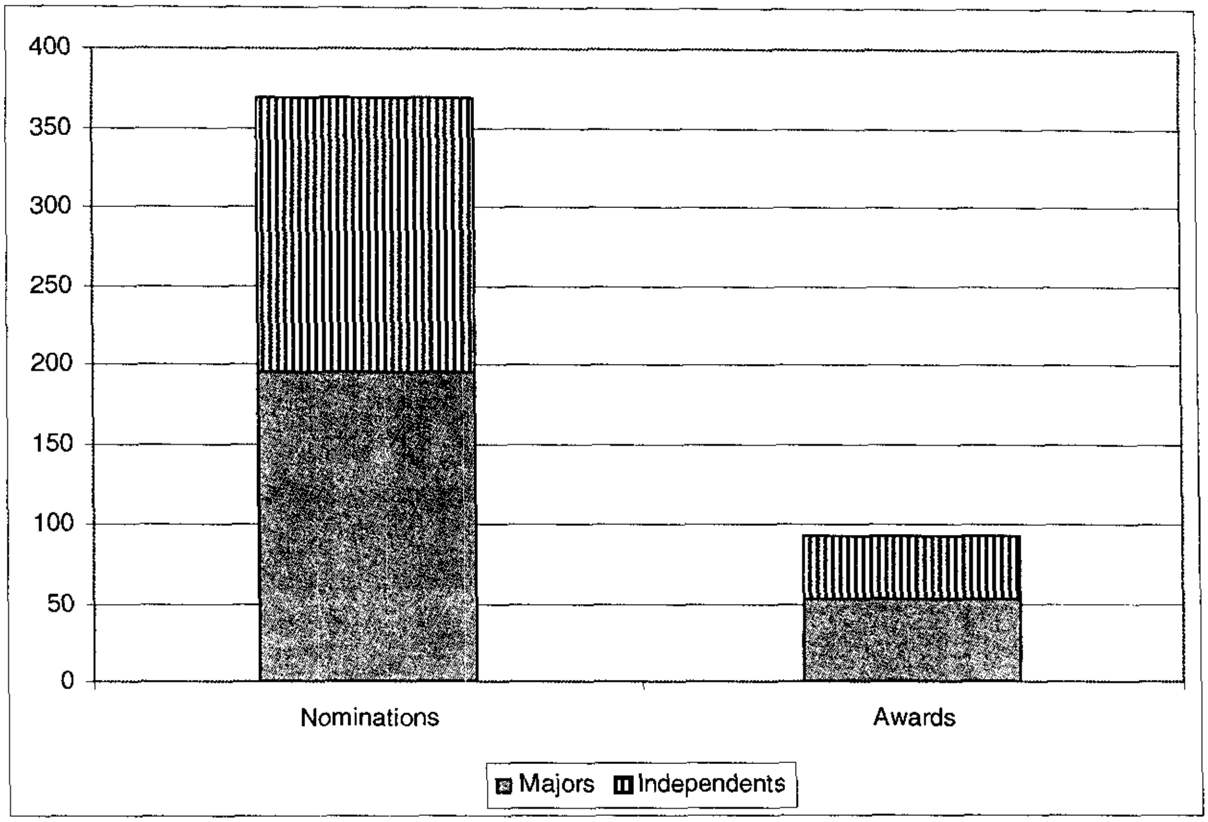
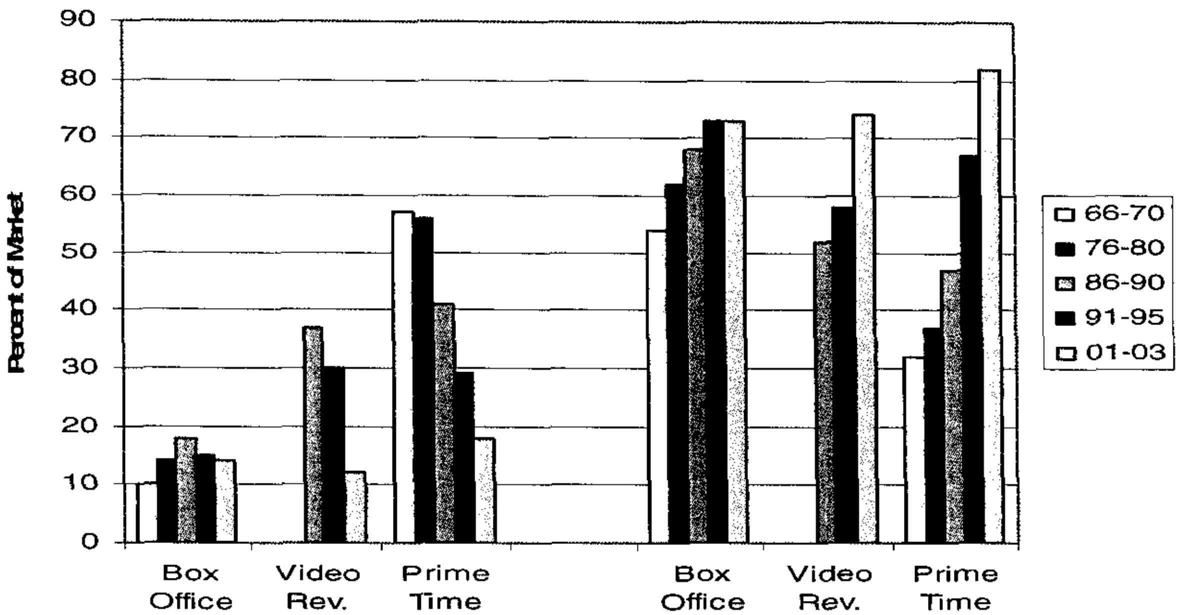
Exhibit VI-2:
Oscar Nominations and Awards 2001-2005:
Majors v. Independents



