

bargaining power over the cable operators. They could insist on a high fee for their national networks or they could negotiate for carriage of other programming. Must-carry and retransmission were government granted rights of carriage, means of ensuring access to audiences. The broadcasters chose to bargain for more channels on cable systems, rather than charge for their broadcast networks.

The 1996 Telecommunications Act reinforced this process. The Act allowed the FCC to lift the ban on horizontal concentration in the television industry. Broadcast licenses had been limited to one per entity in each market. The 1996 Act allowed the FCC to award more than one license per market after it had considered its impact on the industry. The FCC chose to allow duopolies in markets in which there would be at least eight "voices" in the market after the merger of two stations. Generally, the largest markets were opened to duopolies under the reasoning that diversity would be preserved in those markets.

For independents that sold product into TV syndication, this change had the opposite effect. By allowing the broadcast networks to own two stations in the most important markets - especially New York, Chicago and Los Angeles - a second major outlet was pulled into the tightening, vertically integrated core. The new owners of the second station now had a great deal of content of their own since, over the course of a decade, every major network acquired one of the major studios. Vertical integration became complete. Syndication was more difficult because access to the most important markets became much more difficult.

## **STRATEGIC MOVES**

These changes did not take place instantaneously, but unfolded over a number of years for several reasons. When a policy change takes place, it frequently takes a period of time for

regulators to implement legislated requirements. Parties will frequently litigate such changes **and** move slowly until the legal terrain is clear. Further, existing business relations must unwind. Contracts run their course and new models are developed. Finally, because many of these policies are highly visible political decisions, market participants **try** to avoid triggering a political reaction with extreme moves.

The 1990s policy changes triggered a **series** of acquisitions and product developments over the course **of** the decade that created a vertically integrated oligopoly in the television industry (*see* Exhibit **III-2**).

**Exhibit III-2:  
Major 1990s Acquisitions and Launches Involving Broadcasters in the  
Creation of the Vertically Integrated Video Entertainment Oligopoly**

Year	Disney/ABC	Time Warner	Viacom/CBS	G.E.-NBC	Fox
1993		Turner acquire!; Castle Rock & New Line			<b>Fox</b> acquires NFL rights
1994			Viacom acquires Paramount		
<b>1995</b>		Time Warner launches WB	CBS launches UPN		
1996	Disney acquires ABC	Time Warner acquires Turner			
1999			CBS acquires King World Viacom acquires CBS	NBC acquires 30% of Paxson	
<b>2001</b>					Fox duopolies LA, Minn. DC Houston
<b>2002</b>				NBC acquires Telemundo NBC duopolies result	<b>Fox</b> duopolies Chic. Orl.
<b>2003</b>				GE Acquires Universal	

Source: Columbia Journalism Review, *Who Owns What*, August 22, 2006,

Most directly, the networks could monopolize access to audiences in prime time broadcast television, foreclosing the streams of revenue that sustain production of all forms of content. Within a decade, the amount of programming on prime time owned by the networks increased dramatically, from 15% to around 75%. First the independents were excluded from prime time, and then the major studios were absorbed...

"Each of the big three networks merged with a major studio and acquired cable programming over the course of the 1990s. Fox had taken a different path to vertical integration. After being rebuffed in an effort to acquire Warner studio, News Corp. acquired Twentieth Century Fox and a number of television stations in major markets, both in 1985. Since the late 1970s, Twentieth Century Fox had been one of the least active of the major studios in providing television programming. Fox's focus through the 1990s would not be on original programming as traditionally defined for prime time. It would focus on sports in programming and broadcast duopolies.

Interestingly, Fox was vertically integrated but remained below the threshold for being subject to the Fin-syn rules. For the big three networks who were subject to the rules, the repeal of Fin-syn made mergers between networks and studios profitable, as self-supply was now allowed.

## **THE CURRENT STATE OF THE VIDEO PRODUCT ENTERTAINMENT SPACE**

### **Vertical Integration**

Within less than a decade after repeal of Fin-syn and the passage of the 1996 Telecommunications Act, the process of vertical integration and horizontal consolidation was complete. This paper defines vertically integrated entities at the core of domestic video

entertainment as the five firms that, in the past decade, have come to own major studios, broadcast networks and cable TV channels while holding television station licenses as well (see Exhibit 111-3). The names are familiar to all in both the television and the theatrical movie space. All of the entities have a presence in each of the major video entertainment areas – network television, cable television and movie production. These firms account for five of the seven studios that produce motion pictures – known as the majors.

The depiction and data in Exhibit 111-3 are for the early 2000s. While there have been some changes in the direction of deintegration that movement is not complete and its implications are not yet clear. CBS and Viacom have become partially separated. They still share the same Chairman (Sumner Redstone). Each of the **two** potential entities is vertically integrated on its own, with distinct production and distribution facilities. Similarly, Fox and Liberty remain precariously intertwined by substantial ownership of shares, although an exchange and separation of ownership in Fox and DirecTV may be in the offing. These evolving situations may change the landscape somewhat, but the distribution arrangement made by the separate entities would still reflect the legacy **of** vertical integration. Thus, we may *see* these entities unwind toward truer deintegration and independence, although the history of Liberty teaches that spin-offs and pull-backs are entirely possible. Moreover, whether these developments will constitute a **true** opening of the field to independents, or whether these entities will simply substitute contractual relationships to duplicate the integrated flow of content, also remains to be seen. Nor is it clear that the parts that have been broken up will not use their remaining partially integrated assets (production and distribution) to reintegrate across

