

# **Impact of Retransmission Consent in Canada**

**The Impact of a Retransmission Right on the  
Canadian Broadcasting System**

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**Nordicity Group Ltd.**

**Sponsored by Canadian Broadcasting Distribution Undertakings**

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## **About Nordicity Group Ltd.**

Nordicity Group Ltd. ([www.nordicity.com](http://www.nordicity.com)), founded in 1979, is one Canada's leading strategy consulting firms for clients in the media/entertainment, culture/content, and telecommunications sectors: broadcasting, print, music, television/film production, new media, art/museums, cable, satellite and terrestrial wireless/wire-line telecommunications.

Our consultants work with clients in both the private and public sectors to make business and policy decisions, and to understand the impacts of policy and regulatory developments.

Nordicity helps businesses make strategic decisions; we also address regulatory and government policy issues for firms, consortia, and industry associations. Nordicity helps governments and other organizations develop and evaluate policy and regulation.

Our consultants provide clients with strategic planning, business case analysis, market assessment and forecasting, economic analysis, financial modelling, evaluation frameworks, and other tools for strategic and operational decision making.

Nordicity has offices in Ottawa and Toronto, with associates in other Canadian cities. We also offer global delivery of our expertise through affiliations with international professional services firms, notably PricewaterhouseCoopers and IBM Business Consulting Services.

## **Executive Summary**

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In 2001, the World Intellectual Property Organization (WIPO) began working towards the development of an international draft *Treaty on the Protection of Broadcasting Organizations*, (the WIPO Broadcasting Treaty, or WBT). Once finalized, Canada will decide whether to sign and subsequently ratify the WBT. Canadian broadcasting distribution undertakings (BDUs) have serious concerns about the impact of ratification, and commissioned Nordicity Group Ltd. to assess the impacts.

The WBT proposes to grant broadcasters an exclusive right to authorize the use of their respective broadcast signals, such that retransmission consent would have to be obtained by cable, satellite and other distributors in order for those distributors to transmit those signals to their subscribers. Currently, neither Canadian nor U.S. broadcasters enjoy a copyright in their broadcast signals vis-à-vis Canadian BDUs. Accordingly, consent is not generally required for BDUs to retransmit over-the-air signals.

If the WBT were signed and ratified by Canada, U.S. broadcasters would acquire the retransmission rights for their signals. Based on current trends in U.S. practices, U.S. broadcasters would likely make claims for cash payments in exchange for consent from Canadian BDUs. Furthermore, if Canadian BDUs were required to pay U.S. broadcasters for retransmission consent, Canadian broadcasters would likely also seek the same or similar retransmission rights for themselves.

### **The Potential of an Industry-wide Transformation**

Should the WBT be ratified, the main obvious concern of Canadian BDUs about a retransmission consent regime is that they could be faced with making large cash payments to broadcasters. However, this prospect cannot be assessed in a vacuum. The implementation of a retransmission consent regime could well trigger a major restructuring of distribution regulations if not broadcasting regulations as a whole. Hence, a significant transfer of funds from distributor to broadcaster via a copyright regime has the potential to undo the broadcasting regulatory regime established over the last three decades.

At present Canadian broadcasters are accorded extensive carriage and payment

entitlements from Canadian BDUs pursuant to Canada's *Broadcasting Act* and its Regulations (collectively, the "*Broadcasting Act*"), including must-carry rights. These entitlements cost BDUs substantial sums every year (e.g. for providing simultaneous substitution; for support of the Canadian Television Fund), and significantly restrict their commercial practices (e.g. obligation to reserve generous bandwidth for local and regional TV stations; restrictions on tiering and linkage; the provision of non-Canadian services; and specialty and pay service access rights). Broadcasters in the U.S. do not enjoy a similar set of entitlements. If retransmission consent were granted to Canadian broadcasters, they would be receiving much more favourable treatment than American broadcasters from the combination of regulatory support and copyright protection.<sup>1</sup>

To set the stage for assessing the potential impact of a retransmission consent regime, we modeled the financial impact if retransmission consent were layered on to the existing regulatory regime. In that financial analysis we assumed, that apart from the introduction of retransmission signal rights, the Canadian regulatory regime in its current form would remain unchanged.

In broad terms, our analysis suggests that the claims by broadcasters for retransmission consent could be very large. Therefore it is likely that the magnitude of the potential financial impacts would change the dynamics of the regulatory regime, and possibly dismantle some critical parts of the current support mechanisms.

In this assignment we did not attempt to design any new regulatory scenarios, and so have not modeled the financial consequences of any new regulatory scenarios. However, we have some observations that might provide insights as to the potential magnitude of the ramifications for broadcasting regulation.

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<sup>1</sup> It should also be noted that any money paid out by BDUs if broadcast signal rights were introduced in Canada would be directed to broadcasters, not to the programming rights holders who license their programming for exhibition by broadcasters. Program suppliers are already remunerated by payments made by BDUs (approximately \$100 million per annum) with respect to the retransmission of programming distributed in distant signals beyond the markets for which those programs are territorially licensed. The Copyright Board has already recognized broadcasters' rights in their program compilations in its consideration of the value of existing distant signal programming retransmission rights.

- The outcome of negotiations with American broadcasters could result in a major restructuring of the distribution of American signals. Subscribers could see some U.S. stations disappear and be replaced by others that are less familiar. Or, there could be fewer services carried. In addition, U.S. broadcasters might seek to renegotiate, possibly with the assistance of the U.S. State Department, the termination of simultaneous substitution as an in-kind payment. Such an outcome would obviously require changes to Canadian broadcast distribution regulation. In the absence of such change, there would likely be substantial cash-for-carriage claims and a large outflow of monies from Canadian BDUs to U.S. broadcasters.
  