Source: Box Officemojo.com

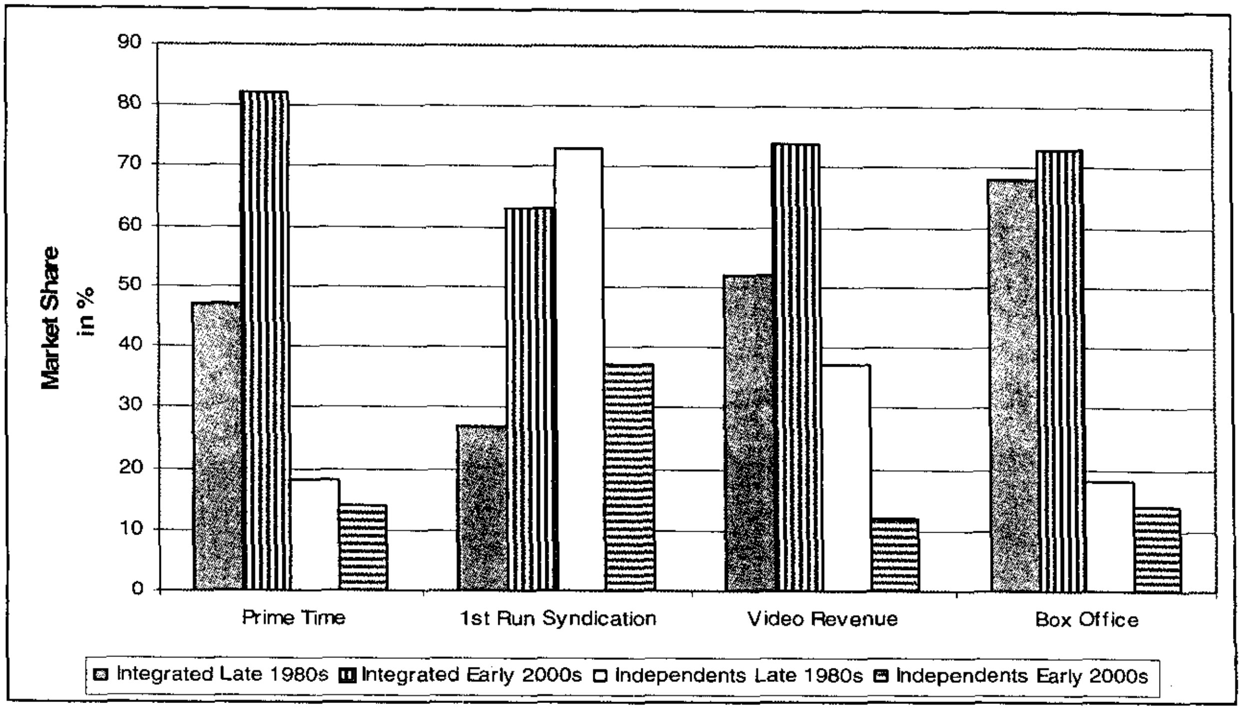
Arguably, a second measure of quality is success. For movies, box office is the predominant measure, although success at the box office reflects many things beyond simple quality, such as the advertising budget. For comparative purposes across time and distribution channels, the market shares in Exhibits VI-3 and VI-4 make a simple point. Independents held their market share in the Box Office much better than they did in the other distribution channels where vertical leverage was most directly exercised.

