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

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of

Review of the Policy Implications of the Changing Video Marketplace

MM Docket No. 91-221

# REPLY COMMENTS OF NATIONAL BROADCASTING COMPANY, INC.

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**SUMMARY**

It is apparent from the Comments received by the Commission in this proceeding that the Office of Plans and Policy accurately described the vast changes that have affected television networks and stations, the decline in broadcasters' competitive position that those changes have caused, and the bankruptcy of many of the Commission's regulations in the face of the new, rapidly evolving marketplace. With each new report on station and network past performance and future prospects, the need for relief from outdated regulations that curtail broadcasters' ability to compete against unregulated media becomes more urgent. This urgency is underscored by the mid-December survey -- released two days ago -- which found that two out of the three traditional broadcast networks will lose money in 1991, while _all_ 14 basic cable programming networks will be profitable (_Variety_, December 16, 1991; See Exhibit A to these Reply Comments).

NBC intends to expand upon its views regarding modification of the network cable ownership ban, and to discuss possible safeguards applicable to network cable operators, in the

separate proceeding the Commission has devoted to that rule. In these Comments, NBC will:

- Respond to those parties who would have the Commission ignore the clear record before it and preserve the regulatory status quo or adopt additional rules that would limit television broadcasters' business activities;

- Support the pending request of The Walt Disney Company, now echoed by CBS, to eliminate the off-network prohibition of the Prime Time Access Rule on the grounds that it furthers neither diversity of program sources nor independent licensee decision-making. For the same reasons, we will ask the Commission to reverse its recent interpretation of PTAR, which treats the productions of network owned stations as "network" programs for purposes of the Rule.

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National Broadcasting Company, Inc., by its attorneys, files these Reply Comments in response to the Comments filed by other parties to the above-referenced proceeding.

## I. INTRODUCTION

The vast majority of parties filing Comments in this proceeding have called for elimination or substantial relaxation of the Commission's rules affecting broadcast television. There is virtually universal recognition of the enormous changes that have occurred in the marketplace, the effect of those changes on broadcasters' competitive position, and the implications for the continuing validity of decades-old Commission regulations.

The only proposed regulatory change on which there appears to be a lack of broad consensus is elimination of the network cable cross-ownership rule. On December 12, the Commission issued a Second Further Notice of Rulemaking in its pending docket in the cable network cross-ownership proceeding.[1] NBC applauds the Commission's decision to expedite its consideration of this rule, which has been the subject of a pending docket for nearly 10 years. We will provide the Commission with further views on modification of the network cable ownership ban, and on the value and efficacy of various "safeguards" on network cable ownership, in that separate proceeding.

Because there is widespread agreement that other Commission regulations should be reexamined and eliminated or repealed,

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[1] Action in MM Docket 82-434, FCC 91-405, December 12, 1991.

NBC's Reply Comments can be relatively brief, and will cover the following points:

- NBC will join CBS in supporting the request made by The Walt Disney Company over a year ago to eliminate the off-network prohibition of the Prime Time Access Rule. We will further argue that the same policy considerations that warrant deletion of the off-network restriction require the Commission to change its recent interpretation of PTAR that treats network owned station productions as network programs; and

- NBC will respond to those isolated Comments that -- ignoring decades of change, today's competitive realities and the Commission's statutory mandate -- call for maintenance of the regulatory status quo or the imposition of additional rules on television broadcasters.

## II. THE PRIME TIME ACCESS RULE SHOULD BE LIBERALIZED TO ALLOW BOTH OFF-NETWORK PROGRAMS AND PROGRAMS PRODUCED BY NETWORK OWNED STATIONS TO BE BROADCAST IN THE ACCESS PERIOD IN THE TOP 50 MARKETS

Over a year ago, The Walt Disney Company asked the Commission to modify the Prime Time Access Rule ("PTAR") to permit network affiliates in the Top 50 markets to broadcast off-network programming during the access period.[2] CBS has reiterated that request in its Comments in this proceeding.[3] NBC agrees that this prohibition should be eliminated, and further requests the Commission to reverse its recent interpretation of the Rule which concluded that programs produced by network owned station divisions are to be considered network programs for PTAR purposes, even if those programs are distributed by an independent syndicator.[4]

The primary purpose of the PTAR is to foster diversity of program sources in prime time. When it adopted the PTAR in

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[2] Comments of The Walt Disney Company in MM Docket No. 90-162 and File No. MMB 901024, November 20, 1990.

