ACI
The American Consumer Institute
Center for Citizen Research

ConsumerGram

Retransmission Consent: The Evidence of Market Power

Steve Pociask[1]

Background

When cable TV services began over 60 years ago, the idea was to improve television reception for consumers living in remote areas. Today, Cable TV services have become so commonplace that they pass nearly every household in the U.S. Alternatively, less than the 10% of households now exclusively watch over-the-air television.[2]

While the decline in over-the-air broadcast viewing reflects consumer preference, public policies have had a harder time letting go. In 1992, Congress enacted the must-carry and retransmission consent rules, allowing local broadcast stations to choose between mandatory carriage and negotiated carriage. If a station elects must-carry, cable TV providers are required to carry that local station's programming. If a station elects retransmission consent, the cable TV provider and the local station negotiate payment and other terms for the programming. However, the negotiations between broadcast stations (such as stations that air Fox and ABC programming) and distributors (most notably cable TV companies) have been somewhat contentious at times, leading to blackouts that have that have left viewers the biggest victims.

One major reason for strained negotiations has been the FCC's network non-duplication rule, which prevents cable TV companies from negotiating with broadcast stations outside of a local market that carry the same programming, thus forcing the cable company to negotiate

[1] Steve Pociask is president of the American Consumer Institute, Center for Citizen Research, a nonprofit 501c3 educational and research institute. For more information, visit www.theamericanconsumer.org.
[2] Nielsen research states that "less than 10% of homes receive their TV signal over-the-air." See, "U.S. Homes Add Even More TV Sets in 2010, Nielsenwire, Nielsen, April 28, 2010, http://blog.nielsen.com/nielsenwire/consumer/u-s-homes-add-even-more-tv-sets-in-2010/.

only with one local station and allowing the station hold its content hostage for higher compensation. After negotiations are completed, those higher programming costs are passed to consumers in the form of higher consumer prices.

Market Conduct

There are concerns that retransmission consent has provided broadcast stations additional leverage in their negotiations with distributors, even undermining the consumer benefits of competition.[3] In fact, a Congressional Research Service report concluded that retransmission consent provides broadcasters a stronger negotiating position over distributors and this leverage has coincided with the increase in cable TV competition with adverse consumer consequences, stating:

> *Ironically, the market consequence of greater competition in the distribution of video programming appears to be greater negotiating leverage for programmers with popular — and especially must-have — programming, resulting in higher programming prices that MVPDs tend to pass through at least partially to subscribers.*[4]

Do broadcasters, in fact, have negotiating leverage over cable TV companies? They do, if you believe the words of broadcast executives who demand an increasing share in compensation compared to other cable programming. As David Smith of Sinclair states:

> *I think it's just going to be an ongoing and continuing part of the business. Forever. This isn't something that just stops tomorrow because [the broadcast networks] deem it that they've got all the money they think they can get. We just have keep upping that number.*[5]

Because retransmission consent apparently provides negotiating leverage to the advantage of broadcasters, the onetime model that over-the-air broadcast would solely be "ad supported" has changed into what News Corporation COO has referred to as a "dual revenue business."[6] The evidence

---

[3] "FCC Votes to Reexamine Its Rules on Negotiations between Broadcasters and Cable Operators," Los Angeles Times, March 3, 2011, http://latimesblogs.latimes.com/entertainmentnewsbuzz/2011/03/fcc-votes-to-reexamine-its-rules-on-how-broadcasters-and-cable-operators-negotiate.html.

[4] Charles B. Goldfarb, "A Condensed Review of Retransmission Consent and Other Federal Rules Affecting Programmer-Distributor Negotiations," CRS Report to Congress, Congressional Research Service, No. RL34079, July 9, 2007.

[5] *Communications Daily*, May 5, 2011, p. 15.