Exhibit VI-3:
The Shares of Independent Producers in Box Office, Video Revenue and Prime Time Hours Late 1960s to Early 2000s



Sources. Box Office and Video Revenue are five year averages from David Waterman, *Hollywood's Road to Riches* (Cambridge: Harvard University Press, 2005), pp. 21, 25, 86-90 and 01-03. Big Five Majors are the studios that have been acquired by major TV programmers – Disney/ABC; Fox/20th Century Fox; NBC/Universal; Warner Bros.; CBS/paramount. Other majors (not shown) are MGM/UA and Columbia. Independents are what Waterman calls "the residual." Prime Time is percent of hours in 1989, and 2002 from Mara Einstein, *Program diversity and the Program Selection Process on Broadcast Network Television* (Washington D.C.: Federal Communications Commission, September 2003), pp. 26. First-run syndication is from C. Puresell and C. Ross, "Vertical Integration and Syndication," *Electronic Media,* 22(1): 2003, for 1993 and 2002. It includes only vertical integration and not internal dealing among the big 5.

Exhibit VI-4:
Growth of Big 5 Market Share and Vertical Integration in Domestic Markets: Late 1980s to Early 2000s



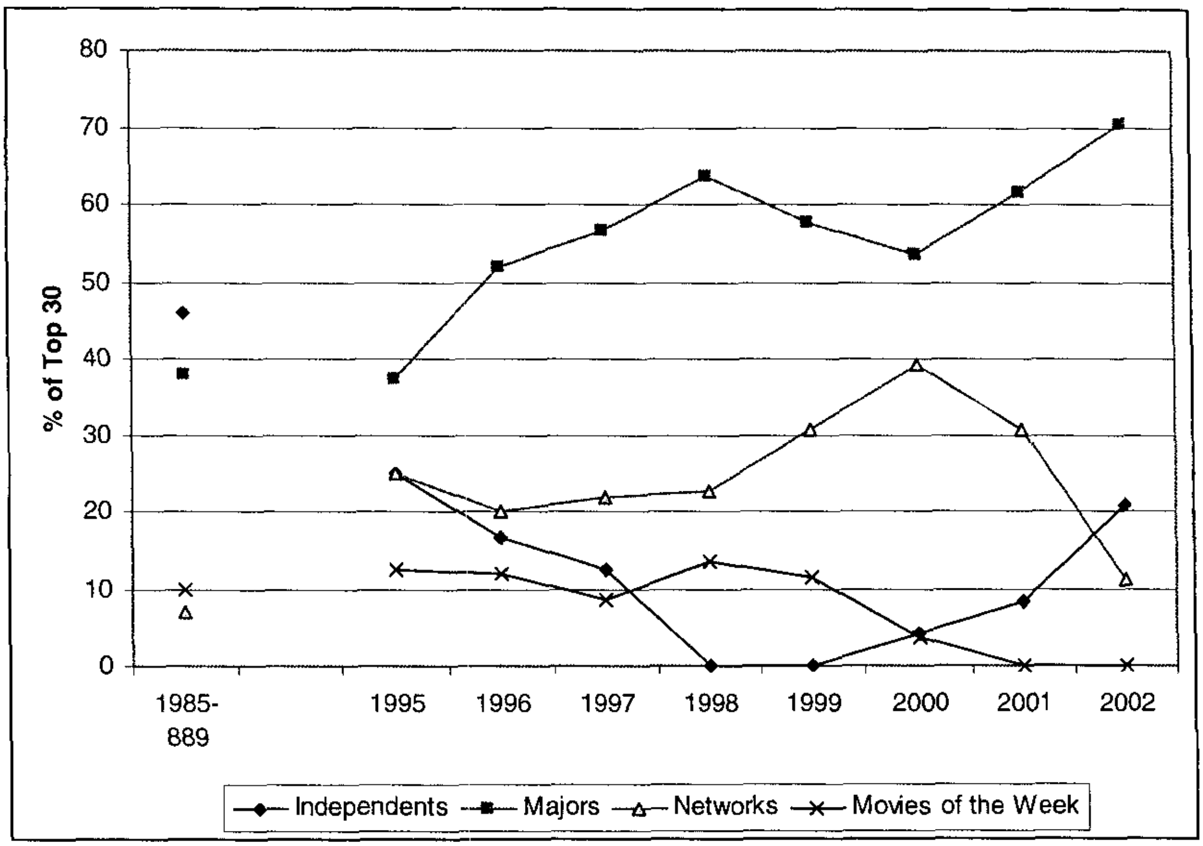
Sources. Box Office and Video Revenue are five year averages from David Waterman, *Hollywood's Road to Riches* (Cambridge: Harvard University Press, 2005), pp. 21, 25, 86-90 and 01-03. Big Five Majors are the studios that have been acquired by major TV programmers – Disney/ABC; Fox/20th Century Fox; NBC/Universal; Warner Bros.; CBS/paramount. Other majors (not shown) are MGM/UA and Columbia. Independents are what Waterman calls "the residual." Prime Time is percent of hours in 1989, and 2002 from Mara Einstein, *Program diversity and the Program Selection Process on Broadcast Network Television* (Washington D.C.: Federal Communications Commission, September 2003), pp. 26. First-run syndication is from C. Puresell and C. Ross, "Vertical Integration and Syndication," *Electronic Media,* 22(1): 2003, for 1993 and 2002. It includes only vertical integration and not internal dealing among the big 5.

