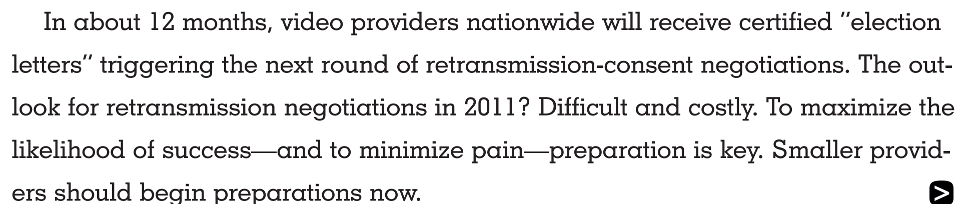
Retransmission-Consent Outlook

DIFFICULT and Costly

BY CHRIS CINNAMON, HEIDI SCHMID AND ADRIANA KISSEL

In a video world where most operators deliver 150-plus channels, broadcast stations represent no more than a small slice of channel lineups. Yet the carriage of a few broadcast channels involves a process that for many video providers, especially smaller ones, entails aggravating uncertainty, intense pressure and irrational cost increases. That process? Retransmission consent.



In about 12 months, video providers nationwide will receive certified "election letters" triggering the next round of retransmission-consent negotiations. The outlook for retransmission negotiations in 2011? Difficult and costly. To maximize the likelihood of success—and to minimize pain—preparation is key. Smaller providers should begin preparations now.

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WHY NTCA IS CONCERNED
About Comcast and NBC Universal

By Steve Fravel, NTCA Manager, Video Services

Those planning for retransmission-consent negotiations should keep an eye on the Comcast/NBC Universal merger, which could have ramifications for those negotiations. The merger between Comcast, the largest cable provider in the United States, and NBC Universal (NBCU), owner of national television network NBC, creates concern on several levels.

Will multichannel video programming distributors (MVPDs) that compete with Comcast have access to the content currently owned by NBC and Comcast at comparable and competitive terms? The fear is that Comcast will withhold access to "must have" content, or increase the licensing fees to unrealistic levels.

Currently, program access rules that prohibit content providers from denying content to competing programmers do not effectively address forced carriage, tying and bundling of network channels.

Comcast is the largest cable multiple-service operator and ISP in the United States. NBC Universal owns 10 NBC broadcast stations in addition to 16 Telemundo broadcast stations. It controls or has influence over nearly 55 "cable" network channels. Comcast controls another seven cable network channels and 11 regional sports networks. This merger isn't just a small bump in size for the two companies. It will lead to a truly "mega" conglomerate with troubling influence over Internet content and access.

Both Comcast and NBC have described their merger as a beneficial vertical integration. Given the horizontal properties of Comcast and the content appetite of such a large distributor, exclusivity and "subscriber"-only access to programs, channels, content and networks are real concerns.

Here are NTCA's recommendations on the proposed merger:

1. Require Comcast and NBCU to provide the Department of Justice and FCC full access to program contracts between Comcast and NBCU and other MVPDs, including access to clauses covering the prices, terms and conditions of programming, currently guarded under nondisclosure agreements.
2. Require Comcast/NBCU to offer rural MVPDs the lowest rate per subscriber for programming that is offered to other MVPDs.
3. Require Comcast/NBCU to offer its most desirable programming to other MVPDs on an a la carte basis with reasonable terms and conditions.
4. Prohibit Comcast/NBCU from bundling video content with Web content.
5. Prohibit Comcast/NBCU from offering its own programming exclusively to its subscribers.

What's the Big Deal?

One might ask: In a 150-plus-channel world, what is all the fuss about carriage rights for a few broadcast stations? For smaller providers, there are two key answers to this question.

