ethnicity in Nielsen's report. Adults aged 25-34 spend the most time each day watching video online (53 minutes).[1037] Hispanics and African Americans spend 34 minutes each day watching video online.[1038]

325. *Subscribership.* According to comments filed in this proceeding, Netflix maintains that it is the largest online video subscription service in the United States, with more than 23 million subscribers as of June 2011. It doubled its subscribership from the end of 2009 through the middle of 2010.[1039] According to one report, at the end of the 2011, Netflix had approximately 20 million streaming members in the United States, Canada and Latin America.[1040] Hulu Plus supported only 875,000 subscribers as of the second quarter 2011.[1041] Industry reports indicated that Hulu suffered a loss in subscribers as a result of changes the firm made in 2011 to pricing and other core structural changes.[1042]

326. *Consumer Purchase Transactions.* Based on a combination of movie electronic sell-through and Internet VOD revenue, IHS Screen Digest estimates that Apple maintains the lion's share of the consumer transactional market, with Microsoft Zune Video Marketplace, Wal-Mart Vudu, Sony Playstation Store, and Amazon rounding out the top five positions in terms of market share.[1043] IHS notes that iTunes's increase of one percent contrasts with its decline of 12 points from the first half of 2009 to the first half of 2010. Apple's iTunes garnered 64.9 percent of market share in 2010 and 65.8 percent in 2011. The next largest market share was reported by Microsoft's Zune with 18.5 percent in 2010 and 16.2 percent market share in 2011. Wal-Mart's Vudu had 1.0 percent of the market in 2010, and 5.3 percent market share in 2011.[1044]

b. Revenue

327. There are multiple potential sources of revenue for online video distribution, including subscription fees from consumers; in-video advertising; display advertising around the video; product placement; advergaming;[1045] and branded entertainment.[1046] We examine each of these in turn below.

[1037] *Id.* at 7.

[1038] *Id.*

[1039] Netflix6/8/11 Comments at 2. In March 2010, Netflix reportedly had 14 million subscribers. *See* Ed Carson, *Born in the USA: Top 5 American Stocks in IBD 100*, Investors.com, May 17, 2010, http://blogs.investors.com/capitalhill/index.php/home/35-politicsinvesting/1761-born-in-the-usa-top-5-american-stocks-in-ibd-100 (visited Mar. 9, 2012). Nielsen reports that 89 percent of Hulu users watch video programming using a computer and 20 percent of Hulu users watch video programming using a computer connected to a television. Nielsen, State of the Media Report, *Consumer Usage Report 2011*, at 3 ("Nielsen 2011 Consumer Usage Report").

[1040] Netflix, Inc., *Netflix and Disney-ABC Television Group Announce Extension of Existing Licensing Agreement to Stream TV Shows* (press release), Oct. 31, 2011.

[1041] Vision2mobile Special Report, *New Television Viewing Models*, Aug. 2011, at 20.

[1042] *See* Christina M. Mitchell, *Yahoo, Netflix a Match?,* SNL Marketweek, Jan. 6, 2012. However, Netflix has reported that domestic streaming and DVD gross cancellations have steadily declined during October and November 2011. *See* Haseeb Ali, *Netflix Provides Negative 2012 Outlook; Streaming, DVD Cancellations Decline*, SNL Kagan, Nov. 23, 2011.

[1043] IHS, *iTunes Gains Share in Online Movies in First Half of 2011* (press release), Aug. 22, 2011.

[1044] *Id.*

[1045] Advergaming, a type of niche marketing, is the practice of inserting paid advertisements in a video game.

[1046] AD AGE White Paper at 4.

328. *Advertising.* Advertising is included with a variety of online video content formats, including television shows, news, short clips, and sports content.[1047] Media buyers are purchasing online video advertising often as an add-on component to traditional television ad purchases. Some experts speculate that, even though the television advertising market is still far and away the dominant media venue for advertising,[1048] it is a marketplace that has likely peaked in terms of the size of the viewing audience, while the online viewing audience is expected to continue growing.[1049] Additionally, advertisers value online video ads because the system allows advertisers to gather information and details about consumer engagement, time spent with the brand, and sharing that are not always readily available with other sources of advertising.[1050]

329. The Interactive Advertising Bureau (IAB) reports that in the 3rd quarter of 2011 Internet advertising reached $7.88 billion, a 22 percent increase over the same period in 2010.[1051] EMarketer reports that total U.S. online ad spending amounted to $32 billion in 2011, and that it expects online ad spending to grow in 2012 by potentially as much as 23 percent to $39.5 billion.[1052] Screen Digest estimated that the four major broadcast networks earned about 50 percent of the total $448 million in advertising-supported online video advertising dollars in the United States in 2008, and an additional 25 percent went to the websites of the cable networks.[1053]

330. ComScore estimates that U.S. Internet users saw 5.3 billion video advertisements in June 2011.[1054] Additionally, slightly more than two billion total ad minutes were viewed during this same time period, with each unique viewer exposed to approximately 35 ads each. This online video advertising content reached 49.2 percent of the U.S. population. ComScore includes in this category streaming video advertisements only, not other types of video monetization such as overlays, branded players, matching

[1047] *See, e.g.*, Pete Barlas, *Video Ad Spending Finally Getting Into the Picture*, INVESTOR'S BUSINESS DAILY, May 14, 2010.

[1048] In 2009, advertisers spent $908 million on U.S. online video advertising compared to the $68.9 billion spent on U.S. television advertising during that same period. *See id.*

[1049] Advertising executive Matt Wasserlauf, of online ad agency BBE, has indicated that, "TV viewership has leveled off and viewership is growing in online video." *See id.* Sports programming promises to become a growth sector in online video. NBC announced that the 2012 Super Bowl would be streamed free of charge over the Internet for the first time and would also be available on Verizon's Mobile NFL Wireless apps. *See* Priya Kanwar, *Watch Super Bowl XLVI 2012 and Other Sports Live Streaming Free on Mobile Phones*, Technorati, Jan. 9, 2012, http://technorati.com/technology/article/watch-super-bowl-xlvi-2012-and/ (visited Mar. 9, 2012).

[1050] *See, e.g.*, Jon Erickson, *Measuring the Total Economic Impact of Customer Engagement*, Forrester Consulting, Sept. 2008; *see also Marketing and Advertising Using New Media*, Baruch New Media, Feb. 27, 2012, http://baruchnewmedia.com/wiki/Marketing_and_Advertising_using_New_Media (visited Mar. 9, 2012).

[1051] Interactive Advertising Bureau, *Q3 '11 Internet Advertising Revenues Up 22% from Year Ago, Climb to Nearly $7.9 Billion, According to IAB and PwC* (press release), Nov. 30, 2011.

[1052] eMarketer.com, *US Online Ad Spend to Close in on $40 Billion*, Jan. 19, 2012, http://www.emarketerl.com/Article.aspx?id=1008783&R=1008783 (visited Mar. 9, 2012).

[1053] IBE, *Major US Broadcaster-Backed Online Networks Claim Lion's Share of Free Online TV*, July 9, 2009, http://www.ibeweb.com/ibe-news/major-us-broadcaster-backed-online-networks-claim-lions-share-free-online-tv (visited Mar. 9, 2012).

[1054] comScore, Inc., *comScore Releases June 2011 U.S. Online Video Rankings*, July 15, 2011, http://www.comscore.com/Press_Events/Press_Releases/2011/7/comScore_Releases_June_2011_U.S._Online_Video_Rankings (visited Mar. 9, 2012). In Table 24, for example, video viewers watched 424 million minutes in the month of June 2011, according to the chart for total U. S home/work/university locations.

banner ads, or homepage ads.[1055] The comScore data also includes several video advertising networks, such as Tremor Media Video Network, BrightRoll Video Network, Specific Media, Undertone and SpotXchange Video Ad Network as well as Adap.tv, a video advertising exchange.[1056] The leading five websites and advertising networks for video ads viewed during June 2011 were: (1) Hulu, one billion ads viewed; (2) Tremor Media Video Network, 753 million ads viewed; (3) Adap.tv, 677 million ads viewed; (4) BrightRoll Video Network, 628 million ads viewed; and (5) Specific Media, 421 million ads viewed.[1057]

Table 24: Top U.S. Online Video Properties by Video Ads Viewed (June 2011)[1058]

Property	Video Ads (in thousands)	Total Ad Minutes (millions/month)	Frequency (Ads per Viewer)	Reach of Total U.S. Population (%)
Hulu	1,001,736	424	38.8	8.6%
Tremor Media Video Network	753,034	429	12.1	20.7%
Adap.tv	677,708	386	11.0	20.5%
BrightRoll Video Network	628,600	396	9.5	21.9%
Specific Media	421,722	214	6.8	20.4%
Undertone	332,597	171	13.2	8.3%
SpotXchange Video Ad Network	281,859	171	7.8	11.9%
Viacom Digital	275,230	134	10.4	8.8%
Microsoft Sites	226,951	125	9.2	8.2%
AOL, Inc.	217,347	85	7.3	9.9%
Total:	**5,286,917**	**2,286**	**35.6**	**49.2%**

331. Although its revenues declined in the early part of the studied period, the availability of professional content has enabled YouTube to win back advertisers. YouTube has indicated that, as of January 2010, it sells ads for more than 10 percent of U.S. video streams, up from six percent in January 2009. In May 2010 it reported that it had increased the number of advertisers using display ads by a factor of ten. YouTube typically charges a CPM of $15.[1059] For its music channel, Vevo, it charges a CPM ranging from $25 - $35. Branded sites, such as ESPN's channel, can earn a CPM of $22. YouTube can earn about $400,000 per day from advertisements on its home page, and generates about $10 million per month from advertising on its home page alone.[1060]

332. Hulu's free online service generates revenue from advertising sales based on the number of consumers that view ad impressions on Hulu.com; from video streams; from its distribution partners'

[1055] *Id.*

[1056] *Id.*

[1057] *Id.*

[1058] comScore Video Metrix.

[1059] Cost per mille (CPM), also referred to as cost per thousand impressions, is a common advertising model. *See supra*, ¶ 192.

[1060] AD AGE White Paper at 9.

websites; and from the embeddable Hulu video player.[1061] Hulu Plus generates revenues from advertising as well as its subscription fees. Hulu currently partners with more than 625 advertisers.[1062] The process by which the networks sell inventory within the programs they distribute on Hulu, however, differs substantially from their traditional process. For example, broadcast networks typically prohibit Hulu from selling specific shows to advertisers. Instead, Hulu offers advertisers access to viewers across many shows, *i.e.*, "run-of-schedule."[1063] Because Hulu cannot guarantee placement in specific shows, it charges lower CPMs than the broadcast network websites (*e.g.*, an average $35 CPM versus $45 for ABC.com).[1064]

333. The broadcast networks, which are equity owners of Hulu, receive 70 percent of the advertising revenue sold on their programs,[1065] while other program suppliers receive between 50 percent and 70 percent.[1066] Press reports have estimated that Hulu sells out about 50 percent of its inventory.[1067] In 2009, Hulu earned $100 million, and was profitable during the fourth quarter of 2009 as well as the first quarter of 2010.[1068]

c. Investment

334. As a nascent business model in the provision of video content, the OVD industry's investment perspective is defined by new content and distribution deals and transactions. As previously discussed, OVDs are entering new partnerships and innovating in products and services in order to retain and attract consumers.[1069] Whether it be the joint venture between Redbox and Verizon or YouTube's partnership with *The Wall Street Journal* and others to create 100 new linear channels, these deals, transactions, and partnerships, as much as any other capital expenditures, demonstrate the investments that companies are making to foster the growth of the OVD sector.

[1061] *See* Hulu FAQ.

[1062] *See* About Hulu.

[1063] Hulu divides its advertising into three formats. As part of its standard ad formats, Hulu sells spots in 15- and 30- second increments, which run before, during, or after an ad break. Other standard ad formats include overlay brand bars, which appear over the content at the bottom of the video, and include a logo and targeted message that enable the user to play a full ad, and overlay logo bugs, which appear in the bottom right corner of the screen that users can opt in to play the full video ad. *See id.*

[1064] *See* AD AGE White Paper at 7 & Chart 7 at 12. This compares with a CPM of less than $20 for a typical broadcast network viewed on a television set via a broadcast station or MVPD. Hulu typically limits sponsorship to one advertiser per episode, which commands ad rates that are up to twice as high for the same ad per thousand viewers than broadcast rates.

[1065] AD AGE White Paper at 8-9.