- With respect to Canadian broadcasters, the trade-off could lead to a much harsher, less regulated market for Canadian conventional, pay, and specialty-TV services. Canadian BDUs would be faced with intense pressure on pricing and new applications from new IPTV-based delivery services and other new technologies over the next several years. Therefore, it would be necessary for Canadian BDUs to cut other programming costs to the extent that they could not pass on retransmission consent fees to their subscribers. The CRTC's digital migration framework already confirms the negotiable nature of specialty and pay TV wholesale fees.
  
- Another area of regulatory renegotiation would be the carriage of so many Canadian stations on the basic digital package for BDUs. Rather than submit to broadcaster claims, BDUs (especially DTH providers) may be forced to change or reduce their carriage of over-the-air broadcasters. These circumstances could well cause significant disruption to Canadians' viewing habits and reduce the breadth of broadcasting distribution services that they may receive. This result may also disproportionately impact Canadians living in rural and remote areas.
  
- Regulations designed to support the Canadian broadcasting system include the payments made by BDUs to the Canadian Television Fund (CTF). The implementation of a retransmission consent regime could become a substitute for the BDU payments to the CTF, wherein conventional broadcasters could be expected to replace the licence fee top-ups provided by the CTF at present.

These examples illustrate some of the trade-offs that could be generated by the implementation of a new copyright regime. In general terms, it is assumed that the greater the potential cost to BDUs in terms of payments claimed by broadcasters, the greater the potential disruption of the Canadian broadcasting system. To assess the magnitude of the costs and the direct financial implications of implementation, we developed a logic structure and an economic model that is described below.

### **A Retransmission Consent Regime in Canada**

The U.S. retransmission consent regime is a rough illustration as to what could happen in Canada should retransmission rights be granted to foreign and domestic broadcasters. We recognize that the size and scale of the U.S. market and the regulatory structure are different from Canada. It is not always a good proxy for the Canadian market. In particular, the U.S. consent regime offers U.S. broadcasters *either* mandatory carriage *or* the right to seek consent, while the Canadian regulatory regime already affords Canadian broadcasters extensive mandatory carriage entitlements. However, there are usually useful lessons to draw from examining the U.S. market, as long as there is due consideration for the differences in conducting the analysis.

Failing any viable alternative proxy, then, we have constructed a possible Canadian approach that takes into account the experience in the U.S. The caveat is that this approach assumes the existing regulatory structure in Canada. However, as noted above that structure would very likely be challenged by BDUs and by the public leading to major changes in regulations as a trade-off.

In the U.S., broadcasters who are part of media conglomerates or large station groups have, in the past, tended to demand a range of in-kind payments from distributors – for example, they request cable operators or satellite providers to carry affiliated specialty channels on a basic tier in exchange for retransmission consent for an over-the-air channel they own. However, going forward there is evidence that these large media enterprises will likely be seeking more cash as the preferred form of payment for all BDUs, and will be seeking higher payments overall.

Historically, smaller cable companies in the U.S. have often lacked the ability to offer significant in-kind payments, partly because of a deficiency in the capacity to take on extra channels. Instead, they generally pay cash-for-carriage. Their

experience provides a useful proxy for application to Canada, although an imperfect one given the differences in the structure of broadcasting distribution in Canada and the timeframe for negotiation.

### **Estimate of Claims Made by Broadcasters' Anticipated Claims**

Based on the evidence in the U.S. we believe that should the WBT be ratified and signed, American broadcasters would be primarily interested in cash-for-carriage payments. Under the current structure there is a limited amount Canadian BDUs can offer U.S. broadcasters to satisfy their claims in terms of in-kind considerations.

Based on U.S. experience we constructed two possible scenarios for the possible claims on BDUs on a per signal per subscriber per month basis. The first scenario is a conservative estimate of what broadcasters would claim from BDUs, whereas the second scenario depicts the results of a more aggressive negotiating stance by broadcasters in the U.S. and in Canada.

The specific rates that could be claimed and the discounts off those rates used in the calculations are outlined for each scenario below. We express caution that these rates in no way reflect the position of Canadian BDUs, but rather an analyst's estimate based on U.S. experience and applying that to Canada. As well, we note that any such rates claimed would likely lead to representations by Canadian BDUs to reduce their other expenditures on Canadian programming, and to demands by BDUs for a discretionary carriage regime.

- Rate claims by U.S. broadcasters would be U.S. \$0.50 in the conservative scenario and U.S. \$0.75 in the aggressive scenario.
  - We discounted the rates by 50% for French language BDU markets; and we did not include claims for PBS signals, based on U.S. precedent.
  - We applied a discount of 10% to the rates claimed by U.S. broadcasters for their signals in the three major border markets – the assumption was that Canadian BDUs could negotiate lower rates because some U.S. stations still derive important revenues from advertising sales in Canada despite simultaneous substitution rules and section 19 (1) of the *Income Tax Act*.
  
- Rates claimed by Canadian broadcasters would be C\$0.50 in both

scenarios.

- For the aggressive scenario, we discounted the base rate claimed by 20% the second through fifth signal of the same television network (i.e., CBC, CTV, Global, TVA, etc.). In effect, we assume that there may be some value in having at least one feed from each region of Canada, although the validity of this assumption may vary from case to case.
  - o If a subscriber had access to more than five feeds, then these additional signals were discounted by 90%. We ascribed little value for a BDU subscriber to have more signal feeds than regions.
  