[3] Comments of CBS Inc., p. 56 _et seq_.

[4] _Memorandum Opinion and Order_, MM Docket No. 90-162, released November 22, 1991, par. 88.

1970, the Commission stated that its goal was "to provide a healthy impetus to the development of independent program sources," and to give Top 50 stations more than "a nominal choice in selecting the programs which they present to the television audiences in their communities."[5] By limiting the amount of programming a Top 50 affiliate could accept from its national network to three hours (with certain specific exceptions), PTAR literally forced these stations to obtain programs in the open market, or to produce programs themselves, for an hour of prime time each evening.

However, as the marketplace has developed over 20 years, the off-network aspect of PTAR has not operated to ensure or foster the diversity of program sources. The same can be said of the Commission's recent "clarification" banning owned station first-run productions from Top 50 affiliate access periods. The only effect of these applications of the Rule is to restrict individual station program choice and lessen competition in the first-run marketplace, without any countervailing public benefit. In the highly competitive marketplace of the 1990's,

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5 Report and Order in Docket No. 12782, 23 FCC2d 382, 395-96, 397 (1970).

affiliates in major markets should not be prohibited by the government from choosing those programs that they believe will be most appealing to their audiences, regardless of whether the programs did or did not appear previously on NBC, ABC or CBS or were produced by one of their owned stations.

The fact is that, in terms of source diversity in prime time, a few companies dominate the programming exhibited by affiliates in the Top 50 markets, both during the access period and during the remainder of prime time hours:

- The prime time access period for Top 50 affiliates is dominated by a King World and Paramount. These two companies represent at least 75% of the programs affiliates in the Top 50 markets acquire for the access period from outside program suppliers

- The networks' prime time schedules are dominated by a few major MPAA studios, which supplied over 75% of the prime time entertainment series programs licensed for the

Fall, 1991 season.[6] As the dominant suppliers of network programming, these same studios also enjoy a dominant share of the off-network syndication market.

Clearly the off-network prohibition of PTAR has not worked to foster source diversity in prime time. The objective of the Rule is hardly advanced because a station runs "Entertainment Tonight," as opposed to "Cheers," during the access period. Both "Cheers" (a so-called network program) and "Entertainment Tonight" (a first-run program) are produced by Paramount. The source is the same. In terms of source diversity, it should not matter as a matter of Commission policy that "Cheers" was exhibited on a network before it went into syndication.

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[6] In fact, the major studios dominate both network and first-run program production. In the current, 1990-91 broadcast season, five out of the ten top first-run syndicators are MPAA studios, which together will control nearly 40% of the market. Paramount ranks second behind King World, with a first-run market share of 13%; it also supplied 13% of the three networks' prime time entertainment programs at the beginning of the current broadcast season. Disney, which supplied 18% of the networks' Fall prime time entertainment schedules, ranks third in the first-run market. Time Warner, which supplied over one-third of the networks' prime time schedules last Fall, is ranked fourth in the first-run marketplace. Paul Kagan Associates, <u>TV Program Stats</u>, October 31, 1991.

In today's marketplace, rather than promote diversity, the off-network provision of the PTAR merely compromises the independent, local station decision-making the Commission was trying to promote by limiting the amount of programming an affiliate could accept from its network. It deprives a particular group of stations of the ability freely to select those programs that will best serve their viewers during an hour of prime time. The Commission should restore these stations' power to make market-based, individual program choices, by opening up their access period to all programs other than those offered as part of a network's prime time programming service.

Restoration of the independent licensee decision-making envisioned by PTAR requires not only elimination of the off-network prohibition, but also reversal of the Commission's interpretation forbidding stations in the Top 50 markets from selecting the first-run productions of network owned stations for broadcast during the access period. Owned station productions are not part of the network programming service, and they should be allowed to compete against the programs offered by the major studios for clearance in the access period in the largest markets.