[1066] Brian Stelter and Brad Stone, *Successes (and Some Growing Pains) at Hulu*, N.Y.TIMES, Mar. 31, 2010, http://www.nytimes.com/2010/04/01/technology/01hulu.html?dbk (visited Mar. 9, 2012) ("Hulu Successes").

[1067] Michael Learmonth, *Hulu's a Towering Success – Just Not Financially*, ADVERTISING AGE, Mar. 29, 2010, http://adage.com/digital/article?article_id=143011 (visited Mar. 9, 2012); *see also* Brian Morrissey, *Hulu Makes Inroads*, ADWEEK DIGITAL, Oct. 15, 2009, http://www.adweek.com/aw/content_display/news/digital/e3i505f5fdeedc76b4275cd6041e29e5fcd (visited Mar. 9, 2012).

[1068] Hulu Successes.

[1069] *See, e.g., supra*, ¶ 304.

d. Profitability

335. Many of the prominent OVDs are subsidiaries or operations within a larger business. Because the assets, liabilities, revenues and expenses of the parent company and the subsidiaries are often presented in consolidated financial statements that are reflective of the total resources of the combined entity rather than any of its specific component parts, assessing the profitability of a subsidiary of a larger enterprise is extremely difficult. Even with respect to the standalone OVDs, we either do not have access to their financial information or, if we do, the publicly available information does not include the specifics that are necessary to analyze the OVD's profitability. Thus, for this Report, we are unable to conduct an analysis of the profitability of OVDs. As OVDs continue to mature and evolve, we anticipate that future public reporting may include data on profitability and other metrics to assess the financial viability of this segment of the delivered video market.

5. Consumer Behavior

336. In this section of the Report, we consider how trends in consumer behavior affect the products and services of OVD providers of delivered video content and other categories of video content. Recent data illustrate which consumers are heavy OVD users and how that use affects other types of video content services.

337. Nielsen's *Cross-Platform Report* indicates that, unlike the near-universality of television watching, viewership of streaming video content is highly concentrated – 83 percent of all streaming takes place among the top fifth of consumers who stream.[1070] Males aged 18 – 49 years old spent the most time per month viewing Internet video content (six hours, 38 minutes per month) during the second quarter of 2011. Males aged 2 and older spent the second highest amount of time per month viewing Internet video content (five hours, 5 minutes per month) during the same quarter. Females aged 18 – 49 years old spent the third highest amount of time per month viewing Internet video content (four hours, 47 minutes per month) during the same quarter.[1071] Asian Americans spent the largest amount of time during the second quarter of 2011 watching video content on the Internet (nine hours, 11 minutes per month); followed by Hispanics (six hours, 15 minutes per month); African Americans (five hours, 58 minutes per month) and Whites (three hours, 50 minutes per month).[1072] Moreover, Americans are increasingly turning to mobile devices to access video content. Nielsen reports an increase of 36.9 percent in mobile video users from third quarter 2010 to third quarter 2011.[1073]

338. In its *2011 Consumer Usage Report*, Nielsen describes the primary methods Americans use to watch television or video content. Traditional television is the dominant device for video consumption as 288 million viewers ages two and up use this method.[1074] The data also show that other methods register far behind traditional television in how consumers watch video: Internet, 143 million;

[1070] Nielsen State of the Media, *The Cross-Platform Report Quarter 2, 2011*, at 2.

[1071] *Id.* at 6.

[1072] *Id.* at 7. Nielsen's 2011 annual data indicates that among consumers ages 13 and over, 232 million use a mobile phone; 211 million use online; 192 million use a personal computer or laptop at home or at work; and 116 million use mobile web. Nielsen 2011 Consumer Usage Report at 1.

[1073] Nielsen Q3 2011 Cross-Platform Report at 5.

[1074] Nielsen 2011 Consumer Usage Report at 2.

time-shifted television, 111 million;[1075] and mobile phone, 30 million.[1076]

339. For years, viewers switched from over-the-air broadcast television to subscribe to cable (and sometimes back again), and more recently, switched between MVPDs to the extent available. The growth and availability of OVDs adds another layer of choice that can be a complement or a substitute.[1077] Many consumers of video programming maintain multiple relations with providers of such services, and can easily shift their spending from one to another.[1078]

340. The record in this proceeding and recent data are mixed regarding the effect of OVDs on the market for the delivery of video programming. Driving the debate are competing explanations for the recent relative drop-off in MVPD video subscribership, the extent of which itself is unclear.[1079] However, MVPDs increasingly acknowledge that consumers will find and watch content that appeals to them even if such content is not provided on major broadcast or cable networks or carried on cable television.[1080] They recognize that the marketplace is already providing a range of alternative equipment and technology to stream content directly from the Internet or from a networked computer to television sets.[1081] Many of these devices, which are used with television sets for other purposes such as gaming devices, DVRs, and Blu-ray players, enable consumers to find and stream Internet content to their sets without requiring the use of a computer.[1082] And, television sets are increasingly incorporating such Internet access. Sales of such sets are rapidly increasing and are projected to exceed 118 million only a few short years after their introduction. Also, iPads and other tablets have emerged as highly popular alternatives for watching online video. Moreover, consumers now have wider choice among standalone devices dedicated to receiving Internet content on television sets. For example, VeeBeam uses a wireless USB point-to-point connection between a laptop and a television, which enables consumers to transmit anything that is on

[1075] The proportion of viewers using time-shifted television grew 11 percent since the second quarter of 2010 according to Nielsen's data. *Id.*

[1076] *Id.* Regarding device ownership, Nielsen reports that 290 million people own at least one television; 253 million own a DVD player; 162 million own a video game console; 145 million have digital cable; 129 million have a DVR (digital video recorder) and 95 million have satellite television. *Id.* at 1.

[1077] Public Knowledge 6/8/11 Comments at 6 ("in practice online video remains complementary to traditional MVPD or broadcast programming, for most viewers"); *id.* at 10 ("whether OVDs compete with MVPDs is a complex question. In some ways they do and in other ways they do not."). *See also* John Hudson, *Cable is Still King, Says Netflix CEO*, The Atlantic Wire, June 1, 2011 (citing Netflix CEO Reed Hastings that "[s]tatistically, no one is dropping cable"), http://www.theatlanticwire.com/technology/2011/06/cable-still-king-says-netflix-ceo/38369/ (visited Mar. 9, 2012).

[1078] *See* Netflix 2010 Form 10-K at 1-2.

[1079] *See* George Szalai, *Analyst: Pay TV Industry to Lose 200,000 Subscribers in 2012*, THE HOLLYWOOD REPORTER, Nov. 28, 2011 (citing Credit Suisse analyst Stefan Anninger), http://www.hollywoodreporter.com/news/analyst-pay-tv-industry-lose-266589 (visited Mar. 9, 2012); *see also* Bloomberg News, *Comcast Profit Advances 16% as Video-Subscriber Losses Slow*, L.A. TIMES, Aug. 3, 2011 (citing Craig Moffett of Sanford C. Bernstein & Co.). *See supra*, ¶ 142 (from 2006 through 2010, cable MVPD video penetration decreased from 53.8 percent of all homes passed by cable MVPDs to 46.5 percent).

[1080] NCTA 6/8/11 Comments at 20.

[1081] This is sometimes referred to as over-the-top viewing. Nielsen describes over-the-top as the use of devices that piggyback on normal distribution channels (cable, satellite, etc.) to pull content directly from the Internet and deliver it to the television set. The equipment can include consumer devices such as DVD players, video game consoles and web-enabled televisions. Nielsen Cross-Platform Report Q3 2011, *Glossary*.

[1082] NCTA 6/8/11 Comments at 24.

their computer screen wirelessly to their television set.[1083] Likewise, other technologies, like the Google TV and Roku devices, provide direct links to major sources of Internet content (such as Hulu, Netflix and Amazon).[1084]

341. Some reports indicate that OVD users are beginning to "cut the cord" and drop their MVPD service in favor of OVD or a combination of OVD and over-the-air television.[1085] One survey contends that nine percent of respondents have already cancelled their cable subscriptions and an additional 11 percent have stated that they are considering doing so.[1086] Cord-cutters, as this group is referred to, tend to be younger consumers, 23–28 years old. Thirteen percent of GenXers indicate that they were considering cutting the cord and seven percent of baby boomers state that they have also considered it.[1087] Twenty-two percent of the survey respondents indicated that they had watched their "favorite TV show" on a free online video site, and 21 percent stated that they had viewed that same show on its own video site.[1088] Additionally, according to one estimate, 13 percent of consumers with a broadband connection "cord-shaved" in the past year.[1089] These data notwithstanding, there are also indications that increased viewing of video content delivered over the Internet does not necessarily

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[1083] *Id.*

[1084] *Id.*

[1085] *See* Ian Olgeirson and Deana Myers, *Over-the-top Substitution Forecast to Erode Multichannel Penetrations*, SNL Kagan, July 15, 2011 (estimating that nearly 4 percent of occupied U.S. households will employ Internet video in lieu of subscribing to a multichannel video package at year-end 2011); *see also* Terrance O'Brien, *Netflix Users More Likely to Cut the Cable Cord*, Jan. 15, 2011, http://www.switched.com/2011/01/05/netflix-users-more-likely-to-cut-the-cable-cord/ (citing a JP Morgan survey that 28 percent of cable subscribers would consider cutting the cord, but that 47 percent of Netflix customers would do so) (visited Mar. 9, 2012); *see also* Andy Plesser, *Roku Owners are 'Cutting the Cord' in Substantial Numbers*, Beet.TV, May 10, 2011, http://www.huffingtonpost.com/andy-plesser/roku-owners-are-cutting-t_b_860280.html (citing interview with Jim Funk of Roku that "[s]ome 15-20 percent of Roku owners are cancelling their cable or satellite services agreement and are relying solely on a broadband connection to get their television programming") (visited Mar. 9, 2012).

[1086] Ryan Lawler, *Deloitte: 9% Have Cut Cable, Another 11% Are Considering It*, GigaOm, Jan. 4, 2012, http://gigaon.com/video/deloitte-cord-cutting/ ("GigaOn Deloitte Report"); *see also State of the Media Democracy Survey, Sixth Edition*, http://www.deloitte.com/view/en_US/us/Industries/media-entertainment/media-democracy-survey-sixth/index.htm?id=us_furl_tmt_somd_010312 (visited Mar. 9, 2012).

[1087] GigaOn Deloitte Report.

[1088] *Id.*

[1089] Cord-shaving generally refers to a downgrading of pay video services from the subscriber's MVPD. *See* Parks Associates, *High-speed Broadband May Accelerate Cord Cutting*, Aug. 24, 2011, http://www.parksassociates.com/blog/article/high-speed-broadband-may-accelerate-cord-cutting (visited Mar. 9, 2012). *See also, e.g.*, Brian Santo, *A Shave and a Service Cut – Two bits*, CED , Oct. 26, 2011, http://www.cedmagazine.com/blogs/2011/10/a-shave-and-a-service-cut-%E2%80%93-two-bits (visited Mar. 9, 2012). One commenter explains that viewing Internet content on a television set can be relatively simple, as "simple as connecting a cable between the HDMI output of a computer and the HDMI input of a television set" though not many consumers may be inclined to view television programming in this manner. Such direct PC-to-TV connections are deemed infrequent and restricted to tech-savvy consumers, with approximately one-third of broadband users connecting a PC to their TV to enjoy PC or online video on "the big screen" at least once a year. *See* NCTA 6/8/11 Comments at 23-24. *See also id.* at 24-5 (citing The Diffusion Group, *PC-to-TV Connectivity More Widespread Than Perceived*, Mar.1, 2011, http://tdgresearch.com/blogs/press-releases/archive/2011/03/01/pc-to-tv-connectivity-more-widespread-than-perceived.aspx).

translate into decreased MVPD subscriptions.[1090] In that regard, a recent survey indicates that, while more than 50 percent of online consumers watch television shows and movies online at least occasionally, there is still growth in their use of VOD, DVR, and other MVPD-provided options and that, surprisingly, the more alternative platforms consumers use, the more they tend to spend on traditional television subscription services.[1091]

342. Although OVDs have begun to make inroads against traditional distributors, online viewership is still dwarfed by its traditional distributors.[1092] According to Nielsen, Americans watched on average 32 hours and 47 minutes a week of traditional television and two hours and 21 minutes a week of time-shifted television, compared to 27 minutes a week of video on the Internet, and only 7 minutes a week of video on a mobile phone.[1093] Screen Digest estimated that all of the a la carte sales of television shows from Apple, Amazon, and other OVD competitors would amount to only $407 million in 2010, compared to what PriceWaterhouseCoopers estimates would be the $143 billion spent on television advertising and subscriptions.[1094]

IV. RURAL VERSUS URBAN COMPARISONS

343. In this portion of the Report, we compare video programming competition in rural and urban areas.[1095] We discuss this issue for each of the three categories of video programming discussed above – MVPD, broadcast, and OVD.

