, p. 35.

target the demographics a particular advertiser is trying to reach.

3. Networks' Diminishing Share Of Television Revenues

According to the OPP Paper, in 1980 the networks' share of television advertising revenues was 44.7%; by 1990 it had fallen to 33.8%. (OPP Paper, p. 126). TvB predicts that the networks' share of advertising will continue to fall, reaching 31.9% by 1995. Veronis, Suhler and Associates predict a three-network advertising share of 32.4% in 1994. (Ibid.) As OPP notes, however, "these predictions are likely to overestimate future network revenues ..." (Ibid.) If the fundamental marketplace shifts described above turn out to be permanent, and network ratings continue to shrink, the networks' share of television advertising will fall faster and further than these predictions would indicate.

If history is any guide, the advertising dollars that networks lose will flow to cable, which already enjoys billions of dollars in subscription revenues, which it uses to bid against the networks for entertainment and sports programming. As program costs continue to rise, it is highly questionable whether advertising revenues alone will provide networks with the economic base to compete effectively against

cable in the entertainment program and sports acquisition marketplace.

> "Large-scale participation of cable networks in the market for program acquisition may both bid up prices of inputs and increase the general level of program prices, which could lead to broadcasters being outbid for specific popular programs. If popular programming moves to cable, the movement of audiences from broadcast to cable viewing will accelerate." (OPP Paper, pp.148-49).

C. The Cost of Entertainment, News and Sports Programming Continues To Escalate

Network and station revenues have declined over the past several years. However, the cost of programming has continued to rise, and, for both broadcast networks and stations, news, sports and entertainment programming represent by far their largest dollar commitment.[32] The OPP's analysis of station costs revealed that over time programming expenditures have increased as a percentage of total costs, and that the cost of outside program purchases has increased faster than total program expenditures (which would also include local news and other local production). (OPP Paper, p. 45). OPP concluded that "increasing costs of broadcast rights [programming]

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[32] See, e.g., OPP Paper, Table 13, p. 42; p. 44.

contributed substantially to the decline in station profits ..." (Ibid).

The impact of cost escalations on the broadcast networks has been even more severe:

- Because of escalating program license fees related to longer running shows, the most popular programs on the networks' schedules may yield little or no profits. (Los Angeles Times, April 9, 1991).

- Sports rights costs have gone through the ceiling. Over a recent 16 month period, television spent $8.5 Billion on major sports events, including over $3.5 Billion on NFL football, $1.5 Billion on Major League Baseball, $2 Billion on pro and college basketball and $1 Billion on the Summer and Winter Olympics. (The Hollywood Reporter, August 28, 1991). CBS recently raised to $604 million its pre-tax charges against earnings in order to reflect losses on its baseball and NFL football contracts. (New York Times, November 2, 1991). All three networks are losing money on their major sports packages.

- This year the three networks spent $150 million covering the Persian Gulf War and another $15-20 million on the Clarence Thomas confirmation hearings. This news

coverage was carried largely on a sustaining, public service basis -- without commercials -- and destroyed any hope of bringing network news divisions into the black in 1991. (Electronic Media, October 28, 1991).

Advertising revenues are clearly not keeping pace with these cost escalations. Unlike cable, which can support its program acquisition and production expenses with both advertising and subscription revenues, the current regulatory scheme forces broadcasters to look only to a shrinking advertising base for the resources necessary to compete in the program marketplace. While that base continues to erode, competition from cable purchasers has kept the cost of programming high. Networks and stations are therefore forced to either bow out of the bidding for expensive programming or look to other ways to control costs:

- All three networks have announced they will no longer pay exorbitant prices for sports events.[33] If the networks stand down, it may mean that cable, which can pass a major portion of program costs off on subscribers

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[33] The Hollywood Reporter, supra.

in the form of fee surcharges,[34] will be able consistently to outbid free, over-the-air television for major sports programming.

