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## Adjusting the Picture: Television Regulation for the 21st Century

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**Abstract**
*Television broadcasting, long subject to uniquely comprehensive regulation, has become economically "normal," characterized today by competition and innovation. The industry however, is seeing growing conflicts between traditional broadcasters and the newer cable and satellite providers over retransmission rights. Some have urged the FCC to take a more active role in order to ease these conflicts. A better approach would be to reduce the FCC's role and to eliminate the morass of unnecessary television rules currently on the books. The Heritage Foundation's James Gattuso explains how the proposed Next Generation Television Marketplace Act is a good starting point for aligning policy with today's television realities.*

This paper, in its entirety, can be found at
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In 1981, then-chairman of the Federal Communications Commission (FCC) Mark Fowler declared: "Television is just another appliance. It's just a toaster with pictures."[1]

The quip caused uproar in Washington, where television has long been considered a unique industry, justifying its protection from competition, and subjecting it to the control of regulators and politicians. But today, 30 years later, Fowler's statement seems remarkably apt: TVs may not toast bread, but the television marketplace has become "normal" in an economic sense, characterized by competition and innovation. It is time that the regulation of television caught up with this marketplace reality.

The television industry today has more than its share of internecine conflict. A particular flashpoint has been the rising fees that broadcasters are demanding from cable and satellite TV providers for the right to retransmit their programming. Cable and satellite TV firms are crying foul, and have asked Congress and the FCC to put the brakes on rates, albeit indirectly, through new regulation. The answer should be "no."

Instead of adding regulations, policymakers should eliminate the

### Key Points

- Broadcast television, once the dominant source of video programming for American consumers, is today only a marginal delivery mechanism for TV signals, and a shrinking source of program content.
- Broadcasters should be able to negotiate compensation from cable firms for the retransmission of their programming. While fees paid to broadcasters by cable firms for such retransmission are increasing, they are still below the rates paid for cable-only programming. The FCC should resist calls to interfere with the private negotiations over these fees.
- Congress should replace the current FCC-based compensation system with one based on copyright law, as proposed in the Next Generation Television Marketplace Act.
- The FCC and Congress should eliminate the many obsolete regulations that distort the television marketplace, including must-carry rules and ownership limits.

morass of unnecessary television rules now on the books to make broadcast policy consistent with the 21st-century television market. Legislation to do just that is now being considered by Congress. The Next Generation Television Marketplace Act, sponsored by Senator Jim DeMint (R–SC) and Representative Steve Scalise (R–LA), would lift federal rules and restrictions on TV programming and distribution that no longer make sense. If fully adopted, the proposal would go far toward ensuring a free marketplace for television content.

## Some TV History

For nearly half a century after Philo Farnsworth began transmitting the first TV signals in the 1930s, the word "television" was synonymous with "broadcast television." Virtually all programming was received via over-the-air signals that were broadcast by local television licensees, most of them affiliated with one of the three major networks—ABC, CBS, and NBC—to rooftop antennas and TV set-top "rabbit ears" across the country. Cable television was a mere backup service, relaying broadcasts for those unfortunates who, for topographical reasons, could not receive broadcast signals directly.

Broadcasters' dominance was not solely due to the absence of alternative technologies or willingness by cable firms to compete. The Federal Communications Commission, relying on its vague statutory mandate to further the "public interest," actively blocked the development of cable TV, arguing that it was a threat to the free television offered by broadcasters.

Cracks began to appear in this managed marketplace in the 1960s, after the courts forced the FCC to lower regulatory barriers. Thereafter, the cable business grew quickly, growing from 650,000 subscribers in 1960 to 4.5 million in 1970, to over 50 million in 1990.[2] During the same period, new cable-only stations, such as the HBO movie channel, the ESPN sports channel, and the all-news CNN, began to offer programming that competed with that of broadcasters.

## The 21st-Century TV Marketplace

Today, broadcasters play only a minor role in the *delivery* of television content to American homes. According to Nielson ratings, only 9.6 percent of U.S. households relied on over-the-air broadcasts last year.[3] While broadcasters still maintain towers and beam signals over their federally licensed frequencies, very few Americans receive their television signals this way.[4]

Cable TV is now the most common delivery mechanism. But even cable faces significant competition in today's world. As of late 2010, cable TV served 60 percent of the "multichannel video programming distributor" (MVPD) market. Satellite providers DIRECTV and DISH Network accounted for another third, with offerings from telecommunications providers, such as Verizon's FIOS and AT&T's U-Verse, serving some 7 percent more.[5]

In addition, yet another choice for television distribution is now becoming available: online video service. This market segment is still developing, but growing fast. Nielson reports that 48 percent of Americans now watch at least some television programming online[6] using services such as Hulu, Amazon, and Apple TV.