344. The availability of satellite-delivered video programming in rural and underserved areas is a goal of Section 628(a) of the Act.[1096] In the *15th Mobile Wireless Report*, the Commission adopted a "baseline" definition of the term "rural" to mean a county with a population density of 100 persons or fewer per square mile.[1097] Under this definition, roughly 61 million people, or 21 percent of the U.S. population, live in rural counties. These counties comprise 3.1 million square miles, or 86 percent of the geographic area of the United States.[1098] We adopt this definition for our analysis.[1099] Because data on the delivery of video programming are not generally available in a manner that enables us to aggregate

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1090 Franks N. Magid Associates, Inc., *Magid Study: Consumers More Connected to TV Sets Than Ever - TV Purchase Intentions Climb to Pre-Recession Levels, Demand for Smart TVs Impressive* (press release), Nov. 22, 2011. Magid surveyed a nationally representative sample of 1,530 online consumers ages 12 years and older in October 2011 in order to track consumer trends in regards to television, HDTV, 3-D TV, online video and mobile video viewing for this annual survey.

1091 *Id.*

1092 For example, Netflix identifies its principal competitors as including MVPDs with TV Everywhere and VOD content; Internet movie and television content providers; DVD rental outlets and kiosk services; and entertainment video retailers. *See* Netflix 2010 10-K at 2.

1093 Nielsen Cross-Platform Report Q2 2011 at 5.

1094 Fowler & Schechner at B1.

1095 *See Further Notice*, 26 FCC Rcd at 14113-15, ¶¶ 56-58.

1096 47 U.S.C. § 548(a) ("The purpose of this section is . . . to increase the availability of satellite cable programming and satellite broadcast programming to persons in rural and other areas not currently able to receive such programming . . .").

1097 *15th Mobile Wireless Report*, 26 FCC Rcd at 9878, ¶ 378.

1098 *See id.* at 9878, ¶ 379. These figures are based on 2000 Census data. *See id.* at 9880, n. 1126.

1099 *See Further Notice*, 26 FCC Rcd at 14113-14, ¶ 56. We received no comments on our proposal to use the same definition as that used in the Wireless Competition Report, *supra*, n. 1097.

county data by population density, we rely on available evidence provided in the record or from other sources to compare alternatives for the delivery of video programming between rural and urban areas.

A. MVPDs

345. MVPDs serving rural and smaller markets provide a range of services to millions of households, including video via coaxial cable and Internet Protocol television ("IPTV"), digital telephony, and broadband Internet access.[1100] ACA reports that its membership of nearly 900 cable operators provides these services to 7.6 million households and businesses,[1101] with more than half of its members serving fewer than 1,000 subscribers.[1102] Many rural MVPDs indicate that they face unique challenges in offering competitive video, voice, and broadband services due to the cost of system build-outs and upgrades in less densely populated areas with a limited consumer base.[1103] For instance, NTCA, a trade association representing more than 580 rural telecommunications providers, states that 252 of its members offered cable service in 2010, a decrease from 2007 when 276 members offered this service.[1104] In addition, NTCA notes a decline in the number of its members selling DBS service. In 2007, 106 of its members sold DBS service, and in 2010, the figure dropped to 66.[1105]

346. NTCA has, on the other hand, seen a rise in the number of its members delivering IPTV – from 61 members in 2007 to 159 in 2010.[1106] NTCA and other rural associations predict this number is likely to increase as the number of members offering broadband service rises.[1107] Overall, NTCA reports that its members are facing increasing competition in the delivery of video services. A 2009 informal NTCA poll indicated that 58 percent of respondents reported facing competition from a cable operator, 92

[1100] *See* ACA 6/8/11 Comments at 1; NTCA 5/20/09 Comments at 1-2.

[1101] *See* ACA 6/8/11 Comments at 1.

[1102] *See* ACA 7/29/09 Comments at 3.

[1103] *See, e.g.*, ACA 6/8/11 Comments at 2. OPASTCO and NTCA also explain that many rural carriers need to share headends to provide video services given the substantial financial cost of entering the video services market. They claim that this business model is threatened, however, by the practice of some programming networks to deny cable or IPTV systems that share headends access to programming. *See* OPASTCO 7/29/09 Comments at 20-21; NTCA 5/20/09 Comments at 11-12. In addition, OPATSCO claims that some networks have denied rural MVPDs using an IPTV platform access to their content or imposed unnecessary expenses based on perceived security concerns. *See* OPASTCO 7/29/09 Comments at 21. Using U.S. Census data as of 2000, the California PUC further reports that a significantly higher percentage of California's rural census blocks are either unserved or served by a single state video franchisee or locally franchised affiliate. In comparison, over 86 percent of California's census blocks with two or more providers are urban. *See* California PUC 6/8/11 Comments at 1-4.

[1104] *See* Rural Associations 6/8/11 Comments at 1 nn. 1 & 2. These results are based on a 2010 survey of NTCA's membership. *See id.* at 2.

[1105] *See id.*

[1106] *See id.*

[1107] *See id.* The Rural Associations view broadband and the provision of video service as key components to their long term viability. *See id.* at 2-3. An NTCA 2008 survey on the offering of broadband services ("2008 Broadband Study") indicated that rural telcos saw video as a "must have offering" for success in a competitive market. Almost two-thirds of respondents already provided video to customers – an increase from 63 percent in 2007 and 42 percent in 2005. Almost 80 percent of rural telcos with future video plans aimed to offer IPTV service. *See* NTCA 5/20/09 Comments at 3.

percent faced competition from a satellite provider, and six percent faced competition from an IPTV provider.[1108]

347. Organization for the Promotion and Advancement of Small Telecommunications Companies ("OPASTCO"), a trade association representing 520 small incumbent LECs serving rural America, found in a 2009 survey of its members that 74 percent of respondents offered subscription video service.[1109] Almost half of the respondents who did not offer video service indicated that they were likely to offer it in the near future.[1110] Sixty-nine percent of survey respondents also indicated that they faced direct competition from one or more non-satellite video providers.[1111] Among these respondents, 22 percent indicated that they competed with two or three non-satellite video providers.[1112]

348. Nielsen finds that rural counties tend to rely on DBS more than urban counties for MVPD services. Nielsen categorizes counties based on Census household counts and proximity to metropolitan areas. It estimates that, as of the end of 2010, the distribution of television households was as follows: 40 percent in highly urbanized counties belonging to the 21 largest Metropolitan Statistical Areas (A Counties); 31 percent in counties with more than 85,000 households that are not defined as A Counties (B Counties); and 29 percent in counties with fewer than 85,000 households (C and D Counties).[1113] According to Nielsen's 2011 estimates, in A Counties, 69 percent of television households relied on cable service and 23 percent of television households relied on DBS. Sixty-four percent of television households in B Counties subscribed to cable and 26 percent subscribed to DBS. In C and D counties, 48 percent of television households relied on cable service, compared with 42 percent who subscribed to DBS.[1114]

349. One of the biggest challenges small and rural MVPDs report facing is access to video content at competitive rates. These MVPDs indicate that a failure to acquire programming at competitive prices and terms reduces their ability to provide consumers with competitive and affordable video service offerings meeting the economic needs of the community.[1115] For example, several small and rural MVPDs contend that, to gain carriage rights to the most popular networks, they are required by the owners of those networks to carry less-popular co-owned networks on an expanded basic tier.[1116] The

[1108] *See* NTCA 5/20/09 Comments at 3.

[1109] *See* OPASTCO 7/29/09 Comments at 1, 3.

[1110] *See id.*

[1111] *See id.* at 4.

[1112] *See id.*

[1113] *See* Nielsen 2010 & 2011 Television Audience Report at 6. Nielsen classifies C Counties as counties not defined as A or B counties that have more than 20,000 households or are in Consolidated Metropolitan Statistical Areas or Metropolitan Statistical Areas with more than 20,000 households. Nielsen classifies D counties as all counties not classified as A, B, or C counties; they are very rural. *See* Nielsen Media Research, *Glossary of Media Terms* (defining Nielsen's classifications of A, B, C, and D counties), http://www.nielsenmedia.com/glossary/ (visited Mar. 21, 2012).

[1114] *See* Nielsen 2010 & 2011 Television Audience Report at 6.

[1115] *See, e.g.*, Rural Associations 6/8/11 Comments at 5-9; ACA 6/8/11 Comments at 5-10; Rural Telcos 6/8/11 Comments at 3-13; SureWest 7/8/11 Reply at 4-5; NTCA 5/20/09 Comments at 6; OPASTCO 7/29/09 Comments at 10-13.

[1116] *See, e.g.*, Rural Telcos 6/8/11 Comments at 3-4, 8; ACA 5/20/09 Comments at 9. The Rural Telcos also indicate that failure to accept such an agreement results in pricing penalties, and that some programmers now force them to carry HD and 3D channels. *See* Rural Telcos 6/8/11 Comments at 4, 8.

rural MVPDs claim that these program "tying" and tiering requirements impose on them unreasonably high wholesale costs for programming in comparison to incumbent cable operators, which they then pass on to consumers.[1117] ACA suggests that small and medium-sized MVPDs pay 30 percent more for national cable network programming than major MSOs.[1118]

350. In addition, several small and rural MVPDs contend that some programmers condition access to traditional cable networks, such as ESPN, on payment for distribution of the online version of the network, such as ESPN3.[1119] These MVPDs maintain that such programmers require the cost of the online versions of the networks to be bundled into basic broadband packages.[1120] They state that the networks charge subscriber fees on the basis of the number of broadband subscribers for the online versions of the networks as well as the number of video subscribers for linear distribution.[1121] These MVPDs argue that this practice forces them to either absorb the additional cost or raise end-user rates for broadband.[1122] Small and rural MVPDs also report having to promote programmers' websites to broadband customers outside of their video service territory.[1123]

351. Several video programmers argue that the programming market is extremely competitive, which has lead to a diverse array of programming choices for consumers.[1124] In particular, these programmers suggest no program supplier has market power thereby allowing new programmers and networks to enter the market freely.[1125] Additionally, Time Warner and Fox argue that bundling is a prevalent practice in the American economy and provides numerous benefits, such as lowering transaction and production costs. They also note many programmers provide MVPDs with the opportunity to purchase networks on an individual basis.[1126] Similarly, Viacom claims that it does not compel any cable operator to negotiate for carriage of multiple networks nor require any cable system to

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[1117] *See* Rural Associations 6/8/11 Comments at 5-6; Rural Telcos 6/8/11 Comments at 9-11. *See also* SureWest 7/8/11 Reply at 5-7. The Rural Telcos also note that these practices preclude them from promoting the lowest basic service package. For example, NRTC reports that its members must sell their expanded basic packages, which at a minimum contain over 70 channels, at a retail price averaging $50-$60 per month. Comparatively, NRTC contends that incumbent rural cable systems not burdened with tying or tiering requirements may carry about 50 channels at $35 per month per subscriber. *See* Rural Telcos 6/8/11 Comments at 10. The Rural Telcos further argue that forced tying and tiering requirements prevent the carriage of independent channels on an expanded basic tier. *See id.* at 11.

[1118] *See* ACA 6/8/11 Comments at 9. OPASTCO further asserts that rural MVPDs lack leverage in negotiating for programming due to mandatory non-disclosure agreements between video programmers and rural MVPDs since these agreements conceal the true market value for programming. *See* OPASTCO 7/29/09 Comments at 18-20.

[1119] *See* Rural Telcos 6/8/11 Comments at 11-13; ACA 8/28/09 Reply at 9-11.

[1120] *See* OPASTCO 7/29/09 Comments 13-15; NTCA 5/20/09 Comments at 5-6.

[1121] *See* OPASTCO 7/29/09 Comments 13-15.

[1122] *See, e.g.*, Rural Telcos 6/8/11 Comments at 11-13; Rural Associations 6/8/11 Comments at 7-8; OPASTCO 7/29/09 Comments at 13-15.

[1123] *See* Rural Association 6/8/11 Comments at 7; OPASTCO 7/29/09 Comments at 13.

[1124] *See, e.g.*, Fox Entertainment Group, Inc. & Fox Television Holdings, Inc. Comments, MB Docket No. 07-198 (filed Jan. 4, 2008) at 19-21 ("Fox 07-198 Comments"); Viacom Inc. Comments, MB Docket No. 07-198 (filed Jan. 4, 2008) at 4-8 ("Viacom 07-198 Comments"); NBC Universal, Inc. & NBC Telemundo License Co. Comments, MB Docket 07-198 ("NBC 07-198 Comments") at 42-45.

