A REVIEW OF THE ECONOMIC BENEFITS OF MULTICASTING MUST CARRY

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1. Introduction

The issues raised by the carriage of local broadcasters' full digital signals, including multicast channels, on cable systems and other multi-channel program distributors (MVPDs) remain the same today as when the carriage question first arose several years ago. By maintaining their dominant position in delivering multiple channels of video programming, local cable systems still control the success of any new video offering. Local broadcasters trying to expand their services to their local communities still need the cooperation of these local cable systems to carry any additional programming that the stations want to offer on their digital channels. Given the incentives of these local cable systems, such cooperation is often not forthcoming, and as a result, local broadcasters are financially unable to offer these additional services. Must-carry for all free over-the-air broadcast channels will ensure that potential local viewers will, at least, have the opportunity to view broadcasters' multicast services, and will provide the needed spur for local broadcasters to introduce these additional services.

As shown in a paper written last year and attached,[1] ensuring carriage of all free, over-the-air broadcast programming, including multicast channels, would produce a number of economic benefits. These benefits include:

- The provision of additional new and unique local programming;
- Strengthening the competitiveness of the local video marketplace by overcoming the incentives of local cable systems to **not** carry local program services;

[1] Mark R. Fratrik, "Economic Benefits of Multicasting Must Carry," August 16, 2005, National Association of Broadcasters (Hereafter referred to as "Economic Benefits Paper").

- Strengthening local television stations which are struggling to recoup the large investments associated with the digital transition; and
- Other local and national benefits associated with fostering more specialized and diverse programming.

In this review, the salient points of each of these benefits will be summarized.

2. Additional Local Programming Offerings

As the video marketplace continues to experience rapid technological and economic changes, local over-the-air television broadcasters are reminded every day of their increasingly difficult competitive position.[2] But local broadcasters' comparative advantage -- what they can do better than other providers of video programming -- is to provide local programming. Many over-the-air television stations already provide a considerable amount of local programming, especially local news and public interest programs. Yet, as detailed in the attached paper, these stations can provide more of this programming by using their digital spectrum to multicast. This additional programming could involve time-shifting their local news programs to reach more local viewers, providing expanded and/or regionalized local news utilizing unused footage and reporters, and adding specialized ethnic programming that would not be financially viable utilizing the main signal.[3]

The additional broadcast programming that would be offered under a viable multicasting model (i.e., with must-carry for all free over-the-air channels) could generate potentially enormous

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[2] See, e.g., *Twelfth Annual Report* in MB Docket No. 05-255, FCC 06-11 at ¶¶ 93, 165 (March 3, 2006).

[3] See Economic Benefits Paper, pp. 9-13. See also NAB, July 2005 Survey of Television Stations' Multicasting Plans (85% of television stations currently multicasting or with plans to

consumer benefits. Because of the nature of the television product, the total consumer benefits of local television are not fully incorporated in the market. Consumers do not "pay" directly for the product of local over-the-air television stations, and thus, they cannot register their total satisfaction for that product. Economists have long suggested that this product is under provided as a result.[4] By making the provision of these additional services more financially viable by ensuring carriage of multicast programming, the Commission could aid in remedying this under provision problem.[5] With a greater supply of programming targeted to and greatly desired by specific demographic groups, those groups could be better served and more involved with the entire community, a result clearly in concert with the goals of broadcast localism.

3. Distribution Hurdle - Local Cable Systems' Incentives to Not Carry Multicast Signals

In order to provide these additional services, local over-the-air television broadcasters must be able to reach their target audiences, and that requires the cooperation of local cable systems. Even though there is some competition in the MVPD marketplace and the prospect for even more competition with the entry of phone companies, local cable systems still and will appear to continue to hold dominant positions in their local markets.[6] In fact, in recent months many large multiple system operators (MSOs) have reported increases in cable subscribers, in large part due to the

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multicast expected some or all of their multicast programming to be locally produced or locally focused, such as local news, weather and sports).

[4] See Economic Benefits Paper, pp. 7-8.

