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*ESPN's ability to win rights to major sports prizes, like Monday Night Football (represented here), is one of the many reasons why retransmission consent victories are so important to broadcasters.*

# FIGHTING FOR CONTROL

## Power could shift in new directions as broadcast stations and networks vie for an increasing share of multichannel subscription dollars.

By JOHN K. HANE

PHOTO: ESPN/SCOTT CLARKE

Changes in the retransmission-consent market could make 2010 the most pivotal year in decades for TV broadcasting.

Broadcast carriage fees could top $4 billion in 2015 – up from less than $1 billion in 2009, according to most sources. That's if network affiliated stations reach the monthly $1-per-subscriber target that many broadcasters contend is a fair rate. Regardless of whether stations hit that mark, broadcast company financial filings attest to the huge growth now underway:

- Fisher Communications' retransmission revenue totaled $11.6 million in the first quarter of 2010, a 19% increase compared to first quarter 2009.
- Gray Television retransmission revenues were $4.6 million in the first quarter, up 27% from the same period last year.
- The non-advertising revenues for Meredith Corp.'s TV group (primarily retrans fees) nearly doubled in fourth-quarter 2009

compared to Q4 2008. They rose another 15% in 2010's first quarter.

Those results are not unusual. And they come despite fierce resistance by multichannel platforms. In a rare display of cooperation, the companies on the paying end of the retransmission revolution – cable, satellite and telco providers – are working together to turn up the legal, political and public relations pressure at every opportunity.

### The Market Today

It's not just the amount of revenue that broadcasters are deriving from operators that's morphing. Lawyers and consultants involved in many different deals know that retransmission terms and conditions are changing so fast that it's difficult to compare deals that are struck even a few months apart.

It's not unusual for one company at the retrans negotiation table to be much larger than the other. And transactional costs can be so high that one party sometimes capitulates. Non-market factors like political pressure and liquidity often influence decisions as well. Because of all these factors, similarly situated parties often sign agreements with significant differences in prices and other terms.

The reasons for the growth in retransmission fees are many and complex, but the most important are:

- More and more broadcasters believe that retrans fees will be a necessary element of the broadcast business model going forward. Investors and analysts are keenly interested in retransmission fees, too, and almost every broadcast group earnings call draws several questions about retransmission deals.
- Broadcast networks are beginning to charge cash fees for access to the signals of their owned-and-operated stations.
- The market is becoming more efficient as it grows.
- Operators that fought retransmission payments for years have finally acknowledged that payments, at least for leading stations, are inevitable.
- There is more competition between distributors, and those that don't offer a full complement of the most popular channels can face subscriber defections.

### Rate Escalations

For years the networks granted retrans rights to their O&O stations' signals for little or no cash consideration, preferring to allocate fees to their non-broadcast networks. That practice probably depressed rates for retrans rights generally.

But the networks are changing their attitude towards retransmission consent. Press reports, which may not be reliable, have indicated that recent deals between network O&O groups and major distributors have ranged from $0.40 to $0.60 per month initially, with significant annual increases. Rates in this range are significantly higher than the average rate most network-affiliated broadcast stations receive today.

Based on my experience with many negotiations over the years, it is reasonable to believe that three- and five-year O&O deals struck in 2009 and 2010 could reflect rates approaching $0.75 or more in two or three years and $0.90 or more in five years. And if current conditions persist, it would be reasonable to expect that existing deals ending in 2012 or 2013 could be renewed at even higher rates.

Other major broadcast groups are likely to seek similar retrans fees in upcoming negotiations. That's not to suggest the stations will keep all that money for themselves, even if the distributors agree to rate increases. Broadcast networks are pressuring their affiliates to hand over a significant share of the proceeds. Program syndicators could be next in line.

Affiliates are wary when networks start asking about retransmission fees. Some affiliates believe that network interest in retransmission fees will make the total revenue pie larger by "normalizing" the market at a higher level – closer to the $1-per-subscriber benchmark that has been something of an industry rallying cry for the last few years. But it's not yet clear whether the affiliates will net significantly higher fees over the long term after the networks take their cuts.