[1125] *See* Fox 07-198 Comments at 20; Viacom 07-198 Comments at 6-8; NBC 07-198 Comments at 42-45.

[1126] *See* Fox 07-198 Comments at 21-22; Time Warner Inc. Reply, MB Docket No. 07-198 (filed Feb. 12, 2008) at 2-5.

purchase any particular network or combination of networks. Viacom further contends that it does not deny small and rural cable operators access to package deals and volume discounts. The company indicates it has adopted a flexible approach in negotiating carriage with small cable operators, including on occasion making certain programming services available to distributors with no license fee or for a nominal amount as well as paying small cable operators for carriage in certain situations.[1127]

352. Disney also disputes the complaints surrounding ESPN3, which it believes relate to private business negotiations. It asserts nonetheless that ESPN does not force distributors of any size to carry any of its products. Disney indicates that ESPN works collaboratively with ISPs distributing ESPN3 to acquire new high-speed data subscribers as well as retain and upgrade existing high-speed data and video customers.[1128]

353. Small and rural carriers also argue that they pay disproportionately higher prices for retransmission consent.[1129] ACA states that small and medium-sized MVPDs pay double the retransmission consent fees of large providers.[1130] ACA submits data indicating that broadcasters receive retransmission consent fees ranging from $0.14 to $0.75 per subscriber per month, with smaller and medium-sized cable operators paying the highest fees.[1131] ACA contends that higher retransmission fees increase consumer costs, which negatively affects entry into the MVPD market and reduces improvements to service and networks.[1132]

354. ACA's members also report facing "take-it-or leave-it" retransmission consent offers that may lead them to temporarily or permanently drop broadcast television stations.[1133] For example, in the 2008 retransmission consent negotiations, 20 percent of respondents to ACA's 2009 survey were forced to temporarily drop a broadcast television station since the parties failed to reach a new retransmission consent agreement prior to the expiration of the previous agreement.[1134] Similarly, nearly half of the respondents in NTCA's 2010 survey indicated that broadcasters issued "take it or leave it" ultimatums.[1135] Sixty percent of NTCA's survey respondents opted to take the offer for fear of losing customers; 22

[1127] *See* Viacom 07-198 Comments at 11-13.

[1128] *See* Disney 8/28/09 Reply at 6-7.

[1129] As indicated previously, the Commission has initiated a proceeding to examine certain concerns related to retransmission consent. *See Retransmission Consent NPRM*, *supra*, n. 154.

[1130] *See* ACA 6/8/11 Comments at 6. According to ACA, generally rural providers also must pay transport fees because they operate outside the local broadcaster's signal contours – a cost that is typically passed on to rural consumers. ACA states these fees are as high as $0.50 per subscriber per signal per month, but are sometimes more. *See id.* at 14-15. In addition, in a 2009 survey of ACA's membership, respondents indicated that retransmission consent fees were rising faster than the cost of other types of programming. According to respondents, retransmission consent fees were about 8 percent of the total video programming expenses in 2009 compared to 2.4 percent in 2008. *See* ACA 5/20/09 Comments at 6-7.

[1131] *See* ACA 6/8/11 Comments at 8. ACA also contends that retransmission consent fees are even higher when two or more broadcasters in the same DMA engage in coordinated retransmission consent negotiations. *See id.* at 10-14.

[1132] *See* ACA 6/8/11 Comments at 8-9; ACA 5/20/09 Comments at 15-16 (indicating that in a 2009 survey of its membership, 88 percent of respondents had or were planning to increase cable rates on their basic service packages). *See also* SureWest 7/8/11 Reply at 5 (arguing that higher retransmission consent costs for smaller MVPDs limit their ability to effectively compete with the incumbent cable operator, and thus negatively impacts consumer choice).

[1133] *See* ACA 5/20/09 Comments at 13-15.

[1134] *See id.* at 14.

[1135] *See* Rural Associations 6/8/11 Comments at 10.

percent of respondents who declined the offer ultimately were barred from receiving access to the broadcast stations.[1136] ACA further explains non-cash/in-kind compensation provides broadcasters with another means to obtain compensation from small MVPDs for programming. These types of concessions may include requiring cable operators to carry multicast feeds, to purchase advertising time from the broadcaster, or to participate in joint marketing campaigns with the broadcaster.[1137]

355. As previously indicated, broadcasters have asked the Commission to reject requests to significantly alter its retransmission consent rules.[1138] With respect to smaller MVPDs, NAB argues that there is no evidence or data to support the assertion that smaller MVPDs receive less favorable retransmission fees, terms, and conditions in comparison to larger MVPDs.[1139] NAB also indicates that retransmission consent fees, terms, and conditions are based on economies of scale, which is a trademark of a competitive marketplace.[1140] NAB therefore contends that even if price differentials exist in the retransmission consent fees between smaller and larger MVPDs, there is no evidence of price discrimination.[1141]

B. Broadcast Stations

356. Television markets serving rural populations tend to have fewer local full-power stations. Consumers may also rely more on multicasting than those in large markets for the delivery of major network signals such as ABC, CBS, FOX, and NBC. As of July 2011, 49 of the 210 television markets had three or fewer full-power commercial broadcast stations assigned to them. All of these markets are ranked below 100.[1142] Combined, all 49 markets with three or fewer stations represent about 4.6 million television households, or four percent of the estimated 115.9 television households nationwide as of the 2010-2011 television season.[1143] Of the 49 markets, 28 receive at least one of the four major networks via a digital multicast signal.[1144] Yet Nielsen estimates for 2011 that the percentage of households relying on over-the-air distribution of broadcast stations is about the same in the three different categories of counties – 9 percent in A Counties, 11 percent in B Counties, and 10 percent in C and D Counties.[1145]

C. OVDs

357. As discussed earlier, consumers need high-speed Internet access in order to have access to OVDs' video content. Unfortunately, many consumers in rural America still lack access to this

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1136 *See id. See also* SureWest 7/8/11 Reply at 7-8 (encouraging the Commission to allow MVPDs to substitute network and syndicated broadcast programming from a station in a neighboring market in order to minimize the competitive harm from broadcasters' withholding retransmission consent).

1137 *See* ACA 5/20/09 Comments at 7-10. ACA indicates requiring the carriage of multicast feeds is a particularly difficult business arrangement for smaller operators with limited bandwidth capacity. *See id.* at 8 &10.

1138 *See supra*, ¶ 60.

1139 NAB 7/8/11 Reply, Attachment A at 49.

1140 *Id.* at 50.

1141 *Id.* at 51.

1142 FCC staff estimates based on data from BIA. DMA ranks and number of stations within each DMA are not directly correlated. *See supra*, ¶ 162.

1143 FCC staff estimates based on data from Nielsen, *Local Television Market Universe Estimates*, used throughout the 2010-2011 season.

1144 FCC staff estimates based on data from BIA, July 2011.

1145 *See* Nielsen 2010 & 2011 Television Audience Report at 6. *See also supra*, n. 1113.

important resource. The Commission's 2011 Rural Broadband Report found that 72.5 percent of the 26.2 million Americans that still lack access to 3 Mbps/768 kbps or faster of fixed broadband service live in rural areas, even though only 21.7 percent of all Americans reside in rural areas.[1146] The report also found that close to three out of ten rural Americans – 28.2 percent – are without access to fixed broadband at 3 Mbps/768 kbps or faster, which is nine times larger than the three percent of Americans without access in non-rural areas.[1147] Additional data further indicates that rural consumers have fewer options with respect to broadband technologies and providers than other consumers.[1148]

358. As discussed earlier, despite these findings, NTCA finds that a significant majority of rural telcos provide broadband service to at least some portion of their service territory and that several rural telcos include a broadband connection in their service bundles.[1149] NTCA's members also report operating in an increasing competitive market for broadband service.[1150] Eighty-one percent of OPASTCO's 2009 survey respondents suggested that the increase of online video has heightened demand for faster broadband speeds – with 91 percent of respondents providing, or planning to offer, tiered broadband services.[1151]

V. KEY INDUSTRY INPUTS

359. In this section of the Report, we consider key inputs that may affect competition in the market for the delivery of video programming. Specifically, we discuss below creators and aggregators of video programming and consumer premises equipment.

A. Content Creation and Aggregation of Video Programming

1. Overview

360. Television programs and movies are often created and licensed by major studios that are subsidiaries of entertainment conglomerates that also own broadcast and cable networks. Collectively, the broadcast and cable networks of seven companies – Disney, News Corp., NBC Universal, Time Warner Inc.; CBS; Viacom; and Discovery – account for about 95 percent of all television viewing hours in the United States.[1152] Of those, only Discovery, which produces its own programming, does not own a

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1146 *See* FCC, BRINGING BROADBAND TO RURAL AMERICA: UPDATE TO REPORT ON RURAL BROADBAND STRATEGY (2011), *attached to Chairman Genachowski Releases Update to 2009 Broadband Report*, GN Docket No. 11-16, Public Notice, 26 FCC Rcd 8680, 8688, ¶ 10 (2011) (noting that the analysis is based upon the State Broadband Initiative Data (formerly known as SBDD Data)).

1147 *See id.*

1148 *See id.*

1149 *See* NTCA 5/20/09 Comments at 2-3.

1150 *See id.* at 3. In the 2008 Broadband Survey, 93 percent of NTCA's survey respondents reported facing competition from at least one service provider for at least some of their customers. The typical respondent competed with two national ISPs, two satellite broadband providers, two wireless ISPs, and one cable company. In particular, 55 percent of respondents facing competition reported that their competitors were only serving cities and towns in the respondent's service area; 45 percent of respondents said their competitors were serving customers throughout the respondent's service area. *See id.*

1151 *See* OPASTCO 7/29/09 Comments at 5. Tiered broadband service refers to the practice of offering a selection of broadband speeds at different price points. *See id.*

1152 Craig Moffett *et al.*, *Weekend Media Blast: Why We Haven't Seen a Virtual MSO Yet*, Bernstein Research, Jan. 27, 2012, at 2.

major television or movie studio.[1153] These conglomerates may also produce programs for each other's networks.[1154] In addition, there are independent studios, such as The Weinstein Company, that create television programming and movies.[1155] Movie and television studios generally produce and distribute their own programs and movies, and retain ultimate distribution rights.[1156] In some cases, however, studios distribute programs and movies on behalf of third parties.[1157] Industry participants claim that the production and distribution of television programming and films are inherently risky businesses.[1158] While studios invest a substantial amount up front to produce video content, the revenues derived from the production, distribution and licensing of such content depend primarily on a program's acceptance by the public, which is difficult to predict.[1159]

361. GAO estimates for the Fall 2009 broadcast prime time schedule, the top five program producers were the studios affiliated with ABC, CBS, FOX, NBC, and The CW (WBTVG).[1160] For the individual networks, the 2010 share of in-house productions was: ABC, 60 percent; CBS, 61 percent; The CW, 90 percent; FOX, 72 percent; and NBC, 63 percent.[1161] Industry observers and participants

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[1153] On the other hand, Sony Corporation operates a television and movie studio, but does not operate cable or broadcast networks.

[1154] For example, News Corp.'s Twentieth Century Fox Television produces *Modern Family* for Disney's ABC, *Awake* for Comcast's NBC, *How I Met Your Mother* for CBS, and *Futurama* for Viacom's Comedy Central. News Corp., *SEC Form 10-K for the Year Ended December 31, 2010*, at 9-10 ("News 2010 Form 10-K").

[1155] The Weinstein Co., *About The Weinstein Company*, http://weinsteinco.com/about-us/ (visited Mar. 7, 2012).