**Exhibit III-3:  
The Vertically Integrated, Video Entertainment Oligopoly**

<b>Parent</b>	<b>Television Property</b>	<b>Cable/Satellite</b>	<b>Film Production</b>
News Corp.	35 TV Stations reach 39% of U.S. Households  9 duopolies – NY, LA, Chic. Minn. D.C. Dallas, Phoenix Orlando, Houston	Fox News, Fox Movie FX, FUEL, Nat. Geog. Speed Fox Sports, Regional Sports, College Soccer  DirecTV	20 <sup>th</sup> Century Fox, Fox Searchlight, Fox Television S, Blue Sky Studios
General Electric	Fox Network 28 TV stations reaching 34% of U.S. households  6 duopolies through Telemundo – NY, LA, Chic., SF, Dallas, Miami	CNBC, MSNBC, Bravo, Sci-Fi, Trio, USA	Universal
Disney	NBC Network 30% of Paxson 10 TV stations reachmg 24% of U.S. households  ABC Network	ESPN, ABC Family, Disney Channel, Toon Disney Soapnet, Lifetime A&E	Walt Disney Touchstone Hollywood Buena vista Pixar Miramax
CBS/Viacom	17 TV stations reaching 39% of U.S. households CBS Network  CW  King World	Showtime MTV, Nickelodeon BET, Mick at Night TV land, Noggin Spike TV, CMT Comedy Central, Flix The Movie Channel Sundance	Paramount Paramount Home
Time Warner	CW Network	HBO, CNN, Court TV,  Road Runner New York News 1  Time Warner Cable 14.5 million subscribers	Warner Bros. Studios, TV Home Video Domestic Pay-TV Telepictures, Hanna- Barbera Witt-Thomas,

Source: Columbia Journalism Review, *Who Owns What*, August 22, 2006.

the entire space.<sup>26</sup> The effects of any real de-integration, if it comes about, will play out over time.

Note that each of the entities has a presence in all of the key areas of video production and distribution. Each owns studios that produce video product for both television and theatrical release. Each has substantial ownership of television distribution. **The four national broadcast networks are represented here. The broadcasters have substantial ownership of TV stations. The fifth entity, Time Warner, is a major cable operator. As a result of the recent Adelphia acquisition and exchange of cable systems with Comcast, Time Warner dominates the two entertainment centers in the U.S., New York and Los Angeles. It also has a share in the new broadcast network, CW, to which its production operations are providing content.**

Each of the five also has substantial cable offerings. Indeed **24** of the top **25** cable channels, as measured by homes passed, are owned by these five entities. In terms of actual viewers, as opposed to homes where programming is available, these five entities account for the vast majority – as much as 85 percent -- of prime time viewing.

### **Horizontal Concentration**

Reflecting this concentration of subscribers, viewers and facilities, these five, vertically integrated entities have come to dominate the domestic U.S. video entertainment product space (*see* Exhibit **III-4**). They accounted for about **three** quarters to four-fifths of the output of the video product in terms of writing budgets, programming expenditures, hours of prime time content, and domestic theatrical **box** office or video sales/rentals.

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<sup>26</sup> Grove, Martin A., "CBS' Moonves Smart to Eye Movies," *HollywoodReporter.com*, July 7, 2006.

**Exhibit III-4: Vertically Integrated Video Oligopoly Domination of Television and Movie Production and Distribution (Circa 2001-2003)**

	TELEVISION						MOVIES/DVD (US Rev)		
	Subscribers*		Writing Budgets		Programming Expenditures		Share of Prime Time	Box Office %	Video %
	# Million	%	\$ Million	%	\$ Million	%	%	%	
FOX/LIBERTY	1230	21	236	19	3803	9	3	11	10
TIME WARNER	925	15	206	17	7627	18	10	22	20
CBS/MACOM	910	15	45	12	9555	22	28	8	7
ABC/DISNEY	705	12	132	11	6704	16	21	20	22
NBC/Universal**	720	12	159	13	3879	9	21	12	15
Subtotal	4315	75	772	72	31568	74	83	73	14
TOTAL	6000	100	1225	100	43212	100	100	100	100
<b>HHI</b>		<b>1179</b>		<b>1084</b>		<b>1226</b>	<b>1775</b>	<b>1213</b>	<b>1258</b>
<b>FOUR FIRM CR</b>		<b>63</b>		<b>61</b>		<b>65</b>	<b>70</b>	<b>65</b>	<b>67</b>

Notes and sources: \* Subscribers includes broadcast and cable homes passed. \*\* Universal added to NBC to project post-merger market. Federal Communications Commission, In the Matter of Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming, CC Docket No. 00-132, Seventh Report, Tables D-1, D-2, D-3, D-6, D-7; Television Market Report: 2001 (Washington, D.C.: BIA Financial Network, 2001); Comments of the Writers Guild of America Regarding Harmful Vertical and Horizontal Integration in the Television Industry, Appendix A. Federal Communications Commission, In the Matter of Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992; Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996 The Commission's Cable Horizontal and Vertical Ownership Limits and Attribution Rules Review of the Commission's Regulations Governing Attribution Of Broadcast and Cable/MDS Interests Review of the Commission's Regulations and Policies Affecting Investment In the Broadcast Industry, Reexamination of the Commission's Cross-Interest Policy, CS Docket No. 98-82, CS Docket No. 96-85, MM Docket No. 92-264, MM Docket No. 94-150, MM Docket No. 92-51, MM Docket No. 87-154, January 4, 2002; Bruce M. Owen and Michael G. Baumann, "Economic Study E, Concentration Among National Purchasers of Video Entertainment Programming," Comments of Fox Entertainment Group and Fox Television Stations, Inc., National Broadcasting Company, Inc. and Telemundo Group, Inc., and Viacom, In the Matter of 2002 Biennial Regulatory Review - Review of the Commission's Broadcast Ownership Rules and Other Rules Adopted Pursuant to Section 202 of the Telecommunications Act of 1996, Cross Ownership of Broadcast Stations and Newspapers, Rules and Policies Concerning Multiple Ownership of Radio Broadcast Stations in Local Markets, Definition of Radio Markets, MB Docket No. 02-277, h4M Dockets 02-235, 01-317, 00-244, January 2, 2003; Federal Communications Commission, Program Diversity and the Program Selection Process on Broadcast Network Television, Mara Epstein, Media Ownership Working Group Study 5, September 2002, pp. 26; David Waterman, Hollywood's Road to Riches (Cambridge: Harvard University Press, 2005), pp. 21, 25.