- For the conservative scenario, we restricted the 20% discount to only the second signal of each television network. Each additional signal was subjected to a 90% discount. In this case, we assumed that most of the value was in having access to a signal from one region. It puts a lower value on a third or additional time network affiliate essentially carrying the same programming.
  - o We also discounted the second networks of large broadcast groups – CH and A-Channel – by 50% in relation to their related primary networks. While the second networks are distinct signals with distinct schedules, in many cases, the programming is considered somewhat similar.

Based on these claims and applied discounts, then, we estimated that the total value which could be claimed (if Canada signed and ratified the WBT and introduced similar rights for domestic broadcasters). It should be made clear that these numbers are derived from the project team's assumptions, and are neither endorsed nor proposed by Nordicity's BDU clients.

The calculations produce a range of **\$1.1 billion** (conservative scenario) to **\$1.6 billion** (aggressive scenario). The amount of the claims made by Canadian broadcasters would be far greater than that claimed by U.S. broadcasters because our calculations assume no change to the number of Canadian signals carried by Canadian BDUs. Claims by Canadian broadcasters would be far greater than to U.S. broadcasters due to the sheer number of local Canadian signals carried by Canadian BDUs. However, as the following table indicates, possible outflows of money from Canadian BDUs to U.S. broadcasters could range from **\$380 million** to **\$570 million** every year.

**Table: Total Estimated Retransmission Claims by Scenario**

	<b>Conservative scenario (C\$ millions)</b>	<b>Aggressive scenario (C\$ millions)</b>
U.S. signals	379.9	570.0
Canadian signals	722.0	1,009.6
<b>Total</b>	<b>1,102.0</b>	<b>1,579.5</b>

Source: Nordicity Group analysis based on data from Mediastats, Statistics Canada, and CRTC.

These estimates are based on today's numbers. Assuming the WBT were implemented three years from now, the figures could be considerably higher. Digital penetration will increase substantially in cable systems, so there would be even more subscribers accessing the additional regional signals that are packaged with the lease of a digital box.

Faced with this level of claim from broadcasters, as noted earlier, it can be assumed that many aspects of the regulatory structure would change. It is probable that BDUs would seek regulatory changes or equivalent trade-offs through negotiation as a consideration for any payment demands made of them by broadcasters

### **Price Increases and Impact on the Consumer**

For the purposes of this study, we assume that BDUs would increase their basic fees by the amount of the payments made to broadcasters – and we excluded any mark-up that BDUs would likely apply to the price increase to preserve part or all of their current margins. If such fees were paid and passed on to BDU subscribers, it would result in a price increase for Canadian consumers of between **\$6** and **\$19** per month – depending on the scenario and whether the subscriber was a DTH or cable (and analog vs. digital within cable) subscriber.

With basic-tier DTH packages currently selling for approximately \$30.00 per month, retransmission fees could bring the total monthly DTH subscriber bill to **\$49** in the aggressive scenario and **\$42** in the conservative scenario. The price increase of a basic DTH package would be significantly higher than that of a basic cable package due to the greater number of Canadian signals DTH carries compared to cable.

The high end of the potential price increases – up to **\$19** for DTH subscribers –

represents a staggering increase for no addition in service or in services. While affordability may be less of an issue for subscribers taking more than the basic package only, the increase is significant as it is 37% over the current basic package. It is almost akin to a “sin” tax meted out by governments who seek to discourage consumption. At that level it is fair to speculate there could be some organized reaction to the price increase. Indeed, at a minimum it would have a significant impact on the competitive balance between DTH and cable, and in the extreme could threaten the very viability of DTH providers and BDU competition. Such an outcome would then mushroom to impact about 2.5 million Canadian TV households.

Based on our demand elasticity analysis, we estimate that **9%** of total subscribers would disconnect from the Canadian BDU systems. This disconnect rate translates into as many as **900,000** TV households who would leave the Canadian distribution system.

In addition, evidence suggests that approximately **20%** of subscribers with discretionary services would not be able to tolerate the rate increase brought on by retransmission fees. It is estimated that one in five BDU subscribers would drop some part of their service (i.e. reduce their discretionary service expenditures) so that they would not see a rise in their total monthly bill.

The price increases would be assessed on the basic tier, which means that they would be similar to a regressive tax. Such price increases would likely hurt most those who could afford it the least. In addition, as a result of negotiations and to cushion the price increase, BDUs might drop certain U.S. and Canadian services, or at least put them on a discretionary tier instead of the basic service. While the outcome would be less of a price increase, there would then be both a price increase (albeit diminished) and fewer channels on the basic service, and if subscription levels to discretionary services falls precipitously, fewer channels overall.

## **Impact of Retransmission Consent on BDUs**

Based on the estimated loss due to disconnects and the amount BDUs would lose in net revenues, we estimate that Canadian BDUs could experience an annual net reduction in EBITDA of between **\$328.3** million (conservative scenario) and **\$425.6** million (aggressive scenario). These estimates assume that Canadian BDUs do not apply any further mark-up to the subscriber price increases caused by retransmission fees. Again, they also assume that there are no other changes in the regulatory system.

These EBITDA calculations are the logical consequence of applying retransmission consent to the structure of the existing carriage practices and existing broadcasting regulations – even if BDUs sought to pass through the broadcaster claims to their subscribers. In reality, however, we anticipate that BDUs would take several initiatives designed to restructure their commercial practices and seek to amend broadcasting regulations to minimize the magnitude of the impact on their bottom line. In effect, BDUs would have to seek a trade-off for the retransmission consent, which could have a major negative impact on the support system for Canadian broadcasters and Canadian programming.