[1156] For example, Warner Brothers Television Group ("WBTVG"), a subsidiary of Time Warner, develops and produces new television series (*e.g.*, *Two and a Half Men*), reality-based entertainment shows and animation programs for Time Warner's cable networks and third parties. Time Warner Inc., *SEC Form 10-K for the Year Ended December 31, 2010*, at 7 ("Time Warner 2010 Form 10-K"). In 2010, Warner Brothers Studios, another subsidiary of Time Warner, wholly financed the production, marketing, advertising and distribution of eight films, while distributing 15 films financed in whole or in part by other parties. *Id.*

[1157] For example, Viacom's Paramount Studios distributes animated feature films produced by DreamWorks Studios and CBS Films. Michael Cieply & Brooks Barnes, *A Studio's Real-Life Drama*, N.Y. TIMES, Jan. 29, 2012, http://www.nytimes.com/2012/01/30/business/media/dreamworks-caught-in-a-real-life-drama.html?pagewanted=all (visited Feb. 10, 2012); Viacom Inc., *SEC Form 10-K for the Year Ended December 31, 2010*, at 66 ("Viacom 2010 Form 10-K"). In addition, Lionsgate has home video distribution rights to prime time series and library titles from ABC Studios, while CBS Television Distribution syndicates Harpo Studio's *Dr. Phil* and *Rachael Ray* to television stations. *See* Lions Gate Entertainment Corp., *SEC Form 10-K for the Year Ended December 31, 2010*, at 18 ("Lionsgate 2010 Form 10-K"); Harpo, Inc., *Oprah Winfrey's Official Biography*, http://www.oprah.com/pressroom/Oprah-Winfreys-Official-Biography/7 (visited Mar. 26, 2012); CBS Studios Inc., *CBS Television Distribution — Featured Shows*, http://www.cbstvd.com/shows_main.aspx (visited Mar. 26, 2012).

[1158] Time Warner 2010 Form 10-K at 19.

[1159] *Id.* According to Time Warner, the public acceptance of the studios' content depends on many factors, including the availability of competing content, the availability of alternative forms of leisure and entertainment time activities, the adequacy of efforts to limit piracy, studios' ability to develop strong brand awareness and target key audience demographics, studios' ability to anticipate and adapt to changes in consumer tastes and behavior on a timely basis, and general economic conditions.

[1160] GAO, *Media Programming: Factors Influencing the Ability of Independent Programming in Television and Programming Decisions in Radio*, GAO-10-369, Mar. 2010, at 13. The CW network is jointly owned by CBS and Time Warner.

[1161] WGAW 6/8/11 Comments at 6. *See also* Deana Myers, *Comedy Returns to Broadcast*, SNL Kagan, May 27, 2011. To promote a more competitive media marketplace, the Writers Guild of America, West proposes that the (continued….)

believe that in order to retain control over the distribution of their content, including OVD and VOD distribution, networks may rely more on in-house production.[1162] Time Warner asserts that despite the increasing number of networks distributed by MVPDs, access to prime time and syndicated television slots for its studio has tightened as networks and O&Os increasingly rely on programming from content producers aligned with or owned by their parent companies.[1163] Time Warner, which owns studios that are not vertically integrated with a broadcast television network, states that this could lead it and similarly situated studios to launch fewer new television series and to receive lower licensing fees.[1164]

362. *Broadcast Programming.* Broadcast networks license programming from in-house production studios, third-party studios, and sports leagues.[1165] Television production studios develop programs in collaboration with independent writers, producers, and creative teams.[1166] Broadcast networks' primary expense is the cost to acquire or license television programming, including sports programming and feature films.[1167] Premium sports programming is the most expensive, while reality and non-fiction programming are the least expensive.[1168] Broadcast networks also incur the expense of producing certain programming, most notably non-entertainment programming, such as news and public affairs, that is unlikely to be acquired from a studio. SNL Kagan estimates that programming costs for 11

(Continued from previous page)
Commission require the broadcast networks devote at least 25 percent of their prime time schedule to programming that is owned and produced by independent sources. WGAW 6/8/11 Comments at 15-16. WGAW defines independent producers as studios or production companies that are not owned or affiliated with a major broadcast or cable network or an MVPD provider. *Id.* at 3.

1162 Spencer Wang, Shub Mukherjee, and Michael Senno, *Entertainment Industry: Not All Cable Networks Are Created Equal*, Credit Suisse, Jan. 31, 2012, at 34 ("Wang") ("[W]e believe that cable networks that own more of their programming will have more control over their destiny. . . [E]ven if the total [number of MVPD subscribers] declines, networks that own the programming that they air will be able to [earn revenue from] their content by selling these rights to [OVDs]."). *See also* Time Warner 2010 Form 10-K at 25; Sony Kabushiki Kaisha (Sony Corporation), *SEC Form 20-F for the Fiscal Year Ended March 31, 2011*, at 31 ("[B]roadcast networks in the U.S. continue to produce their own shows internally.").

1163 Time Warner 2010 Form 10-K at 10-11. Studios differ on how they assess cable and broadcast networks' demand for television programming. Lionsgate expects to see an increase in demand for its programming. It expects key drivers to include the success of the cable industry's bundled services, increased average revenue per user and accelerated growth in advertising. Additionally, Lionsgate claims increased capacity for channels on upgraded digital cable systems and satellite systems has led to the launch of new networks seeking programming to compete with traditional broadcast networks as well as other existing networks. Lionsgate 2010 Form 10-K at 7.

1164 Time Warner 2010 Form 10-K at 25.

1165 The Walt Disney Co., *SEC Form 10-K for the Year Ended December 31, 2010*, at 1 ("Disney 2010 Form 10-K"); News 2010 Form 10-K at 13, 46, 55-56; Comcast Corp., *SEC Form 10-K for the Year Ended December 31, 2010*, at 10 ("Comcast 2010 Form 10-K"); CBS Corp., *SEC Form 10-K for the Year Ended December 31, 2010*, at I-2 ("CBS 2010 Form 10-K").

1166 Individual studios develop half-hour comedies, one-hour dramas, television movies, mini-series, and/or non-fiction programming for cable or broadcast networks. Disney 2010 Form 10-K at 1; Lionsgate 2010 Form 10-K at 48; Time Warner 2010 Form 10-K at 7-8.

1167 Broadcast networks, including CBS, FOX, and ABC, whose television studios operate as separate divisions of their conglomerates, include in-house programming as expenses. News 2010 Form 10-K at 9; Disney 2010 Form 10-K at 30; CBS 2010 Form 10-K at I-2. In contrast, NBC Universal's NBC and Telemundo broadcast networks and production studios operate as a single division, competing directly with other productions studios and content creators. Comcast 2010 Form 10-K at 9-10.

1168 Wang at 31.

nationally distributed English and Spanish-language broadcast networks stayed relatively steady from $13.1 billion in 2006 to $13.4 billion in 2010.[1169]

363. For a typical broadcast entertainment program, about one year ahead of the scheduled air date, each broadcast television network selects approximately two or three dozen shows to develop into a pilot or sample episode. Of the approximately 120 pilots that studios produce for the major broadcast networks, about half are selected for the start of the coming television season. The networks usually commit to funding 13 episodes of a weekly series provided that the show attracts a minimum number of viewers, with an option to order an additional nine to 11 episodes to complete the television season.[1170] As of 2010, an hour-long, scripted pilot could cost a studio between $2.7 million and $3 million to produce, with some costing significantly more.[1171] Broadcast networks may pay a studio about $1.5 million to license the program.[1172]

364. Broadcast networks derive about 99 percent of their net operating revenues[1173] from the sales of advertising time for their network broadcasts.[1174] The ability to sell commercial time and the rates received are primarily dependent on the size and nature of the audience that the network can deliver to the advertiser as well as overall advertiser demand for time on network broadcasts.[1175] A decrease in audience ratings can lead to a reduction in pricing and advertising spending, adversely affecting a

[1169] SNL Kagan, *TV Network Industry Benchmarks: Broadcast (2006 – 2010)* ("SNL Kagan Broadcast Benchmarks"). SNL Kagan defines programming expenses as the direct cost of creating, acquiring, and distributing content and services. For the years 2006-2010, SNL Kagan included financial data from CBS, NBC, ABC, FOX, Univision, The CW, Telemundo, TeleFutura, ION, Azteca America, and MyNetwork TV. For 2006, SNL Kagan includes figures from the networks The WB and UPN in the industry totals. For 2009 and 2010, SNL Kagan also includes figures from Estrella TV in broadcast network industry estimates. *See also* SNL Kagan, *Media Trends*, 2011 Edition, at 20-21 ("SNL Kagan 2011 Media Trends"). NBC has higher costs in even years due to the Olympics. *Id.*

[1170] Each year, studios can lose hundreds of millions of dollars on flops. *See, e.g.*, Meg James, *TV's Evolution Brings New Profit Squabbles*, L.A. TIMES, Jan. 17, 2006, at C1. In contrast, Discovery Networks CEO David Zaslav stated that they have made a concerted effort to "trim the waste" of the development process by waiting to see how a pilot episode performs before ordering more than four episodes at time. Discovery Communications, Inc., *Presentation to Deutsche Bank Media & Telecom Conference*, Corrected Transcript, Feb. 28, 2012, at 5 ("Discovery Presentation Transcript"). Netflix, on the other hand, has ordered 26 episodes of an original series, *House of Cards*, for about $4 million per episode, without a pilot episode. Ben Fritz & Joe Flint, *Netflix Less about Flicks, More about TV*, L.A. TIMES, Feb. 4, 2012, at B1.

[1171] *See* Marisa Guthrie, *Is Network TV's Model Lost?*, BROADCASTING & CABLE, Apr. 26, 2010, at 10. A half-hour situation comedy costs slightly less, about $2-$3 million per episode in 2011. Paige Albiniak, *Will Sheen Get Payne Treatment on New Show?*, BROADCASTING & CABLE, July 25, 2011, at 29. Network reality programs are less expensive to produce, with the average cost between $1.5 million and $2 million per episode. Bill Carter, *NBC to Pay Outsiders for Blocks of Programs*, N.Y. TIMES, Dec. 3, 2007, at C1.

[1172] *See* Bill Carter, *NBC to Pay Outsiders for Blocks of Programs*, N.Y. TIMES, Dec. 3, 2007, at C1.

[1173] Net advertising revenue is the total amount networks charge advertisers to carry their commercials net of commissions charged to client companies by ad agencies to buy time on the networks, *i.e.*, the revenues that broadcast networks actually receive. Net operating revenue includes net advertising revenue plus all other sources of revenues. *See* Table 25.

[1174] CBS 2010 Form 10-K at I-2; Disney 2010 Form 10-K at 1; News 2010 Form 10-K at 45.

[1175] Disney 2010 Form 10-K at 1.

broadcast network's financial performance.[1176] Between 2006 and 2008, net operating revenues for the broadcast television network industry increased from $16.6 billion to $16.8 billion. In 2009, it declined to $15.5 billion, but increased to $16.4 billion in 2010.[1177]

Table 25: Broadcast Television Network Industry Financial Performance[1178]

Revenue (in thousands)

	2006	2007	2008	2009	2010
Gross Advertising	$19,422,445	$19,504,124	$19,680,532	$18,134,566	$19,173,013
Net Advertising	$16,509,078	$16,578,505	$16,728,452	$15,414,381	$16,297,061
Other Operating Revenue	$51,278	$59,994	$48,964	$61,120	$87,006
Net Operating Revenue	**$16,560,356**	**$16,638,499**	**$16,777,416**	**$15,475,501**	**$16,384,067**

Expenses (in thousands)

	2006	2007	2008	2009	2010
Operating SG &A	$2,412,129	$2,326,703	$2,319,787	$2,301,060	$2,350,880
Programming	$13,054,780	$12,728,519	$13,337,526	$12,613,117	$13,414,689
Network Compensation	$246,632	$170,650	$133,563	$81,467	$48,109
Total Operating Expenses	**$15,713,541**	**$15,225,872**	**$15,790,876**	**$14,995,644**	**$15,813,678**

Cash Flow (in thousands)

	2006	2007	2008	2009	2010
Cash Flow	$846,814	$1,412,628	$986,540	$479,857	$570,389
Cash Flow Margin (%)	5.11%	8.49%	5.88%	3.10%	3.48%

365. Studios often do not profit from a show for several years, if ever. They hope to earn large revenues during subsequent distribution windows of the programs[1179] in ancillary markets, including syndication to broadcast television stations and/or cable networks; DVD and Blu-ray release; international distribution; and online distribution. The performance of a television series in subsequent distribution

[1176] News 2010 Form 10-K at 30-31. ABC was nevertheless able to increase its advertising rates between 2009 and 2010 for prime time programming despite a decline in prime time ratings. Disney 2010 Form 10-K at 29-30.

[1177] SNL Kagan Broadcast Benchmarks. Increased revenues for broadcast networks in even years are due in part to the airing of the Olympics. Because most political advertising is purchased on a regional basis (*e.g.*, on a statewide basis for gubernatorial and senate elections as well as presidential campaigns that target swing states), it tends to impact broadcast stations more than broadcast networks. In some cases, however, presidential campaigns may purchase advertising on broadcast networks. *See* Jim Rutenberg, *Nearing Record, Obama's Ad Effort Swamps McCain*, N.Y. TIMES, Oct. 18, 2008, at A1.