The effect of the Commission's recent PTAR interpretation is to limit station programming choices, diminish the diversity of programming broadcast during the access period, and lessen competition among first-run syndicators. The first-run marketplace is not competitive, but highly concentrated, with the top 10 companies enjoying a share of over 83%.[7] As noted above, King World and the major studios -- who also supply over 75% of the networks' prime time entertainment programming -- dominate both the first-run and off-network syndication marketplaces. In terms of production auspices, these same studios consume far more station air time than any of the networks -- who together produced only 16% of their combined prime time entertainment hours this Fall -- or their station groups. If the Commission grants Disney's request to eliminate the off-network prohibition of PTAR, the studios' share of station prime time will inevitably increase dramatically. Yet under the Commission's PTAR interpretation, programming from a different, competitive source -- the network owned stations -- cannot compete against these studios for clearance during access in the Top 50 markets.

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[7] Paul Kagan Associates, <u>TV Program Stats</u>, <u>supra</u>.

This result makes no sense in terms of the Commission's policy goals. First, the Commission should be striving to encourage more program sources in the access period specifically and in the first-run market generally, not locking them out with restrictive interpretations of the PTAR. To the extent those sources are ready and willing to produce first-run programs, the Commission's rules should allow stations in the Top 50 markets to purchase those programs for access. Second, the Commission should want to provide small independent syndicators, who are struggling to compete against colossuses like King World or the vertically-integrated Hollywood studios,[8] with additional sources of first-run product for independent distribution, which the network owned stations could provide. But the Commission's PTAR interpretation, by keeping owned station productions out of the lucrative access period, has effectively made it uneconomic for network O & O's to produce for the first-run market, and for small syndicators to distribute their productions. Thus the outcome of the Commission's reading of PTAR is a less diverse,

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8 Memorandum Opinion and Order, MM Docket No. 90-162, supra at par. 87.

less competitive first-run marketplace -- precisely the opposite of the stated goals of the Rule.

## III. NONE OF THE ARGUMENTS AGAINST CHANGE IN THE COMMISSION'S REGULATIONS, OR IN FAVOR OF ADDITIONAL REGULATION, HAS MERIT

### A. The Attempts To Contradict The Findings Of The OPP Paper Cannot Withstand Scrutiny

Despite the overwhelming evidence that broadcast television is confronting severe economic and competitive challenges that compel reexamination of long-standing Commission regulations, some Commentors, notably the Motion Picture Association of America ("MPAA") and the Office of Communication of the United Church of Christ ("UCC"), take the incredible position that the trends described in the OPP Paper are overstated, transitory or the result of broadcaster mismanagement.[9] They contend,

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[9] The Association of Independent Television Stations ("INTV") uses the opportunity of this proceeding to rehash many of the arguments it advanced in the Commission's fin/syn docket (MM Docket 90-162), and criticizes the OPP Paper as "out of synch" with the Commission's findings and conclusions concerning network "power" in that proceeding (INTV Comments, p. 14). The networks, contends INTV, "remain the gorillas of the video marketplace," and their "continued strength" cannot be ignored by the Commission as it reexamines its existing regulations (Id. at 13). NBC believes, as it argued in the fin/syn and this proceeding, that it is the Commission's regulations that are out of synch with the reality of the networks' declining competitive position. Cutting through its colorful rhetoric, it is clear that INTV's aim is merely to hobble its competitors with the help of the government.

therefore, that deregulation is unnecessary, premature and counterproductive.

Even if MPAA and UCC were right about broadcasters' current and future prospects, the Commission would still be obligated to reevaluate the need for regulations adopted before the explosive growth of cable, before programming was delivered across the country by satellite, before the launch of a fourth network, before the advent of home video, etc. Even these Commentors who belittle OPP's economic analyses and forecasts cannot gainsay the enormous changes that have occurred in the video marketplace. These changes -- and the sheer number of national and local competitors and choices they have engendered -- obviate the basis for most of the Commission's television regulations and require the Commission to act.