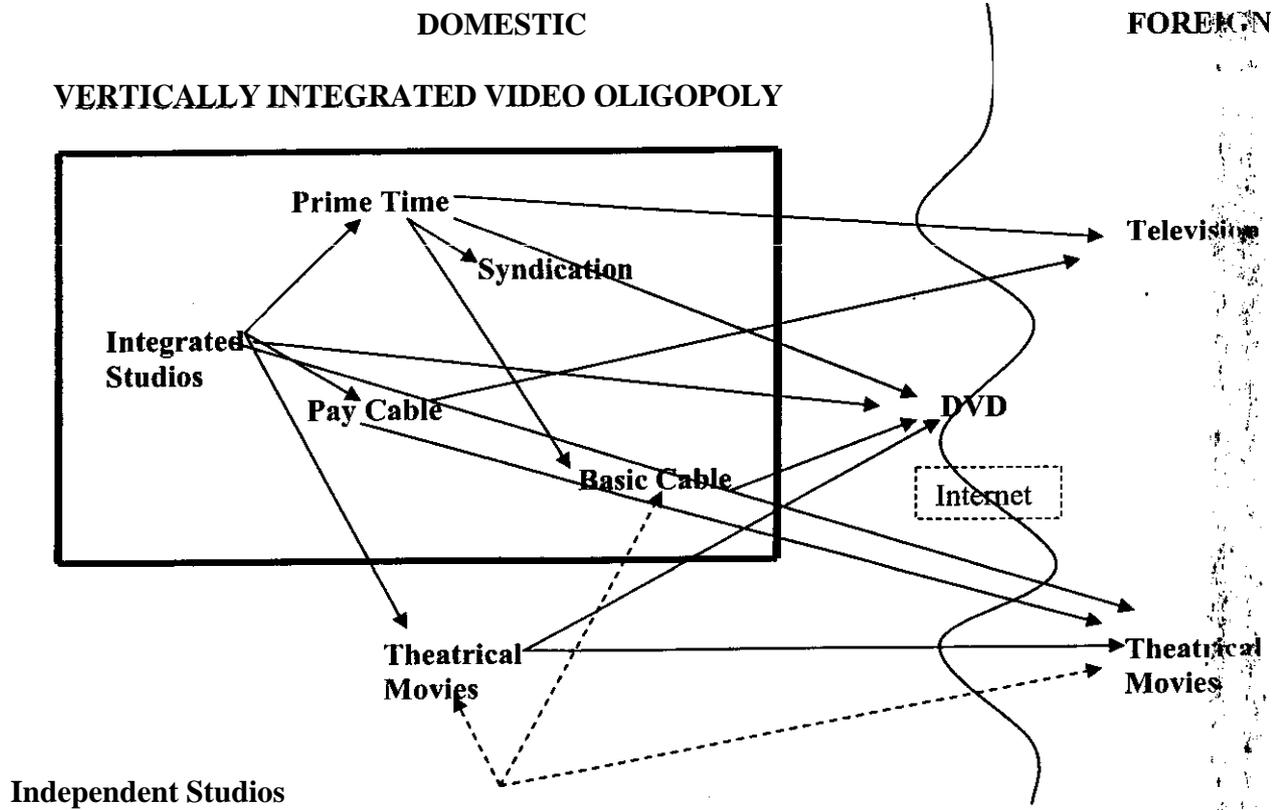
In each case, the HHI is in the concentrated range and the four firm concentration ratio is in the tight oligopoly range. The two potential changes in the sector noted above would not change this basic finding. Each of the measures of concentration would likely remain in the concentrated tight oligopoly range, but the identity of the leading firms might change a bit.

The broadcast space at the core of the vertically integrated oligopoly is extremely important to the overall market for video product (see Exhibit III-5). Where a program or film is placed in television space strongly affects not only its domestic revenues, but has a large impact on where it will be placed and what revenues it can earn in the international arena. By foreclosing the broadcast space, for both movies and series, the oligopoly core cripples independent producers and forces them into the cable arena, insofar as the independents desire to distribute over the television platform. The cable space, though, is a hostile environment as well, wherein the very same entities own the most attractive distribution channels in the space. Independents are forced into the least attractive cable channels on the least favorable terms.

#### **THE CONDITIONS FOR THE EXERCISE OF MARKET POWER**

Thus, the basic conditions for public policy concern about the potential exercise of market power are present. The empirical analysis demonstrates key economic characteristics of the video entertainment product space. It is a moderately to highly concentrated, tight oligopoly that is vertically integrated in production and distribution and exercises monopsony power – control and market power over the purchase of programming from independents.

**Exhibit III-5:  
Location in the Domestic Exhibition Space Strongly Influences Prospects in Foreign Markets**



The remainder of this analysis presents evidence that market power has been exercised. In the process of creating the vertically integrated oligopoly, these entities behaved in a manner that created their market power through mergers, acquisitions and product development and exploited their market power through self-dealing, foreclosure of markets and imposition of onerous terms and conditions on suppliers. The key elements of the video entertainment product space include:

#### Market structure and market power

- Market shares that have risen to the level traditionally defined as a source of concern about concentration setting the stage for the abuse of market power.
- Substantial barriers to entry in the industry.
- A history of anticompetitive practices.