As noted above, the disproportionate impact of retransmission consent on DTH would also upset the competitive balance among BDUs.

## **Impact on Rural Consumers, HD Development, and the Growth of the Grey and Black Markets**

Such a significant price increase that would result from the implementation of retransmission consent would be felt most by consumers in small rural communities for which there is no equivalent cable option – their only viable option to receive multichannel television is via DTH. These rural subscribers may then be tempted to buy grey and black market satellite services.

In addition, the reduction in BDUs' cash flow could reduce their annual borrowing capacity by up to **\$1.7** billion, leading to a slowdown in HD capacity building in Canada. The lack of capacity for HD services could encourage Canadian subscribers with HD sets to turn to the grey and black markets to receive HD signals, leading to a further loss of subscribers from the system. In addition, less BDU capacity to carry all the Canadian HD services could handicap efforts of Canadian broadcasters to head off the U.S. HD competition.

## **Impact on Canadian Conventional Broadcasters**

We estimate that if Canadian broadcasters are granted a retransmission right the amount for those rights that could be claimed could be between **\$722** million and **\$1,010** million per year. We express caution that this calculation in no way reflects the position of Canadian BDUs, but rather an analyst's estimate based on U.S. experience and applying that to Canada. However, we also observe that any such claims on behalf of Canadian broadcasters would likely lead to strong counter-claims by Canadian BDUs for a discretionary carriage model like that of the U.S. – which would have disproportionate impacts on small-markets, less popular Canadian programming, and on broadcasting services. Moreover, BDUs would likely also seek to address retransmission rights claims by reducing their current expenditures on Canadian programming (e.g. on wholesale rates) in a manner that would prejudice specialty and pay services. In short, any financial claims by Canadian broadcasters would not simply translate into additional payments to them, but would lead to significant modifications to current broadcast distribution practices.

If Canadian broadcaster claims were satisfied, the money transferred would more than double broadcaster operating profits. However, it is understood that this windfall revenue might be applied to a number of expenditure categories rather than merely dropping to the bottom line of broadcasters. For example, one of the fastest growing expenditure categories of Canadian conventional broadcasters has been the acquisition of U.S. programming rights. Distributors of these rights could consider increasing their prices to take advantage of the extra revenues flowing to Canadian broadcasters.

It might be assumed that the CRTC would demand more of conventional broadcasters in terms of Canadian content to take advantage of the retransmission consent windfall. However, it cannot be assumed that regulatory intervention would be entirely effective in channeling any windfall to Canadian priority programming.

Broadcasters have maintained that they need extra cash to help them develop content for new distribution platforms like broadband Internet, ipods, and mobile phones. However, these properties would likely be in news, information, and sports. While there may be some extra initiatives in the priority programming

areas (children's, documentaries, variety, and drama), it is questionable as to how much of the windfall gain would be directed toward priority Canadian programming.

### **Financial Impact on Pay/Specialty-TV Services**

As discussed, the increased costs to subscribers from retransmission consent payments will lead some of them to disconnect entirely, churn out of the Canadian distribution system, or to reduce expenditures on discretionary programming services. This consumer reaction would in turn affect all pay and specialty services, by reducing revenue from wholesale fees as a result of subscriber losses. The advertising revenues of specialty services would also likely drop in the order of 5%.

Also, BDUs might proactively prune their packages of the least viable diginets (both Category 1s and Category 2s), thus hurting services already struggling to stay alive, and raising new barriers for new ones. Ethnic-language Category 2 services might be disproportionately affected. In effect, we assume that BDUs might insist that they need to balance out what is paid for retransmission consent rights and to specialty services so that the overall bill to the public could be reduced.

In total, then, we estimate that revenues for pay/specialty services could be reduced on average by about **\$236 million to \$310 million, or 12% to 15%** of total revenues of about \$2 billion. In these calculations, we have assumed that pay/specialties continue to receive the wholesale fees they now obtain in the waning days of the analog world. Already facing a more market-oriented approach in the conversion to digital, analog specialties would be negotiating with BDUs who might be incurring substantial retransmission rights payment obligations. This situation could lead to lower wholesale fees for pay/specialty-TV services, given the additional burden on BDUs. With less subscription and advertising revenue, it would be increasingly difficult for the specialty sector to fund the production of Canadian programming.

Therefore, while conventional broadcasters might benefit from retransmission consent the pay/special sector could bear the brunt of the impact. This impact would certainly affect Canada's fledgling digital channels. It would also reduce expenditure in Canadian content, as pay /specialty service licensees have

significant Canadian programming expenditure (CPE) commitments compared to conventional television broadcasters.

## **Conclusions**

In this assessment, we have sought to quantify the potential impact of retransmission consent, based on various assumptions about how the WBT might be implemented and holding all factors, regulatory and other, constant. As previously noted, however, it is likely that BDUs would seek fundamental regulatory change in response to any new signal rights.

We have found that the impact in terms of possible claims by U.S. and Canadian broadcasters is potentially enormous, and carries very major consequences for the Canadian broadcasting system as well as for Canadian TV households. If BDUs passed on the new copyright fees to BDU subscribers, they would see serious double digit basic rate hikes, especially the DTH market sweet spot of rural and small community Canadian TV households. Many would leave the Canadian BDU system and be prey for the grey and black satellite markets. As well, if broadcasters made signal right claims from BDUs, the BDUs would likely seek significant changes to the Canadian broadcasting system, which already affords Canadian broadcasters extensive protections at significant cost and/or commercial limitation to Canadian BDUs.