All of this means that television viewers today enjoy unprecedented choice in how and by whom their television content is delivered. At the same time, the amount of available content has reached levels once unimaginable. A generation ago, television consumers typically had access to from three to seven television channels. Today, MVPD services offer hundreds of channel sources, with thousands more program options via on-demand services.

Given this explosion in programming choices, it is no surprise that the audiences for broadcast television—even including those watching via cable—have shrunk. During the 1980s, broadcast programming drew 80 percent of the prime time

1. "Reason Interview with Mark S. Fowler," Reason, November 1, 1981.
2. Bruce M. Owen and Steven S. Wildman, *Video Economics* (Harvard University Press, 1992), p. 212.
3. Federal Communications Commission, "Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming: Fourteenth Report," July 20, 2012 (hereinafter FCC Competition Report), footnote 705.
4. In recent years, there has been a small resurgence in viewership of over-the-air television, but the numbers remain small. See Christopher S. Stewart, "Over-the-Air Catches Second Wind, Aided by Web," *The Wall Street Journal*, February 21, 2012, http://online.wsj.com/article/SB1000142405297020405980457729451364593094.html (accessed October 17, 2012).
5. FCC Competition Report, paras. 30–32.
6. FCC Competition Report, para. 237.

TV audience.[7] Today, that share is just above 30 percent.[8] This leaves broadcasters as significant players in the programming marketplace, but hardly the behemoths they once were. In effect, broadcasters are now little more than just another set of cable programmers, with a role and with market power little different than cable-only programmers such as Bravo or Showtime.

## Conflict Over Program Fees

Over the past few years a growing conflict between broadcasters and certain cable and satellite TV firms has emerged over compensation for TV programming.

When cable TV was a mere supplement to traditional broadcast television, little consideration was given to payment for program content—after all, extending the reach of broadcast stations was in the interest of both broadcasters and cable firms. Initially, the Supreme Court ruled that retransmitting broadcast station programming via cable TV did not violate copyright law.[9] This left broadcasters—as well as the original producers of their programming—without compensation for the retransmission of their product.

In 1976, Congress reversed that court decision, but still left copyright holders without significant compensation for the retransmission of their programming by cable providers. Specifically, the 1976 law subjected retransmitted broadcast programming to a compulsory copyright license, which requires rights holders to license retransmissions at rates set by regulators. These rates are exceptionally low, totaling less than $200 million industry-wide in 2009.[10]

Finally, in 1992, Congress provided a new non-copyright avenue for compensation, granting broadcasters "retransmission consent" rights, requiring cable and satellite networks to obtain explicit permission from broadcast stations in order to use their signals. The details of this system of compensation were left to the FCC.

Until recently, "retransmission consent" payments to broadcast stations rarely included monetary compensation, and instead generally were composed of in-kind concessions, such as advertising time. This has changed over the past few years. Broadcasters, faced with shrinking advertising revenues, have turned increasingly to retransmission consent fees as a source of income.

This has prompted a backlash from many, mostly smaller, cable and satellite TV providers. In large part, the conflict has played itself out at the negotiating table, as individual broadcasters and cable networks hammer out compensation agreements. In a growing number of cases, the hard bargaining has led to temporary suspensions of program carriage. Such blackouts have increased in recent years. According to the American Television Alliance, a lobby group representing cable and satellite providers, blackouts in 2012 have already hit record highs, with programming on one or more channels interrupted in more than 40 cities through the first half of the year.[11]

The cable and satellite providers are pushing the FCC to intervene more aggressively in the process. Calling the current system "broken," they have argued that it is time to reconsider "retransmission regulations." Short of full repeal, they have urged the FCC to step in when retransmission negotiations falter, order mandatory arbitration, or impose temporary carriage agreements. While not endorsing such steps, the FCC has proposed some tinkering with the compensation system. These include tightening requirements that the parties negotiate in "good faith," and methods to give consumers better notice of impending blackouts.[12]

## New Regulations Unnecessary

Policymakers should not jump on the fee-control bandwagon. Requiring the consent of broadcasters before their product is used by others does not constitute interference with the marketplace. Rather, consent, and the ability to demand compensation, is part of any marketplace. It is the proposed

7. See Jonathan Levy, Marcelino Ford–Livene, and Anne Levine, "Broadcast Television: Survivor in a Sea of Competition," FCC Office of Plans and Policy *Working Paper* No. 37, September 2002.
8. FCC Competition Report, para. 212.
9. *Fortnightly Corp. v. United Artist Television, Inc.*, 392 U.S. 390 (1968).
10. Government Accountability Office, "Statutory Copyright Licensing: Implications of a Phaseout on Access to Television Programming and Consumer Prices Are Unclear," GAO-12-75, November 2011.
11. American Television Alliance, "Halfway to a Hundred Blackouts: More than a Dozen New Stations Affected," June 8, 2012, http://www.americantelevisionalliance.org/press-releases/halfway-to-a-hundred-blackouts-more-than-a-dozen-new-stations-affected/ (accessed October 17, 2012).
12. For a summary of the various proposals, see Meg Burton, "Reforming Retransmission Consent," *Federal Communications Law Journal*, Vol. 64 (May 2012).