#### Vertical Integration

- Barriers to entry increased by vertical integration.
- The foreclosure of markets to unaffiliated producers through favoritism of affiliated upstream production and the subsequent exit of upstream, unaffiliated product suppliers from the market.
- Parallelism and reciprocity among the dominant firms in the oligopoly.
- A rush to integrate and concentrate across the sector.

#### Monopsony Power

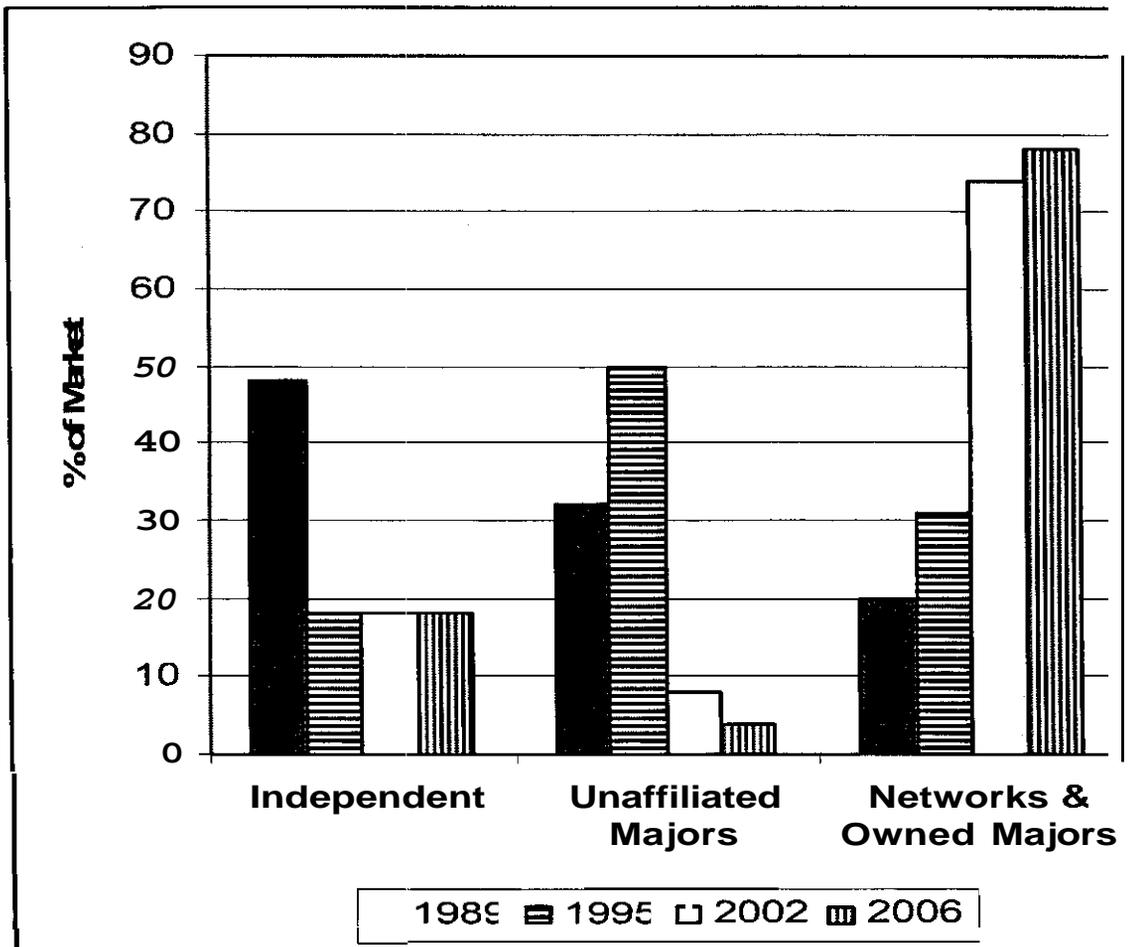
- The imposition of prices that squeeze unaffiliated producers and terms that shift risk onto those producers.
- Indications of a decline of quality in product attendant on the abuse of monopsony power.
- Flooding of downstream outlets with integrated product.

## IV. DOMINATION OF THE TELEVISION PRODUCT SPACE

### PRIME TIME ON BROADCAST/NETWORK TELEVISION

The central empirical fact at the core of the narrative of the 1990s is the dramatic and swift change in the ownership of prime time programming after the repeal of the Fin-Syn rules (see Exhibit IV-1). Studies of prime time programming just prior to the repeal of the

Exhibit IV-1:  
Prime Time Market Shares



Source: 1989-2002 calculated from Mara Einstein, *Media Diversity: Economics, Ownership and the FCC* (Mahwah Lawrence Erlbaum, 2004), p. 169; 2006 based on Baseline Research, *Fall Television Schedule: 2006-2007 Season*.

Fin-Syn rules find that the networks owned around 15 percent of shows aired in prime time, Major studios owned about one-third and independents accounted for about a half. Within five years, the role of the independents had been dramatically reduced – to less than one-fifth of the programming. Networks had grown to almost 40 percent. **The** major studios still accounted for around 40 percent. The mergers of the networks and studios followed and the vertically integrated entities came to dominate prime time, accounting for over three quarters of the programs. In 1989, fifteen entities produced 2 percent or more of the programming on prime time. By 2002, that number had shrunk to five. **The** programming produced by independents in 2006 was largely reality shows, not scripted programming, as had been the case in the recent past.

