RETRANSMISSION CONSENT NEGOTIATIONS:

Market Forces at Work

Mark R. Fratrik, Ph.D.

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EXECUTIVE SUMMARY

Public complaint has been offered by representatives of the cable industry over the negotiating position of local over-the-air television stations concerning their retransmission rights. What the local cable systems fail to mention, however, is that local cable systems have long derived benefits from carrying local stations. In this paper we will demonstrate the relative values of local television stations using audience share information and industry estimates of prevailing cable network monthly subscriber fees.

Some of the major points highlighted in this paper include:

- The affiliates of the four major networks (ABC, CBS, NBC, and Fox) attract notably larger audience shares than major cable networks in the four selected markets.
- Popular cable networks charge local cable systems between .25¢ and .89¢ per subscriber per month in order to carry those signals.
- Local cable subscribers look to local cable systems and pay their monthly cable bills in part for the delivery of local television stations.
- DBS service providers, as well as telephone companies entering into the video programming delivery business, recognize the value of local television stations and have successfully negotiated those retransmission agreements.
- The cable system operators had previously demonstrated the value of these local television stations in prior retransmission negotiations by providing carriage of new cable networks created by broadcasters, such as ESPN2, FX, or local cable news channels.
- The fact that several cable systems are conducting their negotiations through very public campaigns is a clear sign that cable systems place value on those local television stations, hoping outside pressure will lead to lower prices for carrying those stations.

When left to market forces, with local cable systems and local television stations negotiating without restraint, these negotiations will lead to a market-determined price representing the local value of those television stations. Each party has strong incentives to reach an agreement, which will result in cable customers continuing to receive the popular local station programming they expect in exchange, in part, for the payment of their monthly cable bills. Unfettered negotiations leading to these market solutions are exactly what the 1992 Act intended for these industries.

Introduction

Public complaint has been offered by representatives of the cable industry over the negotiating position of local over-the-air television stations concerning their retransmission rights. Local cable companies, and their parent multiple system operator owners, have publicly complained that they are being forced to pay to carry these local television stations that can be seen for free via terrestrial broadcast sets. What the local cable systems fail to mention, however, is that local cable systems have long derived benefits from carrying local stations, and only upon passage of the 1992 Cable Consumer Protection and Competition Act did local stations obtain the rights to negotiate (every three years) for transferring those rights for carriage. These negotiations are similar to negotiations in other industries between a supplier and a reseller and are simply market forces at work. In fact, the 1992 Act was intended in part to ensure the creation of a vibrant and competitive video marketplace that included a variety of program distributors. It has been very successful in this regard, as satellite has gained a significant share of the multichannel video program distribution (MVPD) market, and telephone companies have emerged in recent years as important new MVPD participants.

The negotiations between local cable systems and local television stations are just one set of negotiations that has occurred between local television stations and various providers of video services in the years since the passage of that legislation.[1] Local stations have successfully negotiated with Direct Broadcast Satellite (DBS) services, and very recently, have successfully negotiated with telephone companies entering into the video programming provision industry in many local areas. Only with certain cable companies have the negotiations devolved into situations where the local cable system has mounted a campaign demeaning the value of local television stations to their systems. The other providers, DBS and telephone companies, see the benefits they realize from that carriage and have successfully and quietly negotiated deals with these local stations compensating those stations for the value they give to their video programming services.

In this paper we will demonstrate the relative values of local television stations using audience share information and industry estimates of prevailing cable network monthly subscriber fees. We will also discuss other market revealed information that corroborates the value that carriage of local television stations provides to local cable systems. The retransmission negotiations between those television stations and cable systems, if left to market forces, will lead to market determined values for carrying those local television stations.