First, it's the law. Since 1992, federal law has provided two, and only two, legal ways for a cable operator to retransmit a commercial broadcast station. The first is "must carry"—mandatory carriage for qualified stations that request it. The second is retransmission consent. Must-carry stations aside, the law is clear: no consent, no carriage. Carriage of a commercial station without consent violates FCC regulations, the Communications Act, and constitutes copyright infringement. Simply put, with limited exceptions, carriage of a commercial broadcast station without consent is not an option. (In individual cases, exceptions may be well worth exploring. Those are beyond the scope of this article.)

Second, the "Big Four" are "must have." Many video providers fear this: Without one each of ABC, CBS, NBC and Fox, customers will flee to competitors that carry all four networks. Consequently, most video providers conclude retransmission consent for the Big Four stations is an inescapable business imperative. Is this conclusion correct? Maybe. The evidence is mixed.

Through several proceedings, the FCC has developed a concept of must have channels, meaning channels a cable operator must have to compete. The FCC repeatedly has found that the Big Four networks are must have.

TV ratings data provides some support for this. While broadcast ratings have steadily declined over the past decade, the Big Four are still the most highly watched channels.

Fear of customer loss has some empirical foundation. In 2006, Mediacom engaged in a bitter dispute with Sinclair. Mediacom lost 22 stations for two months. Mediacom reportedly shed over 30,000 customers during and after the dispute.

Another case suggests a different result. In 2005, a dispute between Cable One and Nexstar resulted in the loss of several stations for nearly 12 months, including NBC and ABC affiliates. Cable One reported limited customer losses, attributing the results, in part, to a strong high-speed data business.

The temporary loss of a Big Four station should not doom a smaller video provider, especially if the business and customer communication are well-managed. But no

one should underestimate the difficulty of dealing with a station drop. Upset, confused customers, operational disruptions, high call-center volume and media inquiries will result. Losing a Big Four station is not the ordinary course of business.

Worse, broadcasters use their channels to agitate consumers against cable operators. We know of dozens of cases where broadcasters deployed screen crawls and ads announcing that specific cable companies risked losing a station. Some even encouraged viewers to switch to direct broadcast satellite.

In short, the overwhelming sentiment among video providers is that they want to keep their Big Four stations. And that is why retransmission consent is so important.

The Current Market

Does a retransmission consent "market" really exist? Some argue that the market is a fiction, contending retransmission consent occurs in a highly regulated environment heavily favoring broadcasters. Broadcasters, on the other hand, argue that retransmission consent epitomizes a "free market," just the result Congress intended. Leaving that debate for later, four important characteristics of today's "market" can be identified.

The broadcast business is under significant financial pressure. The economic collapse of 2008–2009 slammed the broadcast business. Advertising revenues, the financial lifeblood of stations, plunged. All major broadcast affiliate groups reported significant declines in revenues. Several significant bankruptcies occurred, including Pappas Telecasting (13 stations), Equity Media Holdings (120 stations), Young Broadcasting (10 stations) and Tribune (23 stations).

Broadcasters report significant increases in retransmission-consent revenue. Retransmission consent is one revenue growth area for broadcasters. In 2009, most broadcasters reported double-digit growth in retransmission-consent revenue (Nexstar, 68.5%; LIN TV, 47%; Belo, 29%), and one broadcaster reported triple-digit growth (Gray Television, 414%).

Broadcasters have tapped larger cable operators for fees. Over the past six years, broadcasters targeted smaller operators for significant fees. Broadcasters now have moved up the ladder to larger cable operators, as shown by recent fights between Time Warner and News Corp./Fox, and between Cablevision Systems and Walt Disney/ABC. After very public battles, Time Warner and Fox reached an accord just before the Sugar Bowl, and Cablevision and Disney settled just as the Oscars aired. While the terms of the deals are not public, it is widely believed that these large cable operators agreed to pay significant cash compensation.

Networks are demanding a cut of affiliate revenue. Until recently, broadcast affiliates retained retransmission-consent fees as compensation. Now, powerful broadcast networks like ABC and CBS, suppliers of network programming to their affiliates, are reportedly demanding, and obtaining, a cut of affiliate retransmission revenues. Reportedly, ABC now requires affiliates to pay the network 50% of retransmission-consent revenues.