Traditional measures of market concentration used in economic analysis reinforce this observation. As Exhibit IV-2 shows, the prime time market moved very quickly from an unconcentrated competitive market (CR4=34%; HHI=541) to a tight oligopoly (CR4=74%) well up into the moderately concentrated range (HHI=1596). If **the** calculations **are** based only on **series**, i.e. excluding movies, the concentration is even greater. Within a decade after

**Exhibit IV-2:  
Concentration of Prime Time Programming**

Year	Four Firm Concentration	HHI	Four Firm Concentration	HHI
	<i>AN Prime Time Hours</i>		<i>Series only</i>	
1989	35	541	40	703
1995	47	776	57	1165
2002	74	1596	<b>84</b>	2070

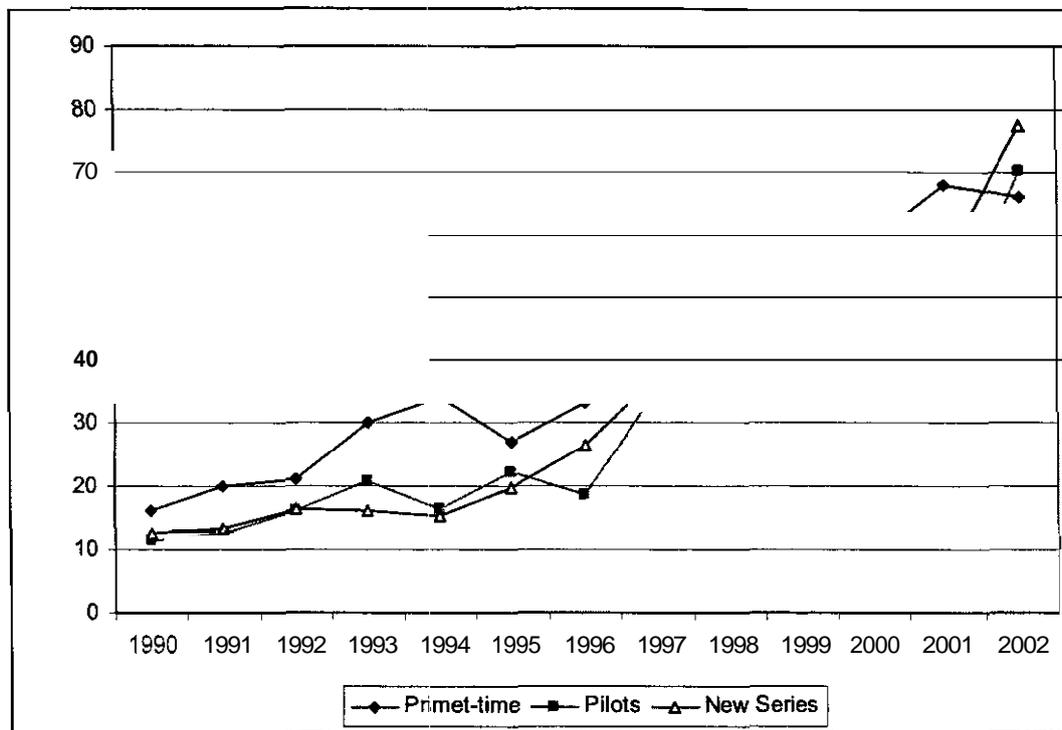
Source: Calculated from Mara Einstein, *Media Diversity: Economics, Ownership and the FCC* (Mahwah: Lawrence Erlbaum, 2004), p. 169.

the repeal of Fin-syn, the market was a highly concentrated (HHI=2070) tight oligopoly (CR4=84).

### NEW SHOWS AND PILOTS

Exhibit IV-3 shows the pattern of ownership by the networks of prime time programming, new shows and pilots. We observe a modest increase in network ownership in the early 1990s, as the Fin-Syn rules were partially repealed, debated and litigated. With final repeal of the rules in 1995, we see a rapid and steady increase in network ownership.

**Exhibit IV-3:  
Network Ownership of Prime-Time Programming 1990-2002**



Source: Calculated from Mara Einstein, *Media Diversity: Economics, Ownership and the FCC* (Mahwah: Lawrence Erlbaum, 2004), p. 171; William T. Bielby and Denise D. Bielby, "Controlling Prime Time: Organizational Concentration and Network Television Programming Strategies," *Journal of Broadcasting & Electronic Media*, 47: 4 (2003), p. 588.

The pattern has persisted, as an analysis of the 2006-2007 season shows (see Exhibit IV-4). The networks get over half of their programming internally. The four major networks also buy programming from one mother. Overall, independents account for less than one-fifth of prime time programming. On the four major networks, the independents account for about one-seventh. The independent programming is generally reality shows, not scripted programming.

**Exhibit IV-4:  
Primetime 2006-2007 Programming  
(Percent of Hours)**

	Self-Dealing	Internal Big-5 Dealing	Sony	Independents
ABC-Touchstone	52	20	3	25
CBS-Paramount	57	38	0	5
NBC-Universal	67	14	5	14
FOX-20 <sup>th</sup> Century	52	29	6	13
CW-Warner/ Viacom	53	0	7	40
<b>Total</b>	<b>57</b>	<b>21</b>	<b>4</b>	<b>18</b>

Source: Baseline Research, *Fall Television Schedule: 2006-2007 Season*

**SYNDICATION**

Syndication has been studied less than prime time, **but** the available data suggests a similar pattern (see Exhibit IV-5). Although there is less self-dealing, the five networks dominate the syndication market because of a large amount of internal dealing. Particularly interesting to note is the lack of recent independent shows in syndication. Having been forced out of prime time, independents simply do not have series to place as product in syndication.

**Exhibit JV-5:  
Self-Dealing and Internal Dealing in First-Run Syndicated Programming (2004)**

TYPE OF TRANSACTION	HOURS	
	All Shows	Shows Less Than 2 Years Old
Self-Dealing (Subsidiaries of Big 5 syndicating to themselves)	32%	61%
Internal Dealing (Subsidiaries of Big 5 syndicating to Big 3 station groups)	41	16
Independents syndicating to Big 3 Station Groups	18	0

Sources and Notes: Calculated from Goro Oba and Sylvia M. Chan-Olmstead, "Self-Dealing or Market Transaction?: An Exploratory Study of Vertical Integration in the U.S. Television Syndication Market," *Journal of Media Economics*, 19 (2), 2006, p. 113.