[6] Chase Carey states "It's not rocket science. It starts with making it a dual revenue business. It doesn't make sense that broadcast is only ad supported." See, Ben Grossman, "Rupert's Main Man: Q&A with News Corp.'s Chase Carey," *Broadcasting & Cable*, Oct. 26, 2009, http://www.broadcastingcable.com/article/366208-Rupert_s_Main_Man_Q_A_With_News_Corp_s_Chase_Carey.php.

of the strong upward influence on the cost of programming can be found in broadcast executives' public statements of their desire to increase prices per cable subscriber, not only faster than inflation or faster than programming costs, but by several fold in just a few years. For example, CBS Corporation's CEO stated that the network would earn $100 million in retransmission fees in 2010, and it expected the number to grow "to at least $250 million" by 2012.[7] Fox executives have characterized as "reasonable" a marked increase in prices from $0.50 to $1 per subscriber for the broadcast content they transmit over the air for free, but also suggested that programming fees as high as $5 to $6 per subscriber were reasonable.[8]

If the current retransmission consent rules favor the broadcasters over the distributors, and broadcasters believe they can increase their prices faster than their costs, regulators have given broadcasters the upper hand in negotiations, which means higher costs for cable TV providers and, more importantly, higher prices for cable TV consumers. If data suggests that programming costs are, in fact, increasing faster than other cable TV costs, this suggests the presence of market power in the hands of broadcasters and public policy gone awry.

Evidence on Market Performance

Consistent with broadcast executive statements that broadcast programming costs should be increasing faster than (or at least keeping pace with) other cable TV programming costs, it is reasonable to expect escalating programming costs in the financial data of cable TV providers. An in-depth analysis by Craig Moffett at Bernstein Research provides a closer look at cable TV's revenues and their cost of programming.[9] Using 2004 through 2009 data for revenue and programming costs, Comcast and Time Warner Cable's programming and other costs were collected, estimated and combined. Analysis of these data shows that programming costs per

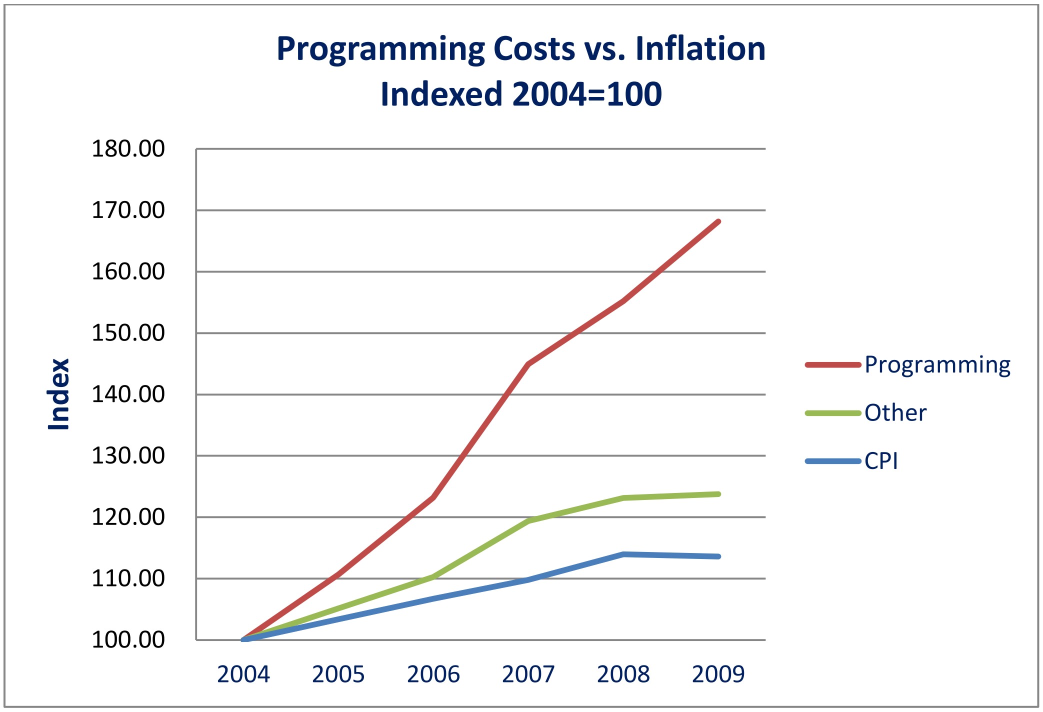
---

[7] "Les Moonves Says CBS Is Getting a Cut of Some Affiliates' Retrans," *Radio Business Report*, Mar. 1, 2010, *available at* http://www.rbr.com/tv-cable/21802.html.