Television

The quantitative analysis of the quality of television is even more complex. Independents were virtually eliminated from prime time and have little opportunity to bring new product to that space, so before and after comparisons tell us little, other than the fact that they were excluded. Moreover, there is no box office to count. The essential point here is that given the opportunity to appear in the exhibition space, independents held their own.

Exhibit VI-5 compares the source origin of the top thirty shows for two periods: 1985-1989, which is the base period I have been using for the Fin-Syn era, and 1995 to 2002 for the post Fin-Syn period. Ratings are the closest equivalent to Box Office. I start with the popularity measure because it tells us about the pattern of types of shows. I have included all non-news shows that appeared in the top 30. I have used the same coding approach as in the earlier analysis of all shows on TV. That is, where a major studio is listed

Exhibit VI-5:
Producers of Top 30-Rated TV Shows.



Source: Tim Brooks and Earle Marsh, *The Complete Directory to Prime Time Network and Cable TV Shows: 1946 – Present,* (New York: Ballantine, 2003), Appendix 3; Beta Study System database.

in a co-production, it is considered the producer. Where the producer uses both the name of a network and a major studio, it is counted as the major. The details of the counts might change somewhat with a different approach, but the basic patterns would be clear.

Prior to the repeal of Fin-Syn, independents and major studios dominated the top shows. The networks did not even pull their weight. They were somewhat underrepresented in these ratings. After the repeal of Fin-Syn, the vertically integrated oligopoly completely dominates the space. There are very few independents and no non-integrated majors in the top 30 shows. When the independents do return to the top 30 in the early 2000s, it is with reality shows, not scripted entertainments.

I have included the category of Movies of the Week, although I do not have the producers for the actual movies for two reasons. First, as we have seen, in the broader market share analysis, these were almost always independents and majors prior to the repeal of Fin-Sin; afterwards, they almost entirely had vertically integrated majors as producers. Second, the nature of prime time movies changed. Movies of the Week were big events with large budgets and appeared in the top 30 shows consistently, accounting for about 10 percent of the total, until the end of the 1990s. They then dropped quickly out of sight. This was the period of the expansion of Basic cable movies.