As they ponder that conundrum, broadcasters are also facing mounting pressure in Washington, as multichannel operators launch attacks on the retransmission consent framework in Congress and at the Federal Communications Commission. In March, 10 of the largest distributors warned the FCC that retransmission fees are "spiraling" and asked for new regulations to limit broadcasters' flexibility in negotiations and to curb fee growth.

However, several FCC commissioners have expressed doubt about the FCC's power to regulate retransmission rates, and the prospect of new legislation seems unlikely this year. But political pressure itself can have a moderating effect on negotiations. That may have been the case when The Walt Disney Co. allowed Cablevision Systems to restore WABC-TV's signal just 15

## TIPS FOR TV BROADCASTERS

**Regardless of the networks' moves, stations that accept retransmission as a core element of business planning will outperform other stations over the long run. Broadcasters should consider the following recommendations:**

**TREAT SIGNALS AS HIGHLY VALUABLE ASSETS.** Broadcasters are the only TV programmers that routinely treat signal carriage casually, and cable operators know it. Stations should know exactly where and how their signals are carried at all times; enforce their program exclusivity rights jealously; work to eliminate out-of-market signal importation, and perform regular audits.

**FOCUS ON NON-REVENUE TERMS.** Broadcasters are always at a disadvantage when negotiating non-cash terms. Many station groups would be shocked if they realized what they have given away without thought in carriage agreements. Major cable operators have been known to negotiate terms that prevent broadcasters from launching mobile services. Operators may never rely on such terms, but they exist for a reason.

**STAFF IT.** Large broadcast groups should have a full-time executive managing all aspects of signal carriage, year in and year out. Negotiations, audits, non-duplication enforcement, carrier relations and related efforts deserve a dedicated person. Broadcasters that can't afford a full-time point person should assign "ownership" of signal carriage to one person, and they should always rely on experienced outside resources during major negotiations.

With variations, the same three points apply to negotiations with broadcast networks for affiliation renewals. Assurance that networks will invest their share of fees in high-quality programming can dull the bite of revenue sharing. The major networks know which station groups are the most savvy in adapting to market conditions. And whether the networks admit it or not, those groups often get the most respect and deference.

minutes into the Oscars broadcast in early March.

**Programming Power Plays**

Operators have three ways to deal with increased retransmission-consent expenses: absorb them; pass them on to consumers, or pressure cable networks during future rate negotiations. If multichannel providers convince the government to regulate retransmission negotiations or rates, that would be encouraging news for established cable networks, which are likely to gain even more competitive strength at the expense of broadcasters.

Cable networks have used reliable and steady growth in subscriber fees to invest in increasingly more compelling programming over the last few decades. In many cases cable programmers have outbid broadcasters for programming rights, like *Monday Night Football*, which were staples of broadcasting for decades. That trend will be jeopardized if operators shift a larger share of their programming budgets to broadcasters.

If stations and networks invest most or all of their retransmission fees in high-quality programming, they could reverse the two-decade trend of declining broadcast viewership – potentially stabilizing the size of their audience or even increasing it.

ESPN is able to collect legendary fees, by some accounts well north of $4 per subscriber month and rising every year, by constantly adding new "must-have" programming to its lineup. Some of the marquee programming on ESPN (and on the fast-growing regional sports networks) was previously carried on broadcast channels. With larger programming budgets, broadcast networks might slow, stop or even reverse that migration.

***Terms and conditions are changing so fast that it's difficult to compare deals that are struck even a few months apart.***

Shifting more carriage dollars from cable to broadcast networks could also polarize the local broadcast business into "haves" and "have nots." More popular stations, especially Big Four affiliates, will have more revenue to acquire better programming, making it even harder for marginal stations to compete.

While broadcasters and multichannel platforms battle over retrans fees, both face the common threat that online viewing could begin to cannibalize their distribution models. An eroding subscriber base could reduce revenue for multichannel platforms and all of the programmers that depend on them to collect subscriber fees – including broadcasters.

Regardless, there's little doubt that retransmission revenues will continue rising in the foreseeable future. If station groups demand that networks reinvest in programming before turning over a share of retransmission revenues, broadcasting could be the video-distribution growth story of the next decade.

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