When considering the market, all of these forces increase the pressure on stations to demand ever higher fees.

What's Next?

We need not consult an oracle to offer this prediction: The price of retransmission consent is going up, and at a rate much higher than video providers would like. Further, the rate of increase of retransmission-consent fees will be greater than for any other input to the video business. That is strong indication of marketplace failure. That conclusion is widely shared. Pointing to "rampant price discrimination against small cable companies," American Cable Association (ACA) President Matt Polka recently stated, "The retransmission-consent regime is broken and needs FCC intervention to protect consumers and promote competition."

The conclusion that retransmission consent is overripe for reform led a diverse group in March 2010 to petition the FCC.

The petition for rulemaking, signed by diverse interests including Time Warner Cable, DirecTV, ACA, Public Knowledge, Verizon and nine others, focuses on retransmission-consent pricing and loss of signals. According to the petition:

> As broadcasters now demand significant cash for carriage of their signals, consumers are held hostage as MVPDs (multichannel video programming distributors) must choose between a rock and a hard place: Pay spiraling carriage fees and raise consumer rates, or be forced to drop local signals. The recurring threats of blackouts, high-stakes public 'showdown' negotiations and recent economic analyses have all confirmed what programming distributors have known for years: The retransmission-consent regime is broken.

To fix it, the petition asks the commission to consider price-setting mechanisms like arbitration, and to prevent broadcasters from pulling signals during disputes. The commission put the petition out for comment, with comments due after this article went to press.

Could this petition lead to genuine reform? Hope springs eternal, but it is hard to predict. While groups like ACA have advocated for retransmission-consent reform for several years, the petition represents the first time such a broad-based coalition has pushed the commission on the issue.

How Should Smaller Providers Prepare?

With that context, here are some practical suggestions. Foremost, the next 12 months will race by and retransmission-consent elections will stuff mailboxes before we know it, so the prudent small video provider should start

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planning now. Our suggestions:

Budget for higher costs. All available evidence points to continuing sharp increases in retransmission-consent costs. Programming budgets and rate increase plans should reflect this.

Trim programming costs. In the face of spiraling retransmission-consent costs, operators face tough choices. Video providers should look for opportunities to reduce programming costs by removing weaker channels when contracts expire, thereby saving license fees.

Educate customers. Smaller providers benefit from closer customer relationships. Rural telcos truly are local businesses, with goodwill and trust built over years. That can provide a basis for customer outreach well in advance of December 2011, educating customers on retransmission consent, the possibility of losing signals and the certainty of increasing costs. For that, they can blame the broadcasters.

Know the rules. Retransmission consent remains a highly regulated transaction. All players must follow a detailed set of rules governing elections, negotiations and carriage. Mistakes by either side can impact carriage rights. It is essential that a smaller provider have a working understanding of these rules or risk being taken advantage of and missing opportunities. If you do not have the expertise on staff, retain someone that does. It will be worth it.

Read the fine print! Beware! Many broadcaster contracts contain costly traps for the unwary. Scrutinize the fine print with care, and negotiate terms and conditions.

Support reform. Finally, if you agree that retransmission consent is broken (and you should), the FCC and Congress cannot hear this message too often. Through organizations like ACA, NTCA and others, you can help deliver the message: Retransmission consent hurts consumers and smaller providers. Fix it!

We cannot sugarcoat it. Retransmission in 2011 will be difficult and costly for smaller providers. To maximize success (or minimize the pain), two overriding themes should guide smaller providers: Realistic assessment of the market and thorough preparation. We hope this article contributes to efforts on both fronts.

The authors are attorneys with the law firm of Cinnamon Mueller. Chris Cinnamon is a managing member of Cinnamon Mueller. He can be reached at cccinnamon@cm-chi.com.