[1178] FCC staff estimates based on data from SNL Kagan. *See* SNL Kagan Broadcast Benchmarks.

[1179] CBS 2010 Form 10-K at I-3; Lionsgate 2010 Form 10-K at 8.

windows is highly correlated with the ratings of its initial telecast.[1180] Typically, a series must be broadcast for at least three to four television seasons to generate a sufficient number of episodes to make it desirable for syndication to broadcast television.[1181] Moreover, not all series lend themselves to subsequent distribution. For example, with respect to the syndication market, broadcast stations and cable networks prefer series with episodes that have self-contained storylines which give them the flexibility to schedule the episodes out of sequence.[1182] The most popular network television series are sold into both broadcast television station and cable network syndicaton.[1183] In the past, studios primarily sold television situation comedies to broadcast television stations. As cable networks have earned more in fees from MVPDs, their programming budgets have increased, enabling them to bid for situation comedies as well as dramas.[1184] Unscripted, or "reality" programming, generally has little value in the syndication after its initial airing.[1185]

Table 26: Television Studio Revenue Streams[1186]
(Revenue in millions)

	2006	2007	2008	2009	2010
Broadcast Network	$12,434	$12,197	$12,786	$12,048	$12,693
Syndication (Cash)	$3,162	$3,303	$3,379	$3,316	$3,227
Syndication (Gross Barter)	$2,902	$2,823	$3,015	$2,878	$2,813
Basic Cable Networks/RSNs (Cash)	$15,197	$17,165	$18,783	$20,855	$22,460
Premium Cable TV Domestic	$2,584	$2,594	$2,611	$2,696	$2,989
Total Domestic	**$36,280**	**$38,082**	**$40,573**	**$41,793**	**$44,182**
Total International	**$8,666**	**$8,965**	**$9,454**	**$10,178**	**$10,555**
Total TV Programming	**$44,946**	**$47,047**	**$50,027**	**$51,970**	**$54,737**

[1180] A network's decision to cancel a program due to poor ratings may prevent a studio from recouping its production expenses, requiring the studio to immediately write-off of any unamortized production costs. Viacom 2010 Form 10-K at 65.

[1181] More recently, syndication sales have occurred within the first two seasons of a show's initial airing. One-hour dramatic series airing on broadcast networks between 2000 and 2010 only had a 17.1 percent probability of being renewed into a fourth season. Deana Myers, *1-Hours: Chance of Success*, SNL Kagan, Dec. 22, 2011.

[1182] *Second Life; Digital $$$ Amp Syndie Biz*, DAILY VARIETY, July 21, 2011, at 1.

[1183] Deann Myers, "Off-Network Deals Continue to Break Records," *Economics of Networks*, SNL Kagan, JULY 9, 2012.

[1184] SNL Kagan, *Syndication: Background*, Economics of TV Programming and Syndication (2007) at 70.

[1185] For this reason, rights holders for reality programming often allow entire seasons to be available online instead. Andrew Wallenstein, *ABC-WBTV Deal Rewrites Syndie, Digital Rules*, DAILY VARIETY, Nov. 14, 2011, http://www.variety.com/article/VR1118046062 (visited Mar. 26, 2012).

[1186] FCC staff estimates based on data from SNL Kagan. *See* SNL Kagan 2011 Media Trends at 196 (containing the data for 2009-2011); SNL Kagan, Data Library, *Worldwide TV Programming Market for U.S. Produces Programming ($Mil.), Historical*, Nov. 30, 2009 (containing the data for 2006-2008).

366. *Cable Programming.* Similar to broadcast networks, cable networks also license programming from in-house production studios, third-party studios, and sports leagues. As with broadcast networks, programming represents a major expense for cable networks.[1187] SNL Kagan estimates that combined, the basic cable networks' programming expenses were $14.4 billion in 2006, representing 44.1 percent of total $32.6 billion in net industry revenues for cable networks, and rose to $20 billion in 2010, representing 44.2 percent of $45.3 billion in net industry revenues for cable networks.[1188] A typical hour-long, scripted cable drama costs less to produce than a broadcast drama, approximately $2 million per episode. And cable networks generally pay lower licensing fees than broadcast networks – about $1 million per episode.[1189] On the other hand, the returns for a studio on a popular cable network show may be less than a broadcast network show because the former tends to attract a fraction of audience in its original airing.[1190] In addition, cable series have about 10 to 13 episodes per series per season compared with 22 to 24 episodes for a broadcast series.[1191]

367. Cable networks are the primary source of profit for entertainment conglomerates.[1192] Cable networks earn revenues primarily from two sources, advertising and MVPD license fees paid on a per subscriber basis. Premium cable networks, described in more detail below, are generally available to subscribers for an additional fee, are commercial-free, and offer specialized programs including unedited movies, original series, and sporting events. Combined, basic cable networks earned about $15.1 billion in net advertising revenues in 2006, and $19 billion in net advertising revenues in 2010.[1193] Subscriber fees rose at a much faster rate. Basic cable networks collectively earned about $16.3 billion in subscriber fees in 2006, and $24.9 billion in 2010.[1194] A two-tier structure has emerged in which the established

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[1187] Wang at 29, 32.

[1188] SNL Kagan, *TV Network Industry Benchmarks: Basic Cable Networks (2006 – 2010)* ("SNL Kagan Basic Cable Benchmarks"). For broadcast and cable networks, sales, general, and administrative expenses ("SGA") represent the other major expense besides programming. We compare the profit margins of the two types of networks in our discussion of sports programming, *infra*, ¶¶ 371-76. *See also* Wang at 27-33 (indicating that programming expenses play a key role in a cable network group's cost structure).

[1189] Because they know that they will earn less money from cable networks, studios adjust their budgets accordingly. They rely on tighter budgets, smaller deficits, and investment by international markets. Bill Carter, *Weighty Dramas Flourish on Cable*, N.Y. TIMES, Apr. 4, 2010, at B1; SNL Kagan TV Programming Report 109.

[1190] In addition, the possibilities for syndication are more limited, since cable networks fear that they might dilute their brand by running programming that originally aired on a competitor. SNL Kagan TV Programming Report at 109.

[1191] Bill Carter, *Embracing Cable's Concept of Opening Night*, N.Y. TIMES, Jan. 15, 2012, at B3. Cable networks generally air episodes of a series consecutively, with no pre-emptions or repeats, while broadcast networks spread the episodes out over a period of nine months. *Id.*

[1192] For five of the entertainment conglomerates (Disney, Time Warner, Viacom, Discovery Networks, and News Corp.), cable networks contribute anywhere from 60 percent to more than 90 percent of companywide earnings before interest and taxes ("EBIT"). Wang at 2. *See also* Comcast Corp., *Comcast and GE Announce Content Joint Venture* (slide presentation), Dec. 3, 2009, at 4 ("Cable channels represent 82% of the new joint venture's OCF [Operating Cash Flow] and drive its profitability."), http://www.cmcsk.com/events.cfm?Year=2009 (visited Mar. 2, 2012); Meg James, *Cost of Cable TV Content Soars*, L.A. TIMES, Dec. 8, 2011, at B1.

[1193] SNL Kagan, *Economics of Basic Cable Networks*, 2011 Edition, at 13 ("SNL Kagan Basic Cable Report"). *See also* Table 27; SNL Kagan Basic Cable Benchmarks.

[1194] SNL Kagan Basic Cable Report at 13. *See also* SNL Kagan Basic Cable Benchmarks. Basic cable networks collectively earned about $1.3 billion in additional operating revenue in 2006 and about $1.4 billion in 2010. Depending on the structure of the cable networks' parent company, this revenue may include ancillary revenues (continued....)

major-brand cable networks charge MVPDs subscriber fees, while newer networks pay MVPDs for carriage in order to launch.[1195] The top networks enjoy relatively high per subscriber license fees, while less viewed cable networks, even those that are well established, might receive only a few pennies per month per subscriber. For example, in 2010 ESPN charged on average $4.39 per month per subscriber (up from $3.48 in 2007). On the other hand, TNT, the most expensive non-sports network, charged $1.06 in 2010 (up from $0.91 in 2007) and MTV Hits charged $0.01 in 2010 (the same price charged in 2007).[1196] Collectively, Comcast, Discovery, News Corp., Disney, Viacom, and Time Warner earned more than 69 percent of total basic cable subscriber fees in 2010, and 84 percent of basic cable network advertising revenues.[1197] For several MVPDs, subscriber fees paid for carriage of programming is a major expense, or their single largest expense item.[1198]

Table 27: Basic Cable Network Financial Performance[1199]

Revenue (in thousands)	**2006**	**2007**	**2008**	**2009**	**2010**
Gross Advertising	$17,762,171	$19,268,379	$20,639,236	$20,459,863	$22,509,530
Net Advertising	$15,097,845	$16,370,881	$17,538,855	$17,388,205	$19,113,100
Subscriber Fees	$16,225,993	$18,340,322	$20,507,329	$22,732,037	$24,756,531
Other Operating Revenue	$1,295,956	$1,541,676	$1,445,783	$1,267,576	$1,376,143
Net Operating Revenue	**$32,619,795**	**$36,252,879**	**$39,491,967**	**$41,387,819**	**$45,265,744**

Expenses (in thousands)

	2006	**2007**	**2008**	**2009**	**2010**
Operating SG&A	$6,614,666	$6,839,323	$6,930,042	$6,572,993	$6,765,499
Programming	$14,358,296	$16,156,814	$17,462,761	$18,567,669	$20,045,769
Total Expenses	**$20,972,961**	**$22,996,137**	**$24,392,803**	**$25,140,823**	**$26,814,919**

Cash Flow (in thousands)

	2006	**2007**	**2008**	**2009**	**2010**
Cash Flow	$11,646,934	$13,257,188	$15,099,056	$16,247,693	$18,450,826
Cash Flow Margin (%)	35.7%	36.6%	38.2%	39.3%	41.0%

(Continued from previous page)
from consumer product licensing, brand licensing, home entertainment sales of programming, and syndication or international distribution. *See* Viacom 2010 Form 10-K at 37-38; CBS 2010 Form 10-K at II-7; Time Warner 2010 Form 10-K at 2.

[1195] *See* Vogel *supra*, n. 463, at 351, n. 17.

[1196] SNL Kagan, *TV Network Summary: Basic Cable Network by Affiliate Revenue Per Avg Sub/Month (2006 – 2010)* ("SNL Kagan Basic Cable Network Affiliate Revenue"). Other networks (*e.g.*, FamilyNet and ReelzChannel) do not charge any monthly subscriber fees. *Id.*

[1197] Wang at 8.

[1198] *See, e.g.*, Comcast 2010 Form 10-K at 4; Time Warner Cable 2010 Form 10-K at 23; Cablevision 2010 Form 10-K at 32; Suddenlink 2010 *Annual Report* at 25-26; Mediacom 2010 Form 10-K at 11; DISH Network 2010 Form 10-K at 19. MVPDs expect these costs to rise. *See, e.g.*, Comcast 2010 Form 10-K at 41; Time Warner Cable 2010 Form 10-K at 38; Cablevision 2010 Form 10-K at 32; Charter 2010 Form 10-K at 8; Insight 2010 Form 10-K at 36; Suddenlink 2010 *Annual Report* at 12-13; DIRECTV 2010 Form 10-K at 19; DISH Network 2010 Form 10-K at 19.

[1199] FCC staff estimates based on data from SNL Kagan. *See* SNL Kagan Basic Cable Benchmarks.

368. *Movies.* Similar to television production, movie production, marketing and distribution can involve significant costs over an extended period of time.[1200] The production process involves decisions regarding financing a movie, development of a screenplay, assembling the artistic and technical staff, and the actual filming and post-filming editing/post-production process.[1201] Studios may distribute their own movie productions or they may acquire movies for theatrical release and/or other distribution outlets from the content's creator.[1202] Feature films typically are produced or acquired for initial exhibition in theaters, followed by ancillary distribution windows.