The pattern of popularity helps to provide background for the analysis of awards – the Emmys. There are a very large number of categories across many different types of shows. The categories also change over time. A separate category for Made for TV Movies was not added until the 1990s, so there is no baseline. For the purposes of this analysis, I focus on the Emmys for Best Comedy and Drama. These are series of scripted shows, for which awards were consistently given, that most parallel movies and were available to independents.

Over the course of the 1980s there were 20 such awards given for each genre (see Exhibit VI-6). The distribution of the awards closely reflected the market share of the different types of producers. The point here is that if these awards represented an independent measure of quality, the independents held their own. The vertical restriction did not cause "inferior" products to be aired. With the repeal of Fin-Syn, independents were banished from these two categories of television entertainment and disappeared from the awards. As I have noted, their presence in prime time is now largely restricted to reality shows. The pattern of awards is similar to the other data we have seen: as Fin-Syn was under attack in the early 1990s the independents declined and were subsequently eliminated after repeal.

Exhibit VI-6:
Emmys for Best Comedy and Drama

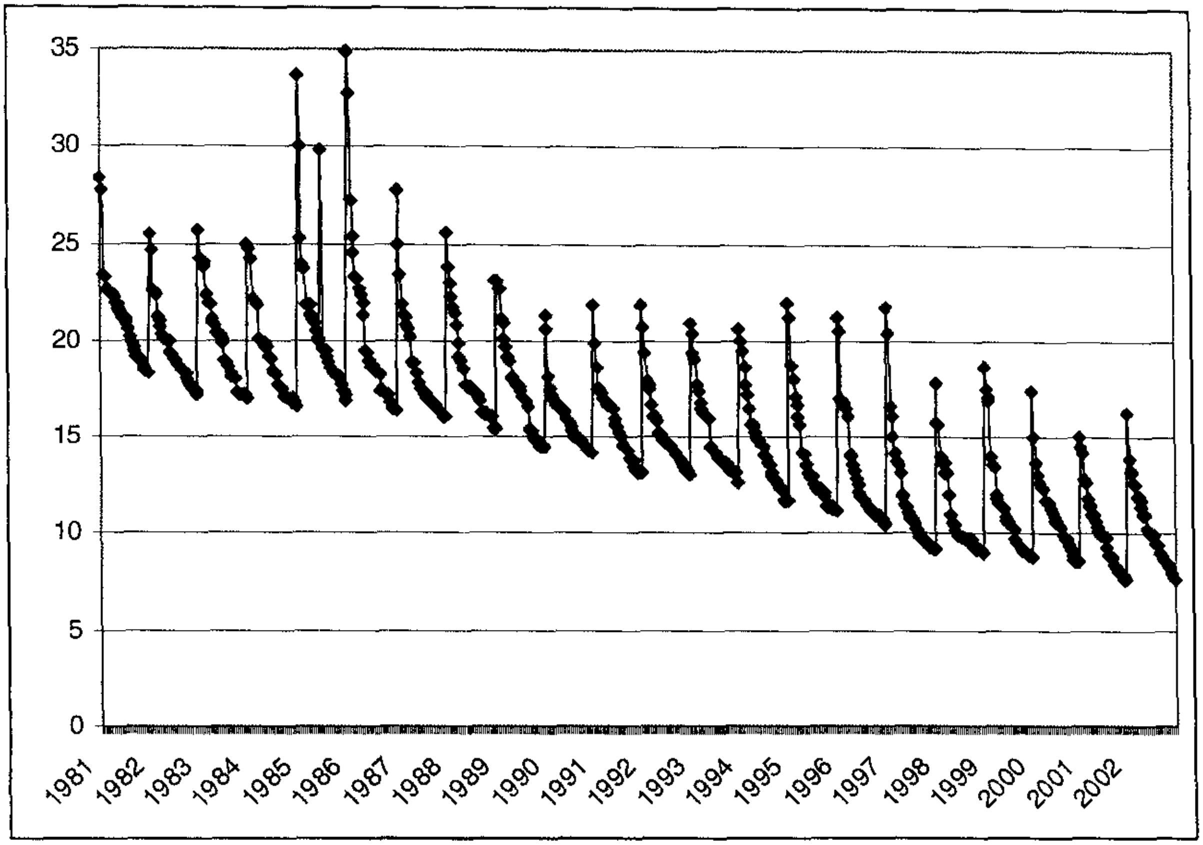
Producer	80-84	85-89	90-94	95-99	00-04
Independents	70	40	20	0	0
Networks	20	40	50	100	60
Majors	10	20	30	0	40

Source: Tim Brooks and Earle Marsh, *The Complete Directory to Prime Time Network and Cable TV Shows: 1946 – Present,* (New York: Ballantine, 2003), Appendix 3; Beta Study System database.