- Cost pressures make it more difficult for network programmers to continue their historic, preferred policy of investing in high price entertainment programming, such as one-hour dramas, and create an environment which favors less expensive reality-based shows. (Los Angeles Times, February 19, 1991; Variety, February 28, 1991).

- Network News Divisions and local stations' news and public affairs programming face mounting cost pressures which force both the networks and local stations to make cutbacks that neither wants to make.

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[34] The NFL package is a case in point. Turner Network Television and ESPN set the level of the total rights package by spending $450 Million each for half of the Sunday night package. Both cable networks then imposed a subscriber surcharge, which covered the underlying cost of the games they carried. In addition, both cable networks sell advertising during the games to generate incremental revenues and profits. The combined broadcast network bids of $2.7 Billion were therefore driven by the rights fee level set by TNT and ESPN. But, since they are dependent exclusively on advertising, the networks, unlike cable, are losing money on their weekend football broadcasts.

■ The unprecedented weakness in up-front and fourth quarter 1991 advertising sales has forced the networks to engage "in the most brutal budgeting process in their history," with the goal of cutting 1992 expenses to 5-10% below 1991 levels. (Electronic Media, September 30, 1991).

■ All three networks had to cut their compensation payments to affiliates, further reducing affiliate income. CBS's financial condition has prompted it to eliminate all affiliate compensation for sports programming, and to initiate an overall review of its compensation system, looking toward further reductions in station payments. (Wall Street Journal, October 18, 1991). Particularly in small markets, network compensation is a critical element of station profitability.

■ Some affiliates in small and medium-sized markets have replaced their local 11:00 pm news broadcasts with entertainment programs. Entertainment shows are considerably cheaper than locally-produced news, and attract higher audiences and revenues. (Wall Street Journal, May 22, 1991).

These various cost reductions may ultimately result in less diverse entertainment programs, less national, international and local news, and fewer major sports events on free television. In the long run, the public interest and significant policy goals may be affected. Moreover, as the need to reduce costs results in less attractive, less compelling programming on broadcast television, broadcasters' ability to compete against cable will be further diminished.

Cost management should be part of any company's sound business strategy. But it should go hand in hand with the ability to adopt and change business strategies in order to maximize revenues, and the flexibility to manage one's business consistent with marketplace developments. Archaic regulations deprive broadcasters of the flexibility to deal with rising costs and lagging revenues by pursuing new revenue opportunities.

D. Increased Competition For Viewers, Advertising And Programming Has Had A Devastating Effect On The Profitability of Networks and Stations

Broadcasting Magazine recently dubbed network television "an $8 Billion Nonprofit Institution." (Broadcasting magazine, July 8, 1991). While it seems incredible that an industry generating over $8 Billion in revenues can be unprofitable, the fact is that the spiraling cost of programming coupled

with declining viewership and revenues will cause two of the three broadcast network businesses to lose money in 1991. CBS just announced the largest quarterly loss in its history -- $169 million. (New York Times, November 2, 1991). The CBS network is predicted to lose $110 million this year, and the total company will operate at a loss of $100 million. (Ibid; Broadcasting magazine, October 21, 1991). NBC is forecast to lose $50 million in its network business in 1991 (Electronic Media, October 21, 1991). This expected flow of red ink will mean that, for the first time in history, the three network businesses combined will be money-losing propositions. And CapCities/ABC, which owns the only network predicted to be in the black this year, is projecting the first full-year earnings decline in its history. (Wall Street Journal, October 18, 1991).

This year's losses culminate a trend that has been evident since the mid-1980s. NBC estimates that in 1984, three-network pre-tax profit margins were 9.2%. Since that time, however, the networks' profit margins have generally trended down. In 1990, network profit margins reached a new low of 1.8% In 1991, collectively three-network margins will fall below break-even for the first time.

While station profits have not declined as dramatically as the networks', OPP found a pronounced downward trend in