Big 3 station groups are CBS/Viacom, Fox and ABC

Big 5 syndicators are King World, Paramount, 20<sup>th</sup> Century Fox, Buena Vista, WB and Universal. Other Major is Sony (Columbia). Independents are "other."

There are 22.5 hours per week of first-run syndicated programming in the 9am to 8pm day part analyzed (77 hours).

The foreclosure of the broadcast/network television market, particularly for 1<sup>st</sup> run series, is reinforced by a complete lack of pilots coming from independents. Interviews with independent producers done for this paper reveal that since there is little chance that they will get on the air, they have abandoned this market.

I have noted that the decision to allow broadcasters to hold multiple licenses in a single market contributed to the difficulties of independents gaining access to the syndication market. The network owners would use their internally produced content on the television stations in the largest markets, squeezing the space available to unaffiliated producers. About 75 duopolies were created soon after the ban on holding multiple licenses was lifted. The national networks concentrated their duopoly acquisitions in the top ten markets, even though

owning multiple stations within a market did not count against the national cap on how many homes they were allowed to reach. These markets account for about 30 percent of all the TV households in the country and almost 40% of all the TV revenues in the country. The big four network's market share in the top three markets was particularly high. These three markets alone account for about 15 percent of the population and almost 20 percent of TV revenues in the nation.

**Exhibit VI-6:**

**Big 4 Network Duopolies and Market Share in Top 10 Markets**

<i>Designated Market Area</i>	<i>Number of Big 4 Duopolies</i>	<i>Market Share of Big 4 Duopolies</i>	<i>Total Market Share of Big 4</i>
New York	2	44	77
Los Angeles	3	62	79
Chicago	2	40	73
Philadelphia	1	25	57
San Francisco	2	31	56
Boston	1	28	42
Dallas	3	59	59
Washington D.C.	1	21	52
Atlanta	0	0	24
Detroit	1	24	42

**Source:** BIA Financial, *Television Market Report, 2003*

**TV MOVIES, THE ROLE OF CABLE**

The history of prime time programming is primarily a story about television series. While a small number of made for TV movies appear in prime time, the overwhelming majority of programming is series. Interestingly, for independents, the growth of cable in the late 1990s was a story about TV movies.

To analyze the changing patterns of TV movies, I examined all films aired in **three** four-year periods (see Exhibit IV-7. The first period was before the Fin-Syn rules were in play (1985-1988). The second period was the four years after Fin-syn was repealed (1995-1998). The third period was after **the** networks became integrated with studios (2001-2004).

**Exhibit IV-7**  
**TV Movies Across All Distribution Channels**

	<b>Percent of Movies</b>		
	<i><b>Broadcast</b></i>	<i><b>Basic Cable</b></i>	<i><b>Premium Cable</b></i>
1985-1988(n=47)			
Independent	39	0	2
Network	47	2	2
Majors	9	<b>0</b>	<b>0</b>
1995-1998 (n=206)			
Independent	33	13	16
Network	18	1	<b>5</b>
Majors	11	0	2
2001-2004 (n=634)			
Independent	7	41	9
Network	<b>5</b>	20	7
Majors	<b>5</b>	<b>5</b>	1

Source: Baseline Beta **Studio** System Database.

I relied on the baseline database and included only movies that **were** aired and for which a network and at least **one** producer was identified. Where a network was listed as a producer, the movie was considered to be produced by the network, even if other (unaffiliated) producers were identified. This is the critical assumption in the **sense** that I am assuming, implicitly, that the movie would not have been aired on **the** network, but for the network's interest in **the** co-production. Of lesser importance is the assumption that where a network and its major movie studio **are** both listed as producers, the studio was considered to be the producer. While these distinctions could be interpreted in other ways, the basic

patterns in the **data** would not change much. The key findings about independent producers are quite clear (as shown in Exhibit **IV-7**).

The pattern of broadcast movies follows the pattern **we** observed for series. The independents played a large role under Fin-syn, were diminished immediately after the repeal of Fin-Syn and then reduced dramatically within a decade. Their share in premium movies grew in the **mid-1990s**, but was reduced after the integration of the studios.

In the most recent period, cable movies have become quite prominent. The numbers of movies produced have increased dramatically. In the mid-1990s, independents aired about 120 movies, 95 **of** them on broadcast and premium cable. In the 2001-2004 period, they produced over 100 movies on broadcast and premium cable, and over 260 on basic cable. The apparent increase in production, however, is less significant than it appears. There are two different **sets** of reasons that the expansion has not helped independents greatly. One set has to do with the nature of the business and **the** distribution channels.

First, broadcast and premium movies have much higher budgets and larger audiences. Thus, the 100 movies produced by independents that aired on broadcast and premium cable probably had a substantially larger total budget and a larger audience than the 260 movies that aired on basic cable.

Second, where studios compete for resources to maintain a production base, the relative output is important. Whereas the independents grew by about 6 percent between **the** mid 1990s and the early 2000s in **the** high value spaces, the networks and major studios grew by almost 60 percent. **As** the networks grew larger and larger, they control more resources in the sector.

Third, placement on basic cable makes it more difficult to tap into other revenue streams – DVD sales/rentals and foreign television – which have become vital to maintaining the program's prominence.

The second set of factors that suggest the growth of basic cable as an outlet is less important than it appears has to do with the market structure.

First, approximately 80 percent of the basic cable movies aired in the **2001-2004** period on networks is now owned by two of the vertically integrated media corporations – ABC/Disney (ABC family, Disney Channel and Lifetime) and NBC (Sci-Fi).

