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A sea change to retransmission landscape in TV

By Jonathan A. Loeb and Sara Rezvanpour

Four million subscribers nationwide staring at test patterns on their television screens; this was the potential disaster Time Warner Cable faced in late 2010 when it reached an impasse in its negotiations with Sinclair Broadcast Group Inc. over Sinclair's demand for higher retransmission fees. Luckily for Time Warner Cable subscribers, the parties reached an agreement in early 2011 and television programming was uninterrupted. New York viewers were not so lucky when a failed retransmission fee negotiation led to a blackout of the first fifteen minutes of the 2010 Academy Awards. Later that year, New York viewers struck out again when another blackout interrupted coverage of the 2010 World Series.

These blackouts are an outgrowth of fee disputes between cable and satellite television distribution companies (distributors), such as Time Warner Cable, and broadcast television networks (content providers), such as Fox and ABC, which provide the programming that is retransmitted by distributors to viewers. The disputes typically center around the amount of money distributors must pay the content providers for the right to broadcast the content providers' programming. These disputes, which are on the rise, signal a major shift in power in favor of content providers.

In 1992, Congress enacted the Cable Television Consumer Protection and Competition Act, which requires content providers to choose whether their programming is carried by distributors via the "must carry" option, whereby the distributor has to carry the signal under rules specified by the Federal Communications Commission (FCC), but the content provider cannot charge the distributor for use of its signal; or the "retransmission consent" option, which requires the distributor to obtain the content provider's permission to carry the content provider's signal, and the content provider is free to demand compensation or to impose other requirements as a condition of carriage. Pub. L. No. 102-385, Sections 4-5, 106 Stat. 1460 (1992).

The Act was passed at a time when there was generally one distributor in each market, namely the franchised cable television company. As a result, content providers — both national networks and affiliated stations in small markets — tended to elect the "must carry" option and had no leverage to demand compensation from the limited number of distributors carrying their signals. However, there are now more distributors, as well as the Internet, both of which are providing additional methods of delivering content to viewers. Now content providers have the luxury of choosing among several distributors, who must vie for the right to carry the content providers' signals.

Another trend that has emerged since the passage of the Act is the vertical integration of content providers and distributors. Several distributors now own a percentage of select content providers. In January of this year, Comcast, the nation's largest cable distributor, inked a deal that gave it 51 percent ownership of NBC. This trend consolidates more power in the hands of content providers who have an incentive to favor their own distributor and discriminate against rival distributors. This shift has created more opportunities for national broadcast and satellite network content providers like Disney/ABC, Viacom/CBS, and Fox to elect the retransmission consent option and charge distributors an increased fee for carrying their signals.

In the past, when content providers elected the retransmission consent option, distributors carried the providers' content in return for a very low monthly retransmission fee (often 25 cents) per subscriber. More recently however, content providers are asking distributors to pay higher retransmission fees, closer to $1 monthly, per subscriber. Typically, content providers charge these increased fees for a bundle of channels combining popular programming with less attractive channels that the content provider wants to get more exposure for.

Content providers argue that increased retransmission fees are fair considering the quality programming they provide to distributors, and that they are essential to recovering advertisement spending. The need to recover advertisement spending is reflected in the shift toward the "pay-to-play" business model, adopted by Apple's iTunes and Netflix subscribers who stream movies on their digital devices. This model is one way to cultivate new revenue from existing programming. But content providers are not stopping there. They are now seeking to obtain higher fees not only from distributors, but also from affiliate stations.

Affiliate stations that produce local news and pass along the content they receive from parent networks to distributors are following the lead of their parent networks by demanding retransmission fees from distributors for their content. In turn, the major networks are demanding a higher percentage of the retransmission fees affiliates are receiving from distributors, arguing that the majority of the content affiliates are providing to distributors is generated by the content provider networks and not the affiliates. Retransmission fee disputes between content providers and affiliate stations could drastically affect viewers, especially with respect to access to local news in smaller markets. National networks are threatening blackouts as well as discontinuation of affiliations with stations that do not comply with these increased fee demands.

On April 12, Fox and its affiliates met at the National Association of Broadcasters meeting in Las Vegas, Nev. to discuss Fox's demand that its affiliates pay higher fees if they want to remain a part of the network. The proposed fee arrangement would require affiliates in the top 125 markets to initially pay content providers 25 cents per subscriber, with the amount to rise to 50 cents per month over four years. Affiliates with smaller markets would have lower fees of 15 cents per subscriber on a monthly basis, which would eventually climb to 25 cents in four years. If its affiliates refuse to comply, Fox has threatened to terminate its affiliation agreements with these stations.

But many distributors are fighting back. They argue that the fee negotiation process is tilted in favor of content providers, which are abusing their position by doubling fees in some cases. Distributors want to avoid blackouts by being allowed to carry content provider programming during the negotiation process and want to require mandatory arbitration when there is a dispute. Distributors are also having consumers weigh in on these disputes. Time Warner Cable recently launched a Web site called "Rollover or Get Tough" where it asks consumers to leave comments expressing whether they would be willing to pay more for programming or face possible blackouts. Distributors are calling upon the FCC to get involved in the debate, but it is not clear that the FCC has the authority to do so.

The FCC has opened a rulemaking on retransmission consent but content providers argue that the FCC should stay out of the debate since the majority of negotiations are completed without major setbacks and that the FCC lacks authority to make the changes distributors are seeking. The FCC has admitted that its authority over the issue is limited. Steve Broeckaert, Senior Deputy Chief of the FCC's Policy Division, stated recently that the FCC cannot order content providers to allow interim carriage of their programming during negotiations. It remains to be seen whether the FCC will intervene in these matters any further.

One thing is for sure...content providers are coming to the negotiating table with far more bargaining power than they used to wield. The growing number of distributors available to carry the content providers' signals in each market has freed content providers up to shop around for the distributor willing to pay the highest price for the content. Content providers can also sell a percentage of their business to distributors who become part owners in the provider company. A distributor with partial ownership of a content provider network is more inclined to carry that provider's signal. This presents content providers with an opportunity to favor their own distributors over other distributors including those willing to pay higher retransmission fees.

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To remain competitive, distributors must now share the revenue they collect from their subscribers with the networks and stations that created the content. Content providers are asserting their financial stake in the television broadcast industry with more leverage than ever before. With the FCC's abstention, the opportunities for content providers' economic growth are seemingly unlimited.

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