369. A studio typically incurs losses during a movie's theatrical exhibition, and may not realize profits until well after that time. Studios indicate that the costs of producing and marketing movies have steadily increased in recent years, outpacing domestic theater revenues.[1203] In particular, Viacom states that the costs of movie production have risen faster than revenues from ancillary markets.[1204] On average, six or seven out of ten major theatrical movies produced may be unprofitable, and one might break even.[1205] Premium cable networks provide a sizable source of production financing for the movie studios, representing nearly 12 percent of their revenues in 2010. These networks commit to spending hundreds of millions of dollars in advance to license a specified number of airings of a studio's movie catalog (sometimes exclusively) for up to nine years.[1206] In turn, the premium networks can retain the allegiance of MVPDs, their primary customers. License fees negotiated by the studios are based on the theatrical performance of the movies in the packages. SNL Kagan estimates that in 2010 premium networks spent about 62.5 percent ($1.87 billion) of their programming budgets on movies, compared with 37.5 percent ($1.1 billion) on original programming.[1207] In 2007, premium networks spent about 66 percent ($1.71 billion) of their programming budgets on movies, compared with $882 million on

[1200] Viacom 2010 Form 10-K at 12-13; Lionsgate 2010 Form 10-K at 24; Time Warner 2010 Form 10-K at 25. The increasing popularity of 3D movies and the trend toward producing event and franchise films (which often entail higher talent costs for movies later in the series) could result in even higher production costs. Time Warner 2010 Form 10-K at 25.

[1201] Lionsgate 2010 Form 10-K at 9-10.

[1202] *Id.* at 13-14. According to Lionsgate, the decision to acquire a movie is based on expected critical reaction, marketability, potential for commercial success, cost to acquire the picture, estimated distribution and marketing expenses, and ancillary market potential. *Id.*

[1203] Viacom estimates that it receives the ultimate revenues for a movie from all distribution windows within ten years of the movie's initial release. It estimates that for acquired film libraries it receives revenues over a period within 20 years from the date of acquisition. Viacom 2010 Form 10-K at 64-65.

[1204] Viacom states that revenues from subsequent markets have historically exhibited a high correlation to domestic theatrical performance. *Id.*

[1205] Vogel at 71.

[1206] *Id.* at 337. For example, the Disney Studio and Sony Studio license television and online viewing rights of their movie catalogs to Starz. Lionsgate, however, generally licenses its films to networks (including TV Guide Network, in which it has an ownership interest), on a film-by-film, rather than an output basis. Lionsgate notes that without multiple output agreements that typically contain guaranteed minimum payments, its revenues may be subject to greater volatility, which could have a material adverse effect on its business, financial condition, operating results, liquidity and prospects. Lionsgate 2010 Form 10-K at 28. In April 2008, Lionsgate, along with Viacom, and MGM studios, formed EPIX, a premium television channel and VOD service, for its theatrical releases after January 1, 2009. EPIX, which launched in October 2009, provides Lionsgate with an additional platform to distribute its library of motion picture titles and television episodes and programs. Lionsgate 2010 Form 10-K at 28; Studio 3 Partners, *What is EPIX?*, http://corp.epixhd.com/ (visited Mar. 26, 2012).

[1207] SNL Kagan 2011 Media Trends at 155.

original programming.[1208] On average, about 25 percent of the retail price MVPDs charge consumers for premium networks goes to the movie studios.[1209]

Table 28: Motion Picture Studio Revenue Streams[1210]
(Revenue in millions)

	2006	2007	2008	2009	2010
Domestic:					
Theatrical Rentals	$4,798	$5,118	$5,119	$5,672	$5,678
Home Video	$12,515	$12,056	$11,384	$10,387	$9,275
PPV/VOD	$621	$674	$804	$1,013	$1,443
Premium Cable TV	$1,731	$1,713	$1,689	$1,820	$1,868
Digital	$16	$70	$242	$503	$752
Basic Cable	$2,611	$2,638	$2,690	$2,714	$2,769
Broadcast Networks	$478	$444	$418	$394	$372
TV Syndication	$152	$158	$163	$168	$173
Other[1211]	$1,285	$1,393	$1,324	$1,205	$1,226
Total Domestic:	**$24,209**	**$24,263**	**$23,833**	**$23,875**	**$23,557**
Total International:	**$23,881**	**$25,379**	**$25,853**	**$26,184**	**$26,453**
Total:	**$48,090**	**$49,643**	**$49,687**	**$50,058**	**$50,010**

370. Home entertainment distribution involves the marketing, promotion and sale and/or lease of DVDs and Blu-ray discs to wholesalers and retailers who then sell or rent them to consumers.[1212] Studios also distribute television programs and movies for individual rental through such companies as

[1208] SNL Kagan, *Media Trends*, 2008 Edition, at 201.

[1209] Vogel at 337-38 & 351, n. 16.

[1210] Wade Holden, *Distributor Revenue Should Continue Growth,* SNL Kagan, Dec. 28, 2010 (containing the date for 2006-2009); Wade Holden, *Home Video a Temporary Lag on Distributor Revenue*, SNL Kagan, Sept. 26, 2011 (containing the data for 2010).

[1211] "Other" includes hotel, airline and merchandise licensing.

[1212] Lionsgate 2010 Form 10-K at 6. Studios may rely on third parties to manufacture the discs, warehouse the discs, and deliver the discs to retailers. Time Warner 2010 Form 10-K at 8.

Redbox and Rentrak Corporation[1213] or via subscription services such as Netflix[1214] and Blockbuster.[1215] While the domestic home video window has accounted for the largest proportion of domestic revenues for movie studios for several years, the proportion of movie studios' revenues attributable to this window has declined from 51.6 percent of the total $24.2 billion in revenues ($12.5 billion) in 2006 to 39.4 percent of $23.6 billion in domestic revenues ($9.3 billion) in 2010.[1216]

371. *Sports.* As noted above, rights for major sporting events are licensed to networks or stations by professional or collegiate leagues.[1217] Some leagues or teams operate their own regional or national cable sports networks (*e.g.*, the NFL Network and Mid-Atlantic Sports network, the latter operated by the Baltimore Orioles and Washington Nationals baseball teams). Many regional sports networks ("RSNs") are affiliated with entertainment conglomerates, such as Disney or Comcast.[1218] We estimate that there are 93 RSNs in operation today.[1219] The networks or stations may supply their own on-air talent, cameras, and production facilities to create sports programming,[1220] and sell advertising and sponsorships for the programs. Alternatively, networks can sell airtime to independent production companies for "time buys," in which an outside producer pays production costs and finds advertisers,

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[1213] Rentrak Corporation is a global digital media and research company. Its Video Retailer Revenue Sharing service is a wholesale operation that provides regional and independent retailers who rent home entertainment products to customers with an opportunity to acquire new inventory from studios in the same manner as major national chains. Rentrak Corp., *Home Entertainment Services: Video Retailer Revenue Sharing*, http://www.rentrak.com/section/homent/video_retailers/index.html (visited Mar. 6, 2012).

[1214] In addition to playing a role in the home video market for movie studios through its disc rental and streaming services, Netflix is also commissioning original television programs and acquiring distribution rights for library content in the traditional syndication window. *See supra*, ¶ 303.

[1215] Lionsgate 2010 Form 10-K at 18. *See also* Time Warner, Inc., *Presentation to Morgan Stanley Technology, Media & Telecom Conference*, Corrected Transcript, Feb. 29, 2012, at 3 ("Time Warner Presentation Transcript").

[1216] Wade Holden, *Home Video a Temporary Lag on Distributor Revenue*, SNL Kagan, Sept. 26, 2011, at 3. *See also* Time Warner 2010 Form 10-K at 41 (noting that while DVD distribution has been one of the largest drivers of its film studio's revenues and profits over the last several years, the industry and the company have experienced a decline in DVD sales in recent years). Home video consumption falls into three major categories: purchase, rental, and subscription, including subscription video on demand.

[1217] Some networks and distributors of content own sports teams (*e.g.*, Comcast owns the Philadelphia Flyers, a National Hockey League team and Liberty Media owns the the Atlanta Braves, a National Baseball League team). *See* Comcast 2010 Form 10-K at 1; Liberty Media Corp., *Atlanta National League Baseball Club*, http://www.libertymedia.com/assets-braves.aspx (visited Mar. 8, 2012). The National Football League, however, bars corporate ownership. *See* John Clayton, *NFL Ownership Growing Increasingly Complicated*, ESPN, July 15, 2008, http://sports.espn.go.com/nfl/columns/story?columnist=clayton_john&id=3485962 (visited Mar. 8, 2012).

[1218] *See The Regional Sports Network Marketplace*, MB Docket No. 11-128, Report, 27 FCC Rcd 154, 160-61, ¶¶ 16-17 (MB 2012). Comcast Corporation also owns Comcast SportsNet Philadelphia, Comcast SportsNet Mid-Atlantic, and Comcast SportsNet New England, as well as the NBC Broadcasting Network. *See infra*, Appendix C, Table C-1. News Corp. also owns a number of RSNs and the Fox Broadcasting Network. *See infra*, Appendix C, Table C-2.

[1219] *See infra*, Appendix D (this figure includes the HD feeds of the RSN networks). NCTA estimates that there were about 51 RSNs in standard, high-definition, or premium format as of 2010. NCTA, *Organizations: Cable Networks*, http://www.ncta.com/Organizations.aspx?type=orgtyp2&contentId =2907#&&CurrentPage=1 (visited May 11, 2010).

[1220] *See* Chris Gratton & Harry Arne Solberg, THE ECONOMICS OF SPORTS BROADCASTING 83-86 (Routledge, Taylor & Francis Group) (2007) ("Gratton & Solberg").

while the network supplies on-air talent and coordination.[1221] The amount of financial risk incurred by a team or league, as well as its dependence on revenues from broadcasting and cable companies, depends on the sport, the market, and the team's performance.

372. Sports programming differs from other television programs and movies in two major respects. First, audience and advertiser interest is more predictable, especially for marquis events. Major sporting events, including professional football, baseball, and basketball, the Olympics, and certain NCAA playoff series consistently generate among the highest ratings of any programming among viewers who are demographically desirable to advertisers.[1222] Audiences,[1223] advertisers, and MVPDs therefore regard such sporting events as "premium" programming.[1224] Second, live sports programs have little value beyond their initial telecast since viewer interest drops substantially once the contest is over and the results known. With the exception of websites that provide opportunities for additional engagement of fans, ancillary markets for sports programming are limited.[1225]

373. The licensing of sports programming for video distribution varies by sport. For example, the National Football League ("NFL") negotiates media rights exclusively on a national basis. In the NFL, each team receives an equal share of broadcast and licensing revenues and 40 percent of gate receipts from away games.[1226] Revenues earned from licensing network television rights have been especially important to the NFL. CBS, FOX, NBC, and ESPN jointly paid nearly $25 billion for the right to air NFL games for eight years, 2006-2013, representing an increase of 42 percent from the previous eight-year agreement.[1227] The combination of the financial cushion from broadcast and cable networks contracts, the NFL's revenue sharing arrangement, and the lack of local television contracts, has means

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[1221] Vogel at 463, n. 6. Examples of this include the Ladies Professional Golf Association, Grand Prix auto racing, and Tour de France cycling. *Id.*

[1222] *See* Wang at 15. *See also* Gratton & Solberg at 10 ("Sports programm[ing] almost uniquely had this ability to attract the size and characteristics of audiences most attractive to distributors, sponsors, and advertisers.").

[1223] According to Nielsen, major sporting events are appealing to advertisers because they are more likely than other programs to attract viewers in households earning $100,000 or more. *See* Nielsen, *State of the Media: Year in Sports 2010*, at 1, http://www.nielsen.com/us/en/insights/reports-downloads/2011/year-in-sports-2010.html?status=success (visited Mar. 27, 2012).

[1224] Wang at 15. When NBC announced that it would stream the Super Bowl in 2012, the American Television Alliance, a group representing MVPDs, argued that free streaming undercut the stations' rationale for justifying retransmission consent fees. *See* American Television Alliance, *Blog*, http://www.americantelevisionalliance.org/uncategorized/new-ad-why-is-sunday%E2%80%99s-big-game-being-streamed-for-free-online-when-broadcast-networks-and-their-affiliates-demand-sky-high-fees-to-show-their-programming/ (visited Feb. 17, 2012).

[1225] According to Nielsen, the mobile web audience among sports sites increased by 22 percent from November 2010 to November 2011. Nielsen, *State of the Media: 2011 Year in Sports* at 2, http://www.nielsen.com/us/en/insights/reports-downloads/2012/state-of-the-media--2011-year-in-sports.html (visited Mar. 27, 2012). In November 2011, the first full month of the NHL season, nearly 1.3 million people visited NHL.com and watched close to 10 million minutes of video content, which is 37 percent more video than was consumed in November 2010. *Id.* at 8.

[1226] Vogel at 453-54, Fig. 12.2.