It is not clear what the impact would be on Canadian programming even if conventional broadcasters benefit from retransmission consent. What is clear is that pay/specialty-TV services would be severely harmed – either by disconnects, dropped services or by substantial wholesale fee reductions. Damaging the pay/specialty services would inevitably affect their ability to fund production of Canadian programming.

In sum, large potential retransmission consent claims could convulse the broadcasting system, ending many years of developing a distribution system that is highly supportive of Canadian broadcasting and Canadian programming. At this time technology is challenging the foundations of the Canadian broadcasting system. The regulatory changes unleashed by a retransmission consent copyright regime could represent another blow to the Canadian broadcasting system that could deprive broadcasters of the financial benefits of retransmission rights they now envisage.

# 1 Introduction

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In this section we provide some background on the WIPO *Treaty on the Protection of Broadcasting Organizations*, or WIPO Broadcasting Treaty (WBT) and its possible implementation in Canada. If a WBT right is ever implemented in Canada we discuss some of the potentially transformative ramifications for the regulation of the Canadian broadcasting system.

Since Canadian broadcasting distribution undertakings (BDUs) have serious concerns about the impact of ratification, they commissioned Nordicity Group Ltd. to assess the impacts. This introductory section describes the Nordicity mandate and the analytical steps used to undertake the analysis.

## 1.1 The WIPO Broadcast Rights Treaty and Retransmission Consent

In 2001, the World Intellectual Property Organization (WIPO) began working towards the development of an international draft *Treaty on the Protection of Broadcasting Organizations*. Since 2001, the WBT has since gone through a variety of iterations, and it could be referred to a diplomatic conference for finalization by the first half of 2007. If finalized, Canada will decide whether to sign and subsequently ratify this WIPO Broadcasting Treaty (WBT).

The WBT addresses a range of issues, including the proposed right of retransmission (Article 6), stating:

“Broadcasting organizations shall enjoy the exclusive right of authorizing the retransmission of their broadcasts by any means, including rebroadcasting, retransmission by wire, and retransmission over computer networks.”<sup>2</sup>

The WBT proposes to grant broadcasters an exclusive right to authorize the use of their respective broadcast signals, such that retransmission consent would

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<sup>2</sup> Draft, *WIPO Broadcasting Treaty*, 2005

have to be obtained by cable, satellite and other distributors in order for those distributors to transmit those signals to their subscribers.

Currently within Canada, local broadcast signals are distributed freely over-the-air. Cable operators, DTH satellite providers, terrestrial fixed wireless operators, and wireline operators – regulated in Canada as Broadcast Distribution Undertakings (BDUs) – can generally pick up these signals and simultaneously retransmit them over their distribution platform without acquiring the consent of the signal owners under the *Copyright Act*.

Although the *Act* does not afford broadcasters a right to consent to retransmission, BDUs are subject to complex carriage rules of the Canadian Radio-television and Telecommunications Commission (CRTC), the regulatory body that administers the *Broadcasting Act* and its Regulations (together, the “*Broadcasting Act*”). For example:

- Cable operators must obtain consent to retransmit distant, over-the-air signals in analog;
- Broadcasters have program deletion rights whereby they can demand payment or carriage commitments from cable systems and DTH providers in exchange for BDUs’ right to retransmit time-shifted signals in digital;
- Each cable system must carry all Canadian local, regional and extra-regional signals within its territory;
- DTH providers must carry specified network and small-market television stations, and are also obliged to maintain a relative balance in their carriage of stations across those owned by major private broadcasters,
- DTH providers must contribute a portion of their gross revenue to a local programming fund (accessible by specified local broadcasters) in response to its national distribution of a wide range of local Canadian television stations.

In the U.S., there has been a retransmission consent regime since 1994, under the authority of the Federal Communications Commission (FCC), which regulates the broadcasting industry. This regime grants a choice for U.S. local commercial stations to be carried under a ‘must-carry’ provision or a ‘retransmission consent’ provision, but not both.

If a broadcaster opts for ‘must-carry’, it must be carried by cable companies in its market area. DTH satellite providers have a different must-carry obligation than cable operators, but operate under a similar principle. While they are not required to carry local stations in every metro area in which they provide service, they must carry all of an area’s local stations if they carry any at all. This is known as a “local into local” or “carry one, carry all” must–carry regime. This provision only applies to stations opting to be carried under the must-carry provision, rather than retransmission consent.

In 2004 in Canada, the CRTC expressly decided against the introduction of a carry one, carry all local signal regime in view of unique features of the Canadian broadcasting and broadcast distribution markets. Instead, the CRTC introduced complex carriage and compensation requirements enumerated above.<sup>3</sup>

If a U.S. broadcaster opts for the retransmission consent provision, it means the cable operators, satellite providers, and any other multichannel signal carriers (called MVPDs or Multichannel Video Program Distributors in the U.S.<sup>4</sup>) must secure that broadcaster’s consent to retransmit its signal.<sup>5</sup> While the regulation does not specify how consent should be granted, typically it is provided in exchange for various kinds of consideration. Retransmission consent only applies to commercial stations, as local non–commercial television stations (e.g. PBS stations) can only seek carriage on a must-carry basis.

Ratification of the proposed WBT by Canada would impose on Canada a retransmission consent regime with respect to U.S. and other foreign broadcast signals. If that were to occur, Canadian BDUs would be required to obtain consent from U.S. broadcasters to retransmit these signals on their networks in Canada. The likely result would be a series of negotiated retransmission consent agreements, whereby Canadian BDUs would be obligated to compensate U.S. broadcasters for the carriage of their signals.