CONCLUSION

The debate over the impact of vertical integration on quality is difficult to resolve, as many factors were affecting the industry. Still, the pattern of declining ratings observed over a twenty year period is consistent with the claim that self-dealing had an impact (see Exhibit VI-7). The Exhibit shows the average rating of the top 30 shows for each year. There are two

Exhibit VI-7: Declining Ratings of the Top 30 TV Shows



Source: Tim Brooks and Earle Marsh, *The Complete Directory to Prime Time Network and Cable TV Shows: 1946 – Present,* (New York: Ballantine, 2003), Appendix 3; Beta Study System database.

shifts downward – one in the early 1990s, as the Fin-Syn rules came under attack; one in the late 1990s and early 2000s as the integration of major studios took place. The correlation with the changing pattern of program acquisition discussed earlier is clear. While the quantitative and qualitative evidence on quality cannot prove that vertical integration was the culprit in the decline of quality, it makes a strong case that independents were eliminated not because of an inability to produce high quality and popular content, but rather as a result of a poorly run marketplace for production.

VII. CONCLUSION: PUBLIC POLICY HAS UNDERMINED SOURCE DIVERSITY, WILL THE INTERNET CHANGE ANYTHING?

VERTICAL INTEGRATION TRUMPS TECHNOLOGY

This paper has shown that the policies adopted by the FCC and Congress in the 1990s lead to a dramatic decline in source diversity on broadcast television. In the early and mid 1990s, the Broadcast networks were given three huge advantages in the television video product space. First, they were given carriage rights on cable networks (1992). Second, the Financial Interest and Syndication Rules were repealed (1995). Finally, they were allowed to own multiple stations in a single market (1996). They used this leverage to extend their control over the video content product space vertically – by merging with studios – and horizontally – by self-supplying content in broadcast prime time and expanding distribution on cable.

A tight, vertically integrated oligopoly now dominates the broadcast, cable and theatrical space in America. Promises that prime time would not become dominated by the networks, and theories that claimed competition would prevent it, have proven misguided. Hopes that cable and its expanding capacity would create vibrant competition have been dashed as the incumbent broadcaster networks extend their reach over cable's viewers by demanding carriage and extending their brand control into the new space. While the purpose of this paper is to document what happened and why, it is clear that if policymakers still believe in source diversity, then a change in policy to promote it would be in order.

Previous technological changes have not been able to deconcentrate the product space. It has taken policy changes to break the stranglehold on distribution. Whether theaters in the

1940s or broadcasters in the 1970s, gate keeping has long been a powerful force in the industry.

Because of the high cost of producing movies and other video content, the aggregation of audiences remains a critical function. With such a powerful hold on all forms of video distribution, it will be extremely difficult to dislodge the dominant players. They are the established brands and continue to gain momentum in the premium, large audience outlets.

THE INTERNET AND DIGITAL BROADCAST PLATFORMS

While the history of the video entertainment product space is clear, as is the basis for adopting policies that promote source diversity, there is no doubt that policymakers who contemplate adopting such policies will be bombarded with claims that, even though the policies that affect the traditional video distribution channels have been disastrous, we need not be concerned because 'the Internet changes everything.'

This claim should be viewed with a great deal of skepticism. In fact, the more likely question that policy makers in this area should ask is "Do the Internet and the new digital era change anything?"

The best assessment at present is that "only a few small experiments in altering the movie-release paradigm have been conducted to date."[74] While the role of the Internet is currently unclear, one thing is certain. It is another distribution platform that the vertically integrated conglomerates are moving to dominate. Whether it will be able to de-concentrate the video exhibition space described in this section remains subject to debate. However,

[74] Thompson, Anne, "Independent Producers and Distributors," *Hollywood Reporter,* August 1, 2006, p. 1.

without sufficient regulation that provides equal access to all, the Internet will fall subject to the same fate as broadcast television, premium cable television, and finally basic cable television: domination by the vertically integrated oligopoly created by the regulatory changes of the last decade.