Second, the genres are highly specialized. These cable networks buy **three** genres, each with a respective dominant buyer. ABC Family/the Disney Channel buy family/children-oriented movies. Lifetime buys romances. Sci-fi buys science fiction films. This is a classic situation for the exercise of monopsony power.

Third, the vertically integrated oligopoly that dominates the other video outlet spaces also thoroughly dominates the TV movie space. **The** five entities I have identified as the vertically integrated oligopoly account for about three-quarters of *the* distribution of movies: one-third through broadcast and premium cable, a little over one-third through basic cable, and another handful on general networks (A&E, MTV, ESPN, FX, Spike).

#### **ACCESS TO TELEVISION IS CRUCIAL TO THE HEALTH OF INDEPENDENT PRODUCERS**

Thus, I have shown that the independents were largely eliminated from prime time broadcasting and relegated to basic cable movies. This places the independents at a severe disadvantage because television and the broadcast space at the core of the vertically integrated oligopoly remain extremely important to the overall market for video product. Exhibit IV-8

presents order of magnitude estimates of the revenues, expenditures and audiences for domestic movie producers and the domestic TV sector. It contrasts cable and broadcast revenues with to sources of revenue for movie producers that are 'independent' of the domestic TV sector – domestic and foreign theatrical releases and home video sales.

**Exhibit IV-8:  
The Importance of Television in the Video Entertainment Product Space  
(circa 2003-2004)**

	MOVIES		TELEVISION	
	Majors	Independents	Broadcast	Cable/ Satellite
<b>Revenues (Billions)</b>				
Domestic			Ad Revenue/ Subscription	\$35
Box Office	\$ 8.0	\$1.0		\$50
Home Video	<u>11.0</u>	<u>1.3</u>		
Subtotal	19.0	2.3		
Foreign				
Box Office	8.0	1.0		
Home Video	<u>8.0</u>	<u>.8</u>		
Subtotal	16.0	1.8		
Total		38.3		85
<b>Programming</b>	<b>7.0</b>	.4		\$40
<b>Budgets (Billions)</b>				
<b>Audience (Hours Per Year)</b>				
Theatrical		13	Broadcast	780
Home Video		80	Basic	830
Total		93	Premium	180

Sources: U.S. Box Office and Programming budgets are based on MPAA, *Theatrical Market Statistical Report, 2005*. Programming budgets do not include marketing and assume 120 releases from the majors. Foreign Box Office, home video and TV revenues are from David Waterman, *Hollywood's Road to Riches* (Cambridge: Harvard University Press, 2005), Table C.1. Independent programming budgets from American Film Marketing Association, *The Economic Impact of Independent Film Production, April 2003*. Cable Revenue is from Federal Communications Commission, *Twelfth Annual Report in the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, MB Docket No. 05-255, March 3, 2006, p. 19.

The revenue from the TV sector is much larger than the domestic revenue sources for the movie industry – about four times as large – even when video sales/rentals are included. Total revenues from these sources are over two times as large. Even if we were to factor in the domestic and foreign TV revenues of movie producers, the domestic TV sector would be almost twice as large.<sup>27</sup>

Programming expenditures of the domestic TV sector are on the order of five to six times as large.

The extreme importance of TV in terms of audience is also clear. Broadcast and cable pull almost twenty times the audience of movies, even combining theatrical and home video viewing. Premium cable (arguably similar to movies since it is a pay service) alone has a larger audience.

Although basic cable and broadcast are about equal in audience, prime time broadcast is still the dominant exhibition space on TV. For example, the advance sales of advertising slots on the four national networks – called the up front sales – equals the total annual Box Office of theatrical releases in the U.S. Advertisers pay a rich premium for this space because the networks still aggregate many more viewers than cable shows. As Mara Einstein, the author of the most comprehensive analysis of the repeal of the Fin-Syn rules noted, the gatekeeper role of the networks is essential since,

while the networks must decide between best show versus best buy, they remain acutely aware of their ability to provide something that no other media vehicle can, and that is the ability to create a valuable asset because no medium can provide the kind of exposure and promotion that network television does.<sup>28</sup>

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<sup>27</sup> The sources cited in Exhibit IV-8 put this revenue at about \$8 billion.

<sup>28</sup> Einstein, Mara, *Media Diversity: Economics, Ownership and the FCC* (Mahwah: Lawrence Erlbaum, 2004), p. 192.

The networks **are** well aware of their advantage. **As** Les Moonves recently put it, “If you want 30 million people, you can’t get that anywhere **else**.”<sup>29</sup> **The** next chapter examines how that gatekeeper role impacted access to distribution under the new policies adopted in **the** 1990s.

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<sup>29</sup> Fabricant, Geraldine and Bill Carter, “A Tortoise Savors the Lead,” *New York Times*, September 12, 2006, p. CC11.

## V. THE IMPACT OF MARKET STRUCTURE ON INDEPENDENT PRODUCTION

### THE CRITICAL ROLE OF GATE KEEPING IN THE VIDEO PRODUCT SPACE

At the center of the picture I have painted of vertical integration following the policy decisions of the 1990s stand the broadcasters as **gatekeepers** of access to audiences. A key role in the process was played by the absorption of the major studios. Interestingly, David Waterman's recent economic history of the major studios is based on the premise that

the most important feature of the studios is their role as *distributors*, and we often refer to them by that term. By controlling distribution, the studios act as gatekeepers: they decide which movies get produced and how they are made, and they also largely determine when and at what price viewers get to *see* them on which media.<sup>30</sup>

The key gate keeping role of distribution in the video entertainment product space was integrated and consolidated with production in single entities in the first **50** years of the movie industry. While there is a debate about the factors that shaped the role of the major studios, Waterman pinpoints two critical issues that parallel the core of my analysis of the video product space in the 1990s. One was a policy decision that forced deintegration.