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<sup>3</sup> Broadcasting Decision CRTC 2004-129 ExpressVu – Licence renewal and Broadcasting Decision CRTC 2004-130 Star Choice – Licence renewal

<sup>4</sup> For the sake of clarity we will always use the Canadian term “BDU” even in reference to the U.S. environment where MVPD is more commonly used.

<sup>5</sup> Communications Act, U.S. Code § 325.

## 1.2 Implementation of the WBT Right in Canada

As noted above, if Canada ratified the WBT, Canadian BDUs would be required to gain consent from U.S. broadcasters to retransmit their signals. This outcome would likely lead to Canadian BDUs negotiating consent deals with American stations for carriage of their signals.

While the terms of the WBT only apply to how Canada must act towards foreign broadcasters, it is possible that the Canadian federal government would consider granting equivalent retransmission rights to Canadian broadcasters.. While in no way proposed or supported by Canadian BDUs, it is recognized that broadcasters would lobby for such a right to be established, notwithstanding that they already benefit from extensive regulatory protections pursuant to the *Broadcasting Act*. Thus, some form of retransmission consent framework would presumably be imposed to provide Canadian broadcasters with a similar or equivalent right<sup>6</sup>.

As a result, the ratification of the WBT could lead to the implementation of retransmission consent rights that would benefit both non-Canadian and Canadian broadcasters whose signals are retransmitted by Canadian BDUs. The result of the ensuing agreements with Canadian BDUs could be significant annual claims by both American and Canadian broadcasters from Canadian BDUs. In order to fully assess the impact of WBT ratification, this report will examine the ramifications for the Canadian broadcasting system and identify impacts on the major stakeholder groups (Canadian consumers, BDUs and broadcasters). We also discuss the potentially major implications for Canadian broadcasting regulation and policy.

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<sup>6</sup> The scope of this study does not include consideration of what, if any, regulatory or copyright regime would be appropriate. For the purpose of quantifying possible impacts we simply assume a status quo regulatory regime, although we also refer to some of the regulatory implications of retransmission consent.

### 1.3 The Potential of an Industry-wide Transformation

Should the treaty be ratified, the main obvious concern of Canadian BDUs about a retransmission consent regime is that they could be faced with large cash claims by broadcasters. However, this prospect cannot be assessed in a vacuum. The implementation of a retransmission consent regime could well trigger a major restructuring of distribution regulations if not broadcasting regulations as a whole. Hence, a significant transfer of funds from distributor to broadcaster via a copyright regime has the potential to dismantle large parts of the broadcasting regulatory regime established over the last three decades.

At present Canadian broadcasters are accorded extensive carriage and payment entitlements from Canadian BDUs pursuant to Canada's *Broadcasting Act* and its Regulations (collectively, the "*Broadcasting Act*"), including must-carry rights. These entitlements cost BDUs substantial sums every year (e.g. for providing simultaneous substitution; for support of the Canadian Television Fund), and significantly restrict their commercial practices (e.g. obligation to reserve generous bandwidth for local and regional TV stations; restrictions on tiering and linkage; the provision of non-Canadian services; specialty and pay service access rights).

Broadcasters in the U.S. do not enjoy a similar set of entitlements. If retransmission consent were granted to Canadian broadcasters, they would be receiving much more favourable treatment than American broadcasters from the combination of regulatory support and copyright protection.<sup>7</sup>

To set the stage for assessing the potential impact of a retransmission consent regime, we modeled the financial impact if retransmission consent were layered on to the existing regulatory regime. In that financial analysis we assumed, that

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<sup>7</sup> It should also be noted that any money paid out by BDUs if broadcast signal rights were introduced in Canada would be directed to broadcasters, not to the programming rights holders who license their programming for exhibition by broadcasters. Program suppliers are already remunerated by payments made by BDUs (approximately \$100 million per annum) with respect to the retransmission of programming distributed in distant signals beyond the markets for which those programs are territorially licensed. The Copyright Board has already recognized broadcasters' rights in their program compilations in its consideration of the value of existing distant signal programming retransmission rights.

apart from the introduction of retransmission signal rights, the Canadian regulatory regime in its current form would remain unchanged.

In broad terms, our analysis suggests that claims made by broadcasters for retransmission consent could be very large. Therefore it is likely that the magnitude of the potential financial impacts would change the dynamics of the regulatory regime, and possibly dismantle some critical parts of the current support mechanisms.

In this assignment we did not attempt to design any new regulatory scenarios, and so have not modeled the financial consequences of those scenarios. However, we have some observations that might provide insights as to the potential magnitude of the ramifications for broadcasting regulation.

- The outcome of negotiations with American broadcasters could result in a major restructuring of the distribution of American signals. Subscribers could see some U.S. stations disappear and be replaced by others that are less familiar. Or, there could be fewer services carried. In addition, U.S. broadcasters might seek to renegotiate, possibly with the assistance of the U.S. State Department, the termination of simultaneous substitution as an in-kind payment. Such an outcome would obviously require changes to Canadian broadcast distribution regulation. In the absence of such change, there would likely be substantial cash-for-carriage claims and a large outflow of monies from Canadian BDUs to U.S. broadcasters.
- With respect to Canadian broadcasters, the trade-off could lead to a much harsher, less regulated market for Canadian conventional, pay, and specialty-TV services. Canadian BDUs would be faced with intense pressure on pricing and new applications from new IPTV-based delivery services and other new technologies over the next several years. Therefore, it would be necessary for Canadian BDUs to cut other programming costs to the extent that they could not pass on retransmission consent fees to their subscribers. The CRTC's digital migration framework confirms the negotiable nature of specialty and payTV wholesale fees.
- Another area of regulatory renegotiation would be the carriage of so many Canadian stations on the basic digital package for BDUs. Rather than submit to a broadcaster claims, BDUs (especially DTH providers) may be

forced to change or reduce their carriage of over-the-air broadcasters. These circumstances could well cause significant disruption to Canadians' viewing habits and reduce the breadth of broadcasting distribution services that they may receive. This result may also disproportionately impact Canadians living in rural and remote areas.