regulation-increasing reforms that would interfere in the marketplace.[13]

Moreover, there is little reason to believe that under the present system, cable and satellite providers are paying unreasonable sums for programming. While, in percentage terms, the increases for which the broadcasters are asking are large—Hearst Television, for instance, is currently seeking a 300 percent increase in fees received from Time Warner Cable—the total compensation received by broadcasters remains far lower than that received by cable-only channels.

According to SNL Kagan, a media statistics firm, while broadcasters account for about 35 percent of all TV viewership, they are predicted to receive only 6.7 percent of the $30.9 billion in total compensation expected to be paid to advertising-supported television programmers in 2012.[14]

The current gap in compensation is even more apparent when looking at specific networks. CBS, for instance, was able to garner an increase is compensation from 18 cents per cable subscriber in 2009 to 45 cents in 2012. That is a hefty increase, but pales in comparison to rates charged by non-broadcast channels. In 2015, SNL Kagan predicts, ESPN will be receiving $6.67 per subscriber; TNT, $1.41; Disney Channel, $1.06; NFL Channel, 95 cents; Fox News, 92 cents; and ESPN2, 85 cents.[15]

Advocates of intervention also point to an increase in program blackouts. Certainly, even small service interruptions are an inconvenience for consumers. Blackouts—especially when it comes to sports coverage—are politically toxic. But they hardly constitute a national crisis. Most, in fact, are limited in scope and duration. In July, for instance, 13 Hearst Television stations in 11 cities were dropped from Time Warner Cable systems. The blackout lasted 10 days before the firms reached agreement on July 19.

Nor are service interruptions a sign of a dysfunctional market. Standoffs between suppliers and buyers in the business world, after all, are not at all unique. Pulling one's product is a negotiating tactic, like walking out of a car dealership as a way to get a better deal from the salesman. Nor does it point to a particular problem in the broadcast television market. Blackouts of non-broadcast cable TV channels also occur, even though such negotiations do not operate under the FCC's retransmission consent framework.[16]

## How to Achieve Three Overdue Goals

Increased regulatory intervention is simply not justified in this competitive and quickly changing marketplace. Rather, policymakers should focus on three goals: (1) removing obsolete restrictions, (2) ensuring that new and old technologies are subject to similar rules, and (3) "normalizing" television by applying the same rules as to the rest of the economy. Legislation is already pending in Congress that would go far toward achieving these goals. The Next Generation Television Marketplace Act (S. 2008/H.R. 3675) would implement the most comprehensive reform of television regulation in decades. Its provisions include:

**Replacing Retransmission Consent with Full Copyright Protection.** Rather than imposing further restrictions on negotiations between program providers and distributors, the Next Generation Television Marketplace Act would replace the current retransmission consent system, overseen by the FCC, with a system based on copyright law, overseen by the courts. Compulsory copyright licensing of content would be eliminated, allowing parties to negotiate rates and transfer rights based on established copyright law principles.

This change would reduce potential meddling by regulators in the negotiating process, sending disputes to independent judges rather than to the FCC, which is more vulnerable to political pressure. It also would place broadcaster–distributor negotiations under the same rules as cable-only program providers and the nascent online video services.

Substantively, a switch to copyright law would provide the underlying rights holders—such as the production studios and sports leagues—a more direct role in the negotiating process, with more compensation

13. See James L. Gattuso, "Fox v. Cablevision: Should Washington Be Cable's Umpire?" The Heritage Foundation, *The Foundry*, October 19, 2010, http://blog.heritage.org/2010/10/19/fox-v-cablevision-should-washington-be-television%E2%80%99s-umpire/ (accessed October 17, 2012).

14. Harry Jessel, "Numbers Justify Retrans Hikes," TVNewsCheck, July 13, 2012, http://www.tvnewscheck.com/article/60774/numbers-justify-station-retrans-hikes (accessed October 17, 2012).

15. Ibid.

16. See, for example, Emily Yahr, "Jon Stewart Reacts to DirecTV–Viacom Battle with a Few Words of Rage," *The Washington Post*, July 17, 2012, http://www.washingtonpost.com/blogs/tv-column/post/jon-stewart-reacts-to-directv-viacom-battle-with-a-few-words-of-rage-video/2012/07/17/gJQAbWo4qW_blog.html (accessed October 17, 2012).

being paid directly to them, and less to local broadcasters. But the final allocation of payments may not be radically different than it is now. Even today, a portion of retransmission fees flows upstream to networks and studios through fees paid to them by broadcast stations.[17] If these rights holders were paid directly, the revenue stream to them from broadcasters would simply decrease accordingly.