As we have seen, in a world with limited shelf space, placement is everything. If you cannot get on the shelf, the audience cannot find you. In a world of infinite shelf space, placement is *still* everything. When there is such a cacophony of outlets, the audience cannot find you unless you have prominent placement. Whether it is simultaneous release on multiple platforms or widespread digital distribution, the key challenge remains "finding a way to brand a movie." In the end, says producer Jim Stark, "Nothing beats five weeks in a theater."[75]

One need only review the critique of the launches of new Internet-based distribution platforms to see the problem in clear relief. The central questions are: what do their libraries look like? What are the majors doing with respect to the platform? If the majors are not there, the platform is deemed to have dim prospects. When the majors and networks are there, they tend to get the best placement and the best deals. Little has changed. They are the most prominent and have the resources to preserve that prominence. This is clearly reflected in the reporting on the announcement of Apple's "video streaming gadget code-named ITV"[76]

> Apple's competition included the movie studios themselves plus many other ambitious firms such as Amazon, which recently unveiled its Unbox download service.
>
> TV shows are also starting to turn up the online service for Microsoft's Xbox...

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[75] Thompson, p. 1.
[76] Ward, Mark, "Apple Video Divides Industry," *BBC News, September 13, 2006,* p. 1.

> Apple pre-announced its ITV box in a bid to convince potential partners that its ambitions are serious... it hoped to build "momentum" and get movie makers and broadcasters talking about putting content on the Apple service. For example, Amazon's Unbox offers movie downloads from 20th Century Fox, Paramount, Sony, Universal and Warner Bros. So far, only Disney movies are available from Apple.[77]

The quote from Les Moonves of CBS above, which touted the advantages that broadcasters have, was actually given in response to claims that the Internet was displacing the networks. Responding to the claim that broadcast share would shrink, Moonves said "If you want 30 million people, you can't get that anywhere else...Television will hold and the Internet will augment what we do."[78]

Dana Walden of 20th Century Fox TV echoes this view. "In the digital space, the extensions seem to come after the fact. We're trying to create brands on the (broadcast) networks that are enhanced by digital opportunities."[79]

While the potential and prospects are unclear, the reaction to a new technology is predictable and the studios and networks will seek to extend their gatekeeper function. Already, as one recent article observed, "studio business affairs executives now were insisting that this exclusivity [in rights to distribute] include the Internet as well."[80]

Thus, the Internet has not done much to break the grip of the vertically integrated oligopoly on the video revenue streams in the video entertainment product space. As the independent producers emphasized in the interviews, these firms control the TV outlets and syndication, have the output deals for domestic and foreign theatrical releases, and have a

[77] Ward, p. 2.
[78] Fabrikant and Carter, p. C11.
[79] "A TV Navigation Guide," *Hollywood Reporter,* September 13, 2006, p. 2.
[80] Hlestand, Jesse, "Profit Anticipation," *Hollywood Reporter,* June 6, 2006, p. 1.

huge advantage in foreign TV deals. They control the branding process with their access to audiences that is being leveraged into dominance of commercial distribution on the Internet.

Given the history of gate keeping in the industry and these observations on the impact of Internet distribution, the advent of digital TV, which will increase the number of channels the broadcasters control as much as six fold, does not hold much promise to deconcentrate the TV sector. Broadcasters, who have leveraged a series of favorable policies into domination of the video entertainment product space, will now have more resources to strengthen their position, enrich their brands and repurpose their content across another distribution channel. Technological change and an increase in distribution capacity have repeatedly failed to restrict the gate keeping power of vertically integrated entities in this product space.

CONCLUSION

If policymakers value source diversity, which they should, structural restraints on the market power of the vertically integrated companies will have to be imposed. These structural restraints will have to apply to both the broadcast and cable distribution channels because public policy created the leverage that broadcasters have used to dominate the cable distribution platform. The restraints should also apply to the Internet and all other developing distribution technologies.