- Regulations designed to support the Canadian broadcasting system include the payments made by BDUs to the Canadian Television Fund (CTF). The implementation of a retransmission consent regime could become a substitute for the BDU payments to the CTF, wherein conventional broadcasters could be expected to replace the license fee top-ups provided by the CTF at present.

These examples illustrate what trade-offs could be generated by the implementation of a new copyright regime. In general terms, it is assumed that the greater the potential cost to BDUs in terms of payments claimed by broadcasters, the greater the potential disruption of the Canadian broadcasting system. To assess the magnitude of the costs and the direct financial implications of implementation, we developed a logic structure and an economic model that is described in sections 5 and 6.

## **1.4 Nordicity Mandate and Analytical Approach**

### **1.4.1 Nordicity Mandate**

Nordicity has been retained by a group of Canadian BDUs representing cable, DTH, and wireline distribution companies with the following mandate:

- To examine and identify the impact of WBT ratification on individual Canadian stakeholders, including consumers, BDUs, and broadcasters; and
- Broadly identify the impact on the overall broadcasting market and public policy objectives.

Nordicity's BDU clients are not advocating the adoption of the WBT. In fact they oppose such adoption. At the behest of the Government, Canadian BDUs are

seeking to analyze and quantify the potential impact of WBT ratification by Canada.

To assess the impact, this study estimates the types of payments and the total value of the fees American and Canadian broadcasters would claim under the two regimes outlined above. The assumptions used are not to be taken as the final outcome of negotiated retransmission consent payment structure, or construed as any kind of “offer” by BDUs. Rather, they are what Nordicity perceives as a possible outcome based on what is now known.

The report converts the impact of the amounts claimed by broadcasters on Canadian consumers. It also considers impacts on the industry income statements of Canadian BDUs and Canadian broadcasters. The impact on BDUs takes into account the likelihood that only a part of the new costs from rights payment claims would be absorbed by their subscribers. The report also examines the possible impact on capital expenditures of BDUs, as well as the possible impact on Canadian pay and specialty-TV services.

The study assumes that if the WBT were ratified, a full retransmission consent framework would not occur until at least 2009. According to those following the WBT rights closely, this start date of three years hence is a realistic implementation date for such a regime, given the lengthy process of international negotiation and domestic ratification and implementation. Therefore, the impact of WBT ratification is assumed to begin in about 2009.

#### **1.4.2 Analytical Approach**

This impact assessment takes the following analytical approach:

- We estimated the likely fee liabilities to foreign broadcasters, primarily based on the current situation in the United States as a proxy for application to Canadian BDUs. In order to make the conversion to claimed fees in the Canadian situation, some assessment of the potential bargaining positions of Canadian BDUs was made.
- The total fees that could be claimed by foreign broadcasters were calculated by estimating the rate per signal per subscriber per month, and multiplying this figure by the number of foreign signals subscribed

to by Canadian BDU customers. We used per-station reach data by province<sup>8</sup> for both Canadian and American stations. Assumptions were made about possible rate structures for different classes of foreign signals, and whether they sell advertising in Canada, among other factors.

- A similar analysis was conducted for the claims that would be made by Canadian broadcasters, assuming that an equivalent copyright regime were to be put into place. Again, the U.S. proxy was considered most relevant, and again assumptions were made as to possible differences in rate structures for different classes of broadcasters.
- Once the additional claim amounts were calculated, we assumed that BDUs would seek to increase fees to cover the additional costs and perhaps would increase fees even more to preserve their margins. Based on input from some major BDUs and previous studies of price elasticity, we examined the price sensitivity of demand for programming services. Given that it would be highly unlikely for all subscribers to absorb the added costs, we estimated the impact in terms of possible disconnects and programming package pruning that would be the consequence of charging a higher price for the basic service of cable, DTH, or other BDU operator.
- Assuming that subscribers would not be willing to absorb the cost of all the new copyright fees, we estimated the impact of disconnects and other cost cutting decisions of subscribers as a result of the larger fee for basic service. We reviewed the impact on BDUs in terms of profitability and the subsequent impact on their ability to attract capital for upgrading their systems to meet consumer demand for new technologies.
- We took into account the net impact in view of the potential losses of revenue from disconnects (churn) and the potential dropping of programming tiers and packages by some subscribers to keep the overall monthly bill in check. We also identified the possible reaction of

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<sup>8</sup> MediaStats

BDUs to keep the prices down by pruning the weaker diginets from the BDU channel line-up.

- We assessed the potential impact on Canadian broadcasters that would occur pursuant to the receipt of retransmission consent fees. The impact on Canadian pay/specialties was noted, as well as the impact on conventional stations.
- We examined the impact on the ability of BDUs to finance the expansion of capacity to carry Canadian and foreign HDTV services in the future – we also noted the potential flourishing of the black and grey markets in light of capacity constraints and higher prices for Canadian BDUs.