**Repealing Must-Carry Rules.** In 1972, the FCC adopted the first "must-carry" rule, mandating that cable TV operators carry all local broadcast stations on their networks. In 1992, the rules were codified, and altered to allow broadcasters—every three years—to choose between operating under "must-carry" protection or under the retransmission consent system. Satellite television firms are subject to a similar rule that requires them to carry all local stations if they carry any local stations in a given market.

Must-carry is of limited value to broadcast stations with popular programming—MVPDs need no additional incentive to run them. The real benefits accrue to stations with less popular programming. But must-carry rules provide this benefit at the expense of most viewers, who—by definition—would prefer to be watching something else.

In effect, must-carry is a subsidy program for bad, or at least unpopular, programming, which—since channel capacity is not unlimited—precludes the transmission of another, more popular, channel. In addition, although the Supreme Court found it to be constitutional,[18] must-carry also raises troubling free speech concerns, since the government is explicitly favoring certain content over others.

**Eliminating Government Mandated Exclusivity.** The FCC's "network non-duplication" and "syndicated exclusivity" rules together prohibit cable systems from carrying two or more broadcast stations with the same programming. Such restrictions are common in many industries, in order to keep franchises operating under the same brand from competing with each other. That is why there are rarely two McDonald's restaurants on opposite street corners. Although there is a short-term reduction of competition, the long-term effect of such contractual restrictions is often positive, encouraging network affiliates to make investments in marketing and other areas. However, any such limits should be imposed through private contracts, subject to competitive challenge, not by government edict. The Next Generation act would repeal these rules.

Unfortunately, the bill also voids private exclusivity agreements now in effect, and (temporarily) prohibits licensees from entering into new agreements. Such a ban is not only unnecessary in today's competitive landscape, but is potentially harmful to consumers.

**Repealing Broadcast Ownership Limits.** A variety of FCC rules limit who can own a broadcast station. Among these are a ban on joint ownership of a newspaper and a broadcaster, the ban on owning more than one (sometimes two) TV stations in the same market, and limits on the number of radio stations that can be owned by a TV station owner in the same market.

Each of these rules is premised on an outdated assumption that broadcasters have significant market power which must be constrained.[19] Given the perilous state of the newspaper industry, the idea that a broadcaster-newspaper combination would wield undue market power is particularly fanciful.[20] In the 21st-century marketplace, broadcasters are only one among many sources of information, competing not just with MPVDs but with the Internet as well.

The FCC already has a rulemaking under way to review these and other media cross-ownership rules, the latest in a decade-long process which has been slowed by controversy and litigation. The Next Generation act would eliminate each of these rules. Instead, broadcast ownership concerns would be governed by established antitrust law, as are such concerns in other industries.

17. The total compensation received by local broadcasters would largely reflect the value of the programming they produce themselves. It potentially could also include the "value added" of their packaging of other programming. It is not clear, however, whether such "compilation rights" are enforceable under current copyright law.

18. *Turner Broadcasting System, Inc. v. FCC*, 520 U.S. 180 (1997).

19. See James L. Gattuso, "The Myth of Media Concentration: Why the FCC's Media Ownership Rules Are Unnecessary," Heritage Foundation *WebWemo* No. 284, May 29, 2003, http://www.heritage.org/research/reports/2003/05/the-myth-of-media-concentration-why-the-fccs-media-ownership-rules-are-unnecessary.

20. See James L. Gattuso, "The FCC's Cross-Ownership Rule: Turning the Page on Media," Heritage Foundation *Backgrounder* No. 2133, May 6, 2008, http://www.policyarchive.org/handle/10207/bitstreams/13495.pdf.

## Conclusion

The television marketplace has been transformed in the past few decades from a market dominated by FCC-licensed broadcasters providing limited choice, to a dynamic and competitive industry offering ever-multiplying options to viewers. In this new environment, the comprehensive regulation imposed on the industry no longer makes sense, if it ever did.

In the current conflict between broadcasters and distributors over fees, policymakers should resist the temptation to place their thumbs on the scales in favor of one side. Instead, they should focus on eliminating regulatory impediments in the television marketplace. The legislation offered by Senator DeMint and Representative Scalise offers a good start to that process.

The changes that television has undergone—and continues to undergo—are exceptional. In an economic sense, by making the TV marketplace more competitive, they have made television something that is no longer unique in an economic sense. That is a good thing. It is now up to regulators and Congress to update television policies accordingly.

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