[5] A similar argument about the under provision of national network programming could have been made prior to the passage of the 1992 Cable Consumer Protection and Competition Act, which guaranteed must-carry rights. After the passage of that Act, we saw the development of several additional over-the-air television networks providing increased diversity for both cable and non-cable households. In the present case, a multicasting must-carry regulation could lead to increased program diversity on a local level as well.

increased amount of services they now offer (e.g., triple play of cable, internet and telephony services), often in bundled packages. Without carriage on these systems, any multicast service will fail because a large percentage of the local audience will find it blocked by their cable provider.[7] Broadcasters have clearly recognized this fact, as nearly 80% have stated that they would be unlikely to offer multicast services if those services were not carried by their local cable operators.[8]

Presently, local cable systems have tremendous incentives to not carry these additional services.[9] First, these cable systems are competing with local broadcasters in the local advertising marketplace, and any additional program streams would provide local broadcasters with more "product" to sell.[10] Secondly, many of the MSOs also have ownership interests in national cable networks that would also be facing additional competition for viewers with these multicast program streams from local broadcasters. Finally, if broadcasters were able to introduce successfully additional streams of video programming, it might provide enough over-the-air programming choices to persuade some existing cable subscribers to cancel or downgrade to a less expensive subscription package of cable services. Cable systems recognize these incentives and are loathe to carry these additional program streams as a result.

4. Strengthening Local Broadcasters – Offsetting Conversion Costs

In the new media marketplace, local television stations are facing increased competitive pressures. More choices of video programming are available to consumers through their MVPD

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6 See, e.g., *Twelfth Annual Report* at ¶¶ 8-9, 42, 152.
7 See Economic Benefits Paper, pp. 4-6.
8 NAB, July 2005 Survey of Television Stations' Multicasting Plans.
9 See Economic Benefits Paper, pp. 6-7.

service or through other distribution means (e.g., Internet, Netflix movie services). Many large advertising groups (e.g., car manufacturers, local apparel retailers) are also reducing their commitments to local television stations.[11] Concurrently, local over-the-air television broadcasters are also being confronted with significant digital conversion costs incurred as a result of the government mandated DTV transition. In addition to purchasing and installing transmission equipment, stations have had to invest heavily in new cameras and other production equipment.

This financial squeeze has significantly challenged local over-the-air television broadcasters, especially those located in mid-sized and smaller markets.[12] In those markets local television broadcasters have been unable to take advantage of synergies associated with local duopoly arrangements under current ownership regulations. For these broadcasters to continue to remain providers of local services, including costly services such as local news, they must develop additional revenue streams and fully utilize their investments in the digital transition. Relying solely on existing business models with the increasing number of stronger competitors in the video marketplace (e.g., local cable systems, national and local Internet sites) will not insure a strong and vibrant local television service. One important alternative for local stations is simply to offer more services via multicasting, but that commitment to provide additional services can only be made with a reasonable certainty that viewers can gain access to the programs. Must-carry for all free over-the-air broadcast channels will provide this needed certainty.

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[10] See *Twelfth Annual Report* at Table 4; ¶ 94 (noting increases in cable revenue from advertising, especially local advertising).

[11] According to BIA Financial Network estimates, the total revenues generated by local television stations nationwide **decreased** by 7.9% in 2005.

5. Other Potential Benefits

Fostering additional programming supplied by local over-the-air television stations can have other benefits, as well as those already mentioned. These include:

- With more local news programming being offered on a regionalized basis, advertising opportunities might open up to businesses that only target those regions and not the entire service area of the television station.[13]
- Businesses that might target specific demographic groups may find it beneficial to advertise on new multicasted programming that target those demographic groups.
- Multicasting would substantially increase the need of stations for programming, thereby producing new opportunities for independent programming networks, including those experiencing difficulties obtaining cable carriage.[14]
- Finally, another set of benefits might emerge as programming is developed by multicasting stations targeting underserved demographic groups in one particular television market that could also be syndicated to stations in other markets also trying to reach these groups.[15]

6. Conclusion

Simply put, carriage on local cable systems is essential for multicast program streams to be successful. Cable systems have significant incentives to not carry these program streams, even

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[12] The FCC has previously recognized the difficulties of television stations in these markets to compete successfully in the video marketplace. See *2002 Biennial Regulatory Review,* Report and Order, 18 FCC Rcd 13620, 13698 (2003).

[13] See Economic Benefits Paper, pp. 15-16.

[14] See *Twelfth Annual Report* at ¶ 173 (citing reports that unaffiliated programming networks have difficulty obtaining carriage on MSOs).

though viewers may want to have them available and they could substantially benefit local communities. Moreover, local over-the-air television stations are facing challenging times, especially in the medium and small markets. Without some assurance that local viewers could access any new offerings, these stations will not be able to expand their offerings through multicasting and will continue to face financial strains in providing local services.

[15] See Economic Benefits Paper, p. 17.