Moreover, the MPAA/UCC arguments defy the documented experience of all three networks and hundreds of television stations. The data submitted to the Commission in this and other proceedings, and almost daily reports in the trade and consumer press, not only bolster the analyses and conclusions of the OPP Paper, but indicate that, if anything, times are getting tougher for television stations and networks. 1991 has witnessed the biggest annual drop in advertising since World War II, and has been characterized by the advertising industry's leading forecaster as "disastrous."[10] Broadcast networks and local television stations have been particularly hard hit: their audiences have continued to decline,[11] and revenues have followed suit.[12] In contrast, cable's audiences continue to climb,[13] cable network advertising is expected to increase between 14% and 16% this year, and local cable operators' advertising revenues will grow an incredible 25-30%.[14] The

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10 Philadelphia Inquirer, December 13, 1991.

11 In the just-completed November Sweeps, the three networks registered their lowest prime time shares ever -- a 62 -- representing 56% of the viewing.

12 According predictions just issued by Robert Coen, the advertising industry's leading forecaster, network 1991 gross advertising revenues will decline by 5% over 1990, and local television advertising will be 1% less than last year. McCann-Erikson "Insider's Report," December, 1991.

13 It has been reported that for the first six weeks of the 1991-92 season, basic cable networks combined averaged a 12.2 rating/20 share in prime time, beating out ABC, which garnered an 11.9 rating/20 share. Advertising Age, December 9, 1991.

14 The Hollywood Reporter, December 10, 1991, citing a study by Myers Marketing & Research.

attempts by MPAA and UCC to cast doubt on the reality of today's marketplace fail miserably.

MPAA disputes the forecasts contained in the OPP Paper and argues that broadcast television will continue to thrive despite the emergence of new outlets and increased competition.[15] It therefore argues there is no need for any change in Commission regulations.

MPAA's entire substantive position is based on a single source for past and future trends in the communications business: the Veronis, Suhler & Associates ("VSA") June 1991 Communications Industry Forecast. MPAA points out that in this latest annual forecast, VSA predicts that total broadcasting ad sales will grow at an annual compound rate of 6.0% between 1991 and 1995 -- a slightly higher rate than during the preceding five years. VSA also forecast that gross advertising

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[15] MPAA Comments, pp. 6-11. NBC agrees that a healthy and vibrant broadcast industry can successfully exist side by side with other providers of entertainment and information, and it is committed to being an integral part of that industry. However, it is becoming increasingly difficult for broadcast networks and stations to compete effectively on a playing field that is tilted by the government toward those media that are not subject to onerous and outdated regulation.

expenditures for network television will increase from $9.8 billion in 1990[16] to $13.5 billion in 1995. Finally, VSA predicts that network prime time audience shares will "bottom out ... at 61 percent".[17]

As far as NBC is aware, VSA is the only forecasting organization to paint such a rosy picture of future broadcast revenue growth and network audience retention. Typically, one does not go back to see if a forecaster's predictions come true. But since MPAA is urging the Commission to base its entire regulatory structure for television in the 1990's on VSA's prognostications, it behooves the Commission to assess whether VSA's past forecasts have been accurate and reliable.

In fact, VSA's past predictions have proven to have almost no validity in terms of what actually comes to pass in the

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16 These gross revenue figures, which include agency commissions, overstate the amount of money that actually flows to the networks. According to the networks' own reports to Ernst & Young, the net revenues they received in 1990 totalled $7.4 billion -- over $2 billion less than the amount reported by VSA.

17 NBC has repeatedly pointed out that Nielsen share points are not percentages of viewing. See, fn. 19 of our November 21, 1991 Comments in this proceeding.

# Veronis, Suhler & Associates
# Annual Growth of Broadcast Television Advertising
# Forecast vs. Actual

| VSA Communications Industry Forecast, June 1989 | Actual* |
|---|---|
| 1989 - 6.4% | 1989 - 2.5% |
| 1990 - 8.4% | 1990 - 4.8% |
| 1991 - 8.9% | 1991 - 1.9% |

| VSA Communications Industry Forecast, July 1990 | Actual* |
|---|---|
| 1990 - 5.2% | 1990 - 4.8% |
| 1991 - 6.0% | 1991 - 1.9% |

* Per VSA Communications Industry Forecast, June 1991

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* Per VSA Communications Industry Forecast, June 1991

marketplace. A comparison of past VSA Communications Industry Forecasts and actual marketplace performance reveals a string of wildly optimistic predictions, which have consistently and dramatically overstated broadcasters' future viewing levels and revenue growth. As the chart on the following page indicates, actual 1989 - 1991 broadcast revenue increases turned out to be only 1/2 to 1/5 as great as VSA predicted in its 1989 and 1990 Forecasts. As recently as July, 1990, VSA estimated that broadcasters' 1991 revenue growth would be 6.0%; only a year later the prediction had been lowered to 1.9% -- less than 1/3 the rate originally forecast!