Value of Local Television Broadcasters

It is very easy to demonstrate the value of local television broadcasters by examining the audience shares these stations attract relative to the audiences attracted to the cable networks that local cable systems pay considerable sums to carry. Table 1 below shows the shares of the major television stations (ABC, CBS, Fox, and NBC affiliates) in four television markets along with

[1] The FCC groups these providers into the Multichannel Video Program Distributor services (MVPDs).

the shares of some of some popular[2] cable networks (Discovery, MTV, TBS and TNT). These audience shares are from the most recent completed audience survey period[3] in November 2006.

Table 1

COMPARISION OF LOCAL TELEVISION STATIONS WITH NATIONAL CABLE NETWORKS IN FOUR MARKETS

Anchorage, AK		**Honolulu, HI**		**Las Vegas, NV**		**San Francisco, CA**	
Station/Cable Network	**Share[4]**	**Station/Cable Network**	**Share**	**Station/Cable Network**	**Share**	**Station/Cable Network**	**Share**
KTUU (NBC)	23	KGMB (CBS)	13	KLAS (CBS)	12	KGO (ABC)	10
KTVA (CBS)	13	KHON (Fox)	13	KVBC (NBC)	11	KPIX (CBS)	8
KIMO (ABC)	7	KITV (ABC)	10	KTNV (ABC)	7	KNTV (NBC)	7
KTBY (Fox)	5	KHNL (NBC)	8	KVVU (Fox)	5	KTVU (Fox)	6
Discovery	0	Discovery	0	Discovery	2	Discovery	0
MTV	0	MTV	0	MTV	1	MTV	2
TBS	0	TBS	0	TBS	2	TBS	2
TNT	0	TNT	2	TNT	3	TNT	2

Clearly, in all of these markets the local television stations affiliated with the traditional networks attract noticeably larger audiences than the general entertainment cable networks.[5] Yet,

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2 All four of these networks are in the top 20 cable networks in terms of audiences. *Economics of Basic Cable Networks, 2006*, 12th annual edition, Kagan Research 2006, pp. 45-46.

3 The four months of the year when all 210 television markets are surveyed are commonly referred to as "sweeps periods."

even with those smaller audiences, these cable networks are able to extract substantial monthly amounts from local cable systems in their negotiations for carriage. Table 2 below shows the average monthly fees that cable systems pay these national cable networks for that carriage.

Table 2

2006 Cable Network Monthly License Fees per Subscriber

Cable Network	**Monthly Fees**[6]
Discovery	.25¢
MTV	.29¢
TBS	.30¢
TNT	.89¢

While there has been a decline in viewing shares to local television stations over the past twenty years, local viewers are still attracted to the programming provided by their local television stations. They look to the local cable systems and pay their monthly cable bills in part for the delivery of those local television stations. Some consumers may be in areas where they cannot receive those signals via over-the-air means or just want greater ease in viewing those channels by not having to deal with outside antennas.

[4] The audience share used is the Sunday through Saturday, 7:00 AM – 1:00 AM, full week share.

[5] The traditional networks affiliates tend to have noticeably larger shares in all local television markets.

[6] The monthly fees listed are the calendar year average fees for 2006 as reported in *Economics of Basic Cable Networks, 2006,* 12th annual edition, Kagan Research 2006, pp. 58-60.

The DBS service providers knew the benefits that that local viewers place on the provision of local television stations, as they have successfully obtained the rights to retransmit those signals through negotiations. Since DBS service providers started providing those local signals, the number of DBS subscribers has substantially increased, finally providing some competition to local cable systems. Likewise, local telephone companies that are beginning to provide those video programming services also have successfully negotiated with local television stations for those retransmission rights. They too recognize the value of having those local stations for their overall service.

Finally, the cable industry itself had previously demonstrated the value of these local television stations in prior retransmission consent negotiations. Soon after the passage of the Act, during the first and second retransmission consent negotiation periods, many local cable systems and their parent multiple system operator owners negotiated with the owners of some large television groups agreeing to carry the new cable networks associated with these groups in order to obtain the rights to retransmit their local television stations. The local cable systems were able to continue to reap the benefits of carrying local stations while indirectly "paying" the owners of these local stations.