[8] Citing an increase from $0.50 to $1 per subscriber as reasonable, see "Fox TV Chief: $1 Per Subscriber Is Reasonable," *CNBC Money Control*, Dec. 30, 2009, http://www.moneycontrol.com/news/business/fox-tv-chief-361-per-subscriber-is-%60reasonable%60_433018.html; citing $5 as reasonable, see Joe Flint, "News Corp.'s Chase Carey Is Getting Ready for Battle with Cable, Satellite Operators," *Los Angeles Times*, Dec. 7, 2009, http://latimesblogs.latimes.com/entertainmentnewsbuzz/2009/12/news-corp-coo-chase-carey-geting-ready-for-battle-with-cable-operators.html; and citing $5 or $6 as reasonable, see "Letter of Michael Hopkins to Bill Lake," Chief, Media Bureau, Oct. 25, 2010, at 4, *available at* http://www.fcc.gov/fox-letter-2010-25-10.pdf.

[9] Craig Moffett, "Retransmission Consent: Sizing Up the Battle between Broadcasters and Distributors," Bernstein Research, *Whitebook*, May 2010.

subscribers has, in fact, raised prices much faster than the general rate of inflation.[10] The graph below shows the change in content costs, other inputs and general inflation (as measured by the Consumer Price Index for all items).[11]



To summarize, the data derived from Moffett's *Whitebook* show that programming costs are increasing at a compound annual rate of 11.0%, compared to 4.4% for all other inputs and 2.6% for general inflation. That is, programming costs are increasing more than *four times* faster than the rate of inflation. Considering that broadcast executives have stated their intention to increase programming prices relative to other cable programming, broadcast programming costs per subscriber most likely increase faster than other (non-broadcast) programming costs per subscriber. In other words, the increase in programming cost (as depicted in the graph above) likely underestimates the true rate of increase in broadcast programming costs. Thus, broadcast prices are likely to be increasing faster than broadcast input costs. The divergence between price increases and cost increases suggests the

[10] Direct Gross margins for the years 2004 through 2009 are available for Comcast and Time Warner Cable (see Moffett's analysis at Exhibit 37 on p. 23). Direct Gross profits per dollar per subscriber for the years 2004 through 2009 are available for Comcast and Time Warner Cable (see Moffett's analysis at Exhibit 38 on p. 23). Content costs can be derived using Moffitt's definition of direct gross margins, which equals total revenues minus content costs, all divided by total revenues (see Moffitt at p. 23).
[11] Other inputs are the difference in revenues and content costs, essentially other expenses (including wages, salaries and supplements), cost of capital (profits), depreciation, taxes and other costs.

increasing presence of market power.[12] Thus, retransmission consent is providing a windfall to broadcasters and consumers are ultimately paying more for cable TV services.

Summary

This *ConsumerGram* provides evidence that broadcasters are increasing prices by at least four times the rate of inflation, and have done so over the course of several years. This sustained rate of increase suggests that broadcasters are exerting market power – even over the largest cable TV providers, who should be in the best position to negotiate. This leverage may even be more pronounced in competitive markets, thus undermining the consumer benefits of competition. Based on these data, regulations that provide broadcasters an upper hand in negotiation are no longer needed, and in fact are counterproductive to consumer welfare.

Based on the high and rising prices for over-the-air programming, it is clear that distributors are at a disadvantage when it comes to negotiating with broadcasters. This means that consumers are the big losers of retransmission consent – both by potential blackouts and paying higher prices for years to come.

About The American Consumer Institute Center for Citizen Research
The American Consumer Institute Center for Citizen Research is a 501(c)(3) nonprofit educational and research institute. For more information, please visit www.theamericanconsumer.org.

[12] A well-known economic test for the presence of predatory pricing is based on the divergence between price and cost (namely, the Areeda-Turner Rule).