VSA's prescience on network revenue growth has been equally unimpressive. In its 1989 Communications Industry Forecast, VSA predicted that total expenditures on network advertising would equal $11.3 billion in 1991. By its June, 1991 Forecast, VSA had to reduce its estimate by over a billion dollars.

Finally, VSA's view -- expressed less than 6 months ago -- that network prime time shares would, at some time in the future, "bottom out" at a 61 most clearly proves it is sadly out of touch with marketplace reality. Three-network prime time shares reached a 61 in 1990 -- before the VSA 1991 Forecast was published -- and have continued to decline this year.

MPAA describes VSA's predictive track record as "formidable," but the only thing that seems formidable is the extent to which VSA consistently overstates the future revenue and audience performance of broadcast television in general and network television in particular. MPAA argues these predictions demonstrate that there is no need to alter the Commission's regulation of television. But surely the Commission cannot fail to review and modify outdated regulations on the flimsy basis of such consistently inaccurate crystal-balling.

In contrast to MPAA, UCC relies on historical revenue trends to support its claim that declining broadcast profits are due to excessive expenditures, and not to marketplace competition or waning revenue growth. Broadcasters have enjoyed healthy revenue increases throughout the 1980's, UCC argues, and broadcaster mismanagement and over-spending does not justify deregulation. These arguments, and UCC's attempt to inflate historical broadcast revenue growth by selective use and mischaracterization of data, must be rejected.

For example, UCC notes that inflation-adjusted broadcast revenues grew between 1975 and 1989, including the period 1985-89. No one has disputed that television broadcasters have enjoyed revenue growth over the past 15, or even the past 5 years. However, as a result of increased competition and fundamental changes in the marketplace, there has been a dramatic slow-down in that growth since 1985. The OPP analysis cited by UCC itself[18] demonstrates that while inflation-adjusted television revenues grew 26.8% between 1975 and 1980, and 49.8% between 1980 and 1985, the increase sank to 5.7% between 1985 and 1989. UCC cannot seriously expect the Commission to accept, much less base regulatory policy on, the kind of selective reliance on the data it urges.

Next, UCC tries to convince the Commission that television broadcasters' are enjoying healthy revenue increases by totally mischaracterizing the data it cites in support of its arguments. Relying on NAB figures, UCC claims revenue growth enjoyed by various categories of stations was well over 100% between 1984 and 1989[19]. But an examination of UCC's underlying data reveals that the percentages cited do not represent the increase in revenues between these two years, but rather the percentage

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[18] UCC Comments, p. 4; OPP Paper, Table 12, p. 41.

[19] UCC Comments, pp. 4-5; Exhibits II-VII.

relationship between the 1984 and 1989 revenue figures, which is several times larger than the percentage increase figure.[20] The same flawed methodology pervades UCC's entire revenue growth analysis, which, accordingly, should be ignored in this proceeding.

The undisputed changes in the video marketplace, and the trends the broadcast industry has and continues to experience -- all of which are well-documented in the OPP Paper and in the Comments of numerous parties to this and other proceedings -- are obvious. A reexamination of and change in outdated Commission regulations is clearly required in light of these changes.

B. The Commission Should Reject Calls For Additional Regulation

INTV and UCC both call upon the Commission to adopt additional regulation of television broadcasters. INTV seeks extension of the anti-warehousing safeguards of the Commission's

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[20] For example, UCC's Exhibit II indicates that an average affiliate's revenues were $10.8 million in 1984 and $15.8 million in 1989, which UCC erroneously claims represents a 147% increase. But the $5 million increment in fact represents an increase of only 47% -- not 147%.