**Fox**, MGM, Warner, Paramount, and RKO, known at the time as the five majors, were vertically integrated into production and theater exhibition and had consistently dominated the industry since the mid-1930s. The three others – Universal, Columbia and United Artists, **known** as “the minors” at the time – owned no theaters. . . All eight of these studios were brought to trial by the U.S. Justice Department in the 1940s, and an eventual Supreme Court decision in 1948, *United States v. Paramount Pictures, Inc. et al.*, ruled that the eight distributors had violated the Sherman Act and other antitrust laws. . . The Court ordered **the** five major distributors to divest their extensive theater holdings. . . established a number of regulations on contractual relationships between

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<sup>30</sup> Waterman, David, *Hollywood's Road to Riches* (Cambridge: Harvard University Press, 2005), p. 16.

distributors and theaters that were incented to level the playing field for independent companies.”

The second factor that shaped the market for theatrical movies was the growth of television.

After the *Paramount* decision, the prewar stability of industry structure among the eight *Paramount* defendants began to crumble. Industry positions of the majors and the minors converged, and the extent of independent entry increased. We argue in the following chapter that the almost coincident diffusion of television has more profound long-range effects on the movie industry than did *Paramount*, but it is likely that ascendance of all three of the minor studios into the majors ranks, and perhaps the rise of independents in the 1960s, were related to the Court's intervention.<sup>32</sup>

Thus, the policy of forcing deintegration of production and distribution of theatrically released movies opened the door to entry, while the advent of television created a whole new channel for the distribution of video product. Waterman reckons that the technological factor played a large part in shaping the video entertainment space, although not so much in determining concentration as in altering the types of products the sector produced and the marketing patterns of those products. However, from the point of view of the analysis in this paper, the critical point is that the convergence of the same two factors – integration policy and multiple distribution platforms – that worked to weaken the gatekeeper role of the studios in the 1950s, worked in the opposite direction for the broadcasters in the 1990s. Removing the policy restriction on vertical integration opened the door to reintegration of the production and distribution of video product and the merger of production (studios) and distribution (broadcasting and cable). The lesson is clear: if given the chance, entities will merge and integrate vertically in order to dominate the sector by controlling distribution.

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<sup>31</sup> Waterman, p. 30.

<sup>32</sup> Waterman, p. 23.

Mara Einstein, already described above as conducting the most thorough investigation of the Financial Interest and Syndication rules, notes that before and after **the** policy limiting vertical integration the broadcasters used their control over access to audiences to monopolize ownership of network programming.

Before the Fin-Syn rules were in place, networks asserted ownership over prime-time programming.

In the 1970s, what led **the** FCC to institute the financial interest and syndication rules was a concern that the networks were becoming both too powerful and too demanding when it came to the [program] selection process. Too powerful in that they were the gatekeepers of news, information, and entertainment for the American public. This was so because of the limits of radio spectrum... Too demanding, because networks were requiring an equity stake in a program before it would be accepted as **part** of **the** prime-time schedule.... [T]he networks had ownership of more than 70% of their prime-time schedule by the mid-1960s, up from only **45%** the previous decade. The strong arming of producers was a fundamental reason for the creation of fin-syn.<sup>33</sup>

**The** timing is informative. TV arrives on the scene in the 1950s and becomes the dominant medium by the early 1960s. In the early days, broadcasters lacked both production capacity and market power to self-supply content. Once television achieved ascendance, the broadcasters used their resources and leverage to assert ownership over prime time programming.

The broadcast networks also had a history of antitrust problems in their role as gatekeepers of access to the television audience. In 1978 they lost an antitrust case that paralleled the *Paramount* case

In the *Unites States v. National Broadcasting Co.*, The government specifically accused the National Broadcasting Company (NBC) of restraint of trade as it related to purchasing programs from independent producers and of using its

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<sup>33</sup> Einstein, Mara, *Media Diversity: Economics, Ownership and the FCC* (Mahwah: Lawrence Earlbaum, 2004), p. 179

network power to monopolize prime-time programming production of shows broadcast on the network. **The** Department also claimed that NBC, with CBS and ABC, was trying to develop a monopoly over the television programming market.<sup>34</sup>

After a twenty-year period in which the networks were restrained by the Fin-Syn rules, the broadcasters moved to reassert ownership in prime-time programming once the rules were repealed.

Since the rules were repealed in 1995, the economic structure of the industry changed drastically. The television networks have become vertically integrated institutions with the ability to produce programming through internal business units. Corporate parents put pressure on the networks to purchase programming internally to achieve synergies and, of course, increase profits. Being part of large media conglomerates, there is added pressure on the networks to **be** profitable so that Wall Street may find the parent company appealing.<sup>35</sup>

The networks each have at least a 50% stake in the programming on their air and some have as high as 70% and even 90%.<sup>36</sup> **The** networks could never achieve those kinds of ownership numbers without requesting a **stake** in the programming that appears on their air. It is no secret to anyone that the networks do this.<sup>37</sup>

In *the* previous section I have noted the evolving pattern of behavior by the broadcasters in asserting ownership of prime time programming. Bielby and Bielby have argued that network behavior was political, as well as economic, and noted the evolving nature of their rhetoric. At first the broadcasters argued that the independents would not **be** squeezed out. Later they argued that independents were irrelevant.

The network executives' initial position was that independent producers would thrive in a deregulated industry and that network ownership was not a threat to creativity and program quality. Increasingly, in recent years, network executives and deregulation advocates have taken the position that their opponents' positions are irrelevant, because they are out **of** touch with the

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<sup>34</sup> Einstein, p. 60.

<sup>35</sup> Einstein, pp. 179-180.

<sup>36</sup> Einstein, p. 217, citing Mermigas, 2002,

<sup>37</sup> Einstein, p. 217.