These negotiations led to the early acceptance and quick growth of several cable networks such as ESPN2, FX, and America's Talking (which later evolved to CNBC). While local cable systems did not *pay* local television stations cash for carriage, they certainly provided value to many owners of these stations by offering carriage of these new, broadcaster-owned cable networks, and in fact, paid the television station/new cable network owner monthly cable subscription fees.

Public Campaigns Against Local Broadcasters – What it Tells Us

Economists try to decipher information from existing markets and the actions that economic agents (consumers and firms) take in order to explain values of products and services. The relative audience share, along with the monthly subscriber fees local cable systems are paying for the cable network programming discussed above, paints a very clear picture showing that local television stations provide value to local cable systems. Secondly, evidence from the first series of retransmission negotiations when cable systems were providing channel capacity for new broadcaster-owned cable networks also supports that claim.

Further evidence is also now being offered during the present negotiations by the simple fact that several cable systems are conducting their negotiations through very public campaigns. If those cable systems realized little or no value from the carriage of these local television stations, they would instead make their offer to these local stations and if a mutually agreed to price was not arrived at, they simply would choose to not carry those local stations. Instead, these cable systems would substitute other cable networks on those available channels. The public campaign being run by these local cable systems is clear evidence that they realize the importance of carrying these local stations to their businesses, and simply do not want to pay that value to the owners of those stations. Dropping the stations from their channel lineups would lead some cable subscribers to cancel their subscriptions, leading to a decrease in local cable system revenues and profits. These cable systems are just trying to foster public pressure on local television stations to lower the prices that they are requesting.

When cable systems enjoyed a near monopoly status in the marketplace in the past, they had less reason to fear subscriber defections to competing MVPD services, and thus were in a position that enabled them to take advantage of the value that local television stations provided to cable services. These stations would not be paid the appropriate level of value in compensation for their carriage rights. Now that greater competition to cable systems exists, cable is arguing that it should not have to pay fair value to carry local television stations' signals, even though satellite and telephone companies choose to do so. In essence, the cable operators want their long time "free ride" to continue indefinitely, trying to use public pressure to substitute for market forces in these negotiations.

Conclusions

Negotiations between any suppliers (e.g., local television stations) and any resellers (e.g., local cable systems) are always tough. These negotiations become even more difficult when one level of this vertical change becomes more competitive and the outlook for further competition is even greater. This situation is clearly the case with local cable systems. After many years of virtually no competition, cable systems are finally facing increasing competitive pressures from DBS services and the new entry of telephone companies into video services. Therefore, it is not surprising to see local cable systems make these strong public arguments that they are being held hostage by local television stations. It is their attempt to develop outside pressure that they hope will lead to lower prices for carrying local television stations in order to maintain their profitability in the face of new competition.

Yet, no matter what you call it, this is still a negotiation between two independent parties – local television stations and local cable systems – who see benefits from successful negotiations. Each side has a strong incentive to find an optimal solution in such instances: stations desire cable carriage in order to receive the widest possible distribution for their programming, and therefore, have the opportunity to attract the largest possible number of viewers. At the same time, cable systems seek to provide their subscribers with the most attractive programming possible, among which local television station programming is invariably included, so as to not risk losing their customers to alternate multichannel programming distributors. This incentive for each side to reach agreement clearly works. Since the enactment of the 1992 Cable Act, there have been only a handful of instances where negotiations between stations and cable operators have reached a stage where a station actually has been removed from a cable system. In the vast majority of cases, the market forces at work have resulted in agreements that have been reached without such highly publicized actions.

In sum, when left to the market forces with these two groups negotiating without restraint, these negotiations will lead to a market-determined price representing the local value of those television stations. Unfettered negotiations leading to these market solutions are exactly what the 1992 Act intended for these industries.