[1227] SNL Kagan 2011 Media Trends at 19. ABC, which had aired NFL games for the previous 36 years, gave up the rights to its sister network, ESPN. ESPN's high subscriber fees enable it to earn higher cash flow margin than the broadcast network. For example, in 2010, ABC had $2.9 billion in programming costs (primarily entertainment) and a cash flow margin of 1.7 percent, while ESPN had total programming costs (sports programming) of $4.9 billion and a 25 percent cash flow margin. *Id.* at 18.

that the most profitable NFL team usually generates only 20 percent more gross revenues than the least.[1228]

374. For Major League Baseball ("MLB") and the National Basketball Association ("NBA"), revenues from licensing fees are highly correlated with the size of the market and individual team performance. The NBA and MLB allow teams to negotiate local broadcast rights contracts. For this reason, RSNs may carry professional basketball and baseball games. Traditionally, the NBA and MLB have been less dependent on television revenues than the NFL, in part because they play many more games in their home markets.[1229] In August 2010, however, the Texas Rangers signed a 20-year licensing agreement with FOX Sports Net valued at $3 billion that includes an equity stake in the network, escalator clauses, and profit participation. This transaction has set in motion a series of negotiations between baseball teams and RSNs for major television contracts, at least for many teams in larger markets.[1230] Similarly, in February 2011, Time Warner Cable signed a 20-year, $3 billion licensing agreement with the Los Angeles Lakers to launch English-language and Spanish-language RSNs built around the team, and other teams have subsequently signed major contracts with RSNs as well.[1231]

375. While the broadcast networks generally lose money on sports, the programming attracts viewers, especially with pre- and post-game programming, enabling broadcast networks to develop their brands and promote their non-sports programming schedules.[1232] Nevertheless, since sporting events are less vulnerable than other types of programming to competition, broadcast and cable networks are paying increasingly large amounts for sports rights, supported in part by subscriber fees charged to MVPDs, and/or contributions from broadcast affiliates to cover rights and production costs. One recent trend has been the migration of some major sports, including the NBA and MLB, to cable networks.[1233] Cable and broadcast networks sometimes share in the bidding for sports rights. For example, in 2010 CBS and TNT jointly won a bid for the National Collegiate Athletic Association ("NCAA") men's basketball tournament rights, providing additional outlets for sports programming.[1234] For MVPDs, sports-themed cable networks are considered "must have" programming because their programming is unique and

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[1228] Vogel at 453.

[1229] *Id.* at 454-55.

[1230] Bob Nightengale, *Cash Flows Through MLB Cable Outlets*, USA TODAY, Feb. 10, 2012, at 1C. According to Arizona Diamondbacks' President Derrick Hall, "[i]t's the biggest game changer a lot of us have ever seen. The landscape changed in Texas . . . You're seeing clubs double or triple their TV value." *Id.*

[1231] Mike Reynolds, *TWC's Lakers Deal Changes Game*, MULTICHANNEL NEWS, Feb. 21, 2011, at 8. The agreement made the Los Angeles Lakers the most valuable team within the league. Kurt Badenhausen, *L.A. Lakers Top 2012 List of the NBA's Most Valuable* Teams, FORBES, Jan. 25, 2012, http://www.forbes.com/sites/kurtbadenhausen/2012/01/25/the-nbas-most-valuable-teams/ (visited Mar. 13, 2012).

[1232] SNL Kagan 2011 Media Trends at 21.

[1233] Deana Myers, *Sports Rights: Paying Off for Broadcast?*, SNL KAGAN, Feb. 7, 2012. *See also* Pete Toms, *What Does a Drop in Cable TV Subscribers Mean for MLB?*, BIZ OF BASEBALL, Nov. 29, 2010 ("Fewer and fewer games are available on local 'over-the-air' channels as sports continue to migrate to the more lucrative 'dual revenue' (sub fees and ads) model of cable TV."), http://bizofbaseball.com/index.php?option=com_content&view=article&id=4899:lwiib-what-does-a-drop-in-cable-tv-subscribers-mean-for-mlb&catid=67:pete-toms&Itemid=155 (visited Mar. 26, 2012).

[1234] *A Modified Madness*, DAILY VARIETY, Mar. 9, 2011, at 3. According to CBS Sports Chairman Sean McManus, "[w]e realized we couldn't bid for this just as an over-the-air broadcaster . . . . We needed a partner from a (number of) standpoints." Beginning in 2011, for the first time, every game was available for viewing in its entirety. *Id.*

cannot be easily replicated.[1235] ESPN charges the highest per subscriber license fee, $4.39 per month as of 2010, of all cable networks.[1236]

376. Sports cable networks earned about $2.2 billion in net advertising revenue in 2007, representing 25.9 percent of net operating revenues and $2.6 billion in 2010, representing 22.8 percent in net advertising revenues, lower percentages of net operating revenue than non-sports networks as reported above. Similar to the EBITDA and operating cash flow metrics we used to measure profitability in the previous sections,[1237] broadcast and cable network cash flow margins serve as indicators of their profitability.[1238] As we noted earlier, cable networks, such as ESPN, have higher cash flow margins than broadcast television networks, such as ABC.[1239] Among cable networks, however, sports networks, both national and regional, have lower cash flow margins than general entertainment and other genres.[1240] For instance, ESPN, which earns 15 percent of cable network industry revenues, had a cash flow margin of 25.3 percent as of 2010, while Nickelodeon had a cash flow margin of 64.6 percent.[1241] Sports fees have continued to rise during the recession. Between 2000 and 2010, RSN subscriber fees quadrupled from $1 billion to $4.2 billion. As of 2010, several MVPDs attributed expected additional increases in programming costs in part to rising fees for sports programming.[1242] Some analysts question whether RSNs, ESPN, and other networks will be able to pass on the increasing costs of sports programming onto MVPDs.[1243] Given the potential for subscribers to substitute or cut back on their MPVD subscriptions, some MVPDs have decided to price sports programming on a separate tier, and others may follow suit.[1244]

[1235] *See, e.g., News Corp-DirecTV Order*, 23 FCC Rcd at 3305, ¶ 87, *supra*, n. 101. For example, when Disney first considered purchasing full season NFL rights for $8.8 billion for ESPN in 1998, CEO Michael Eisner justified the acquisition after getting a guaranteed 20 percent compounded growth rate in subscriber fees from all MVPDs. James Andrew Miller & Tim Shales, ESPN: THOSE GUYS HAVE ALL THE FUN 406-412 (Back Bay Books/Little, Brown & Co.) (2011). According to Comcast CEO Brian Roberts, "Michael Eisner knew that the NFL was unlike any other programming, and he used it to impose the most dramatic rate increases ever on cable customers. ESPN raised their rates more than 20 percent for seven straight years." *Id.* at 409-10.

[1236] SNL Kagan Basic Cable Network Affiliate Revenue. In 2010, Comcast SportsNet Washington charged the next highest rate, an average of $3.18 per subscriber per month.

[1237] *See supra*, Secs. III.A.4., III.B.4, and III.C.4.

[1238] For networks, cash flow equals total revenues (*i.e.*, net advertising revenue, MVPD license fee revenues, and other revenue sources) minus SG&A and programming expenses. It excludes depreciation of plant property and equipment as well as amortization of goodwill. Cash flow margin equals the percentage of revenues attributable to cash flow. *See* SNL Kagan, *TV Network Industry Benchmarks: View Definitions.*

[1239] *See supra*, Tables 25 & 27.

[1240] FCC staff analysis of SNL Kagan data. *See* SNL Kagan, *TV Network Summary: Basic Cable Network by Net Advertising Revenue (2006 – 2010).*

[1241] SNL Kagan Basic Cable Report at 4, 7.

[1242] Charter 2010 Form 10-K at 8; Comcast 2010 Form 10-K at 25; Insight 2010 Form 10-K at 36; Suddenlink 2010 *Annual Report* at 12; Mediacom 2010 Form 10-K at 11, 25.

[1243] Sarah Barry James, *The Danger of Specialized Sports Networks*, SNL Kagan, Oct. 24, 2011.

[1244] One recent example is Cox Communications' offer of an economy package for $35 a month that includes several basic cable networks, but excludes ESPN and RSNs. Comcast and Time Warner Cable have also tested and offered similar tiers. Deborah Yao, *Cox Rolling Out Economy Cable TV Tier*, SNL Kagan, Jan. 24, 2012, at 1-2. DISH Network, which positions itself as a low-cost MVPD (in contrast to sports-centric DIRECTV, which offers exclusive NFL Sunday Ticket programming), has reportedly considered dropping ESPN if it does not agree to be distributed on a separate sports tier, to keep prices in check for subscribers who are non-sports fans. In New York, (continued….)

2. Distribution Strategies

377. As discussed elsewhere in this Report, technology continues to evolve and provide alternative methods for the distribution, storage, and consumption of video content, such as DVR and VOD.[1245] Alternative distribution of video content entails an evolution of rights between the networks, affiliates, and studios as well as strategic business decisions of the parties. We now describe key examples of these evolving relationships below.

378. *Broadcast Television Programming and Network Affiliates.* The increasing availability of network programming through a variety of video distributors has impacted the relationship between networks and their affiliates. As described above, broadcast network programming is available both via MVPD VOD service and from OVD services such as iTunes and Hulu. For example, iTunes began selling broadcast network programming in 2005. Specifically, in October 2005, ABC struck an agreement with iTunes for EST for $1.99 per episode.[1246] NBC followed with an iTunes agreement in December 2005 to distribute programs from NBC Universal broadcast and cable networks.[1247] When these networks began selling programs to iTunes, they did not have formal compensation agreements concerning these types of arrangements with their broadcast television affiliates in place.[1248] Many affiliates were displeased that the networks had neither apprised them nor sought their permission prior to striking the deal with iTunes.[1249] NBC offered iTunes more programs than ABC, in part because its affiliation agreements allowed redistribution of more in-season programs, while ABC's affiliation agreements limited it to redistribute only 25 percent of its prime time schedule.[1250]

(Continued from previous page) DISH Network has dropped three RSNs – SportsNet New York, YES, and MSG Plus. DISH Network CEO Charlie Ergen has stated that if only 15 percent of subscribers in a market actually watch sports programming, it may be a good idea for one of the MVPDs not to carry RSNs. Derek Baine, *Dish to Dump ESPN?*, SNL Kagan, Sept. 13, 2011, at 11.

1245 *See, e.g.*, News Corp. 2010 Form 10-K at 33; Time Warner 2010 Form 10-K at 18.

1246 The agreement also covered series from the Disney Channel. The Walt Disney Co., *Disney, ABC & Apple Announce Deal to Sell TV Shows Online; Hits to Include "Desperate Housewives," "Lost," and "That's So Raven"* (press release), Oct. 12, 2005.

1247 Apple Inc., *NBC Universal & Apple Offer New Primetime, Cable, Late-Night & Classic TV Shows on the iTunes Music Store* (press release), Dec. 6, 2005. Sales from iTunes sales breathed new life into NBC's *The Office*. While the show was not a primetime hit as of January 2006, it often took up half the slots of Apple's lists of top 20 television episodes for sale on iTunes. Josef Adalian, *Peacock Preening with iTunes Presence*, DAILY VARIETY, Jan. 3, 2006 at 1.

1248 Glen Dickson, *Broadcasters Cut Out of Convergence*, BROADCASTING & CABLE, Jan. 16, 2006, at 38. CBS, however, agreed to provide a share of revenues to affiliates when it reached a distribution agreement with Google. *Id.*

1249 Michele Greppi, *ABC Affils Remain Uneasy; Network Does Little to Erase Concerns Raised by iPod Pact*, TELEVISION WEEK, Oct. 24, 2005, at 5. ABC claimed that Disney's non-disclosure agreement with Apple prevented it from doing so. Andrew Wallenstein & T.K. Arnold, *Disney-Apple Pact Upsets Affiliates*, THE HOLLYWOOD REPORTER, Oct. 13, 2005. Likewise, ABC did not believe a prior agreement it reached with affiliates to limit the amount of programming it redistributed applied to iTunes. Michele Greppi, *Affils Slighted by Big 3's VOD Deals; Stations Want Info on How Revenues Will be Split*, TELEVISION WEEK, Nov. 14, 2005, at 5.

1250 Josef Adalian, *Peacock Preening with iTunes Presence*, DAILY VARIETY, Jan. 3, 2006 at 1. Years earlier, ABC, CBS, and FOX had reached agreements with affiliates that gave affiliates additional advertising spots in network programming and/or other revenue-sharing opportunities in exchange for allowing the networks to redistribute a limited amount of network programming in-season and on a nationwide basis. In return, the affiliates helped defray the networks' costs for sports rights. Michele Greppi, *Affils: Exclusivity is Dead*, TELEVISION WEEK, Apr. 17, (continued....)