## **2 Current U.S. Retransmission Practices**

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The existing retransmission consent regime in the U.S. can serve to illustrate how a retransmission consent regime might be applied between Canada and the U.S., as well as within Canada. There are, of course, key differences between the U.S. and Canadian situations which would mean that the U.S. regime could not be transposed to Canada. However, since the U.S. experience is a good proxy, we begin with a description of the forms of payment in retransmission consent agreements, a distillation of the overall amount of payments made on a per-subscriber basis, and the identification of trends and some possible impacts.

### **2.1 Forms of Payment**

There are several forms of consideration made by BDUs to broadcasters in the U.S. for retransmission consent, and largely derived from the existing structure of the U.S. broadcasting system.

Many U.S. stations are owned by large powerful media conglomerates or by large local station groups. For example, the ABC network is owned by The Walt Disney Company, and Fox Broadcasting Company by News Corporation – both are large media conglomerates owning a wide variety of other media properties, including a range of specialty channels (called just “networks” or “cable channels”

in the U.S.). Many other stations are owned by large conventional television station group owners. For example, Hearst-Argyle Television, Inc. owns approximately 25 local affiliates of the major networks such as ABC and NBC.

Retransmission deals between stations and BDUs are typically influenced by the ownership structure of the negotiating station. While some stations will demand direct cash-for-carriage deals, others may ask for 'in-kind' payments related to affiliated properties within the media group. We have identified four major forms of payment demanded by broadcast stations, although other forms have been accepted from time to time:

- **Cash-for-carriage deals paid on a per subscriber basis:** A broadcasting company charges a BDU provider a set fee per subscriber per signal carried.
- **Carriage of affiliated services on the distribution system:** An in-kind payment, where the broadcasting company either waives or reduces the above fee if the BDU agrees to carry a channel owned by the company on their distribution system, or moves the signal into a more widely distributed package.
- **Advertising deals:** An in-kind payment, where a cable operator (typically) or a station could grant the other air time as a factor in the negotiation. A cable operator could contribute advertising minutes within its local availabilities ('local avails'), or conversely a television station could grant the cable operator local air time minutes to sell to advertisers to increase the value of the fee being paid by the cable operator.
- **Special or extra promotion or marketing of services or content:** An in-kind payment, where the MSO or DBS provider agrees to promote a specialty or pay TV service specifically affiliated with a broadcast station in exchange for the consent to retransmit its signal.

The average deal as seen in the U.S. to date is comprised of a combination of the above forms of payment. For example, a broadcaster may demand cash-for-carriage, but will discount the rate per subscriber if the American BDU is able to offer in-kind payments. That has been the key – the capacity of the BDU to offer in-kind payments, which is partly a function of the channel capacity of the BDU.

For example, large cable operators with substantial bandwidth can distribute affiliated channels or move them to higher penetration tiers.

Smaller cable systems tend to have less capacity and sometimes cannot technically take on the extra channels; nor are they financially able to afford to pay the wholesale rates for more network (specialty) channels. Therefore, smaller cable companies unable to make in-kind payments are often unable to negotiate discounts in the rates paid per subscriber. They are forced more frequently to pay in cash to receive the retransmission consent.

In addition, broadcasters may offer 'bulk discounts' to larger BDUs with significant numbers of subscribers, as such a deal would be helping the broadcaster to extend its reach and thus increase its advertising revenues. Smaller cable companies are unable to add significant reach, and again lack the ability to negotiate lower rates because their reach generates little or no incremental ad revenue for broadcasters. DTH<sup>9</sup> providers as well as larger cable companies tend to receive discounts simply because they have significantly more subscribers.

Indeed, the size and ownership structure of the broadcaster setting the negotiations lends to differences in the types of deals struck. Media conglomerates such as News Corp/Fox or in the past Viacom/CBS would demand deals that fit with their strategies of pay and specialty channel expansion plans. Consequently, they may demand carriage of company-owned specialty channels on basic or high-penetration tiers, which increases the reach and fees paid to their specialty channels. Most conventional television station groups, on the other hand, do not own specialty channels – and demand cash-for-carriage or barter advertising spots in exchange for consent.

Some major networks also have begun to build exclusivity arrangements into their network affiliate agreements, contractually prohibiting affiliates from granting retransmission consent to cable operators' outside of a station's market area. This practice prohibits the cable operator from being able to pursue lower-cost options from nearby stations affiliated with the same network. The result is that

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<sup>9</sup> In the U.S., satellite television providers are called 'DBS' – or Direct Broadcasting Satellite. However, for consistency in the report we have used the Canadian term DTH (Direct-to-Home) when referring to either U.S. or Canadian satellite providers.

the small cable operator is stuck with whatever retransmission fee is demanded by the affiliate in its area.

## **2.2 Fees Paid and Overall Value of Deals**

Typically, cash deals are calculated on a rate charged on a “per-subscriber per-signal per-month” basis. In-kind payments are more difficult to value directly, and make up a portion of the total value of the deal or are used to discount the rates. For example, some deals cited contain an advertising component as one-third of the value of a total deal, while in others no component value was disclosed.

As cash-for-carriage arrangements are increasingly becoming the main component of deals, it is easier to establish the total value in terms of the monthly rate per subscriber per signal. American BDUs pay on the basis of subscribers reached. The outcome may sometimes mean that cable operators pay for signals from outside their local area if they choose to carry these signals. However, as DTH providers beam local signals into specific local communities, they only pay per local subscriber that receives that specific local signal.

As noted above, the rates negotiated between BDUs and broadcasters vary widely. As well, specific rates paid are often kept confidential by larger industry players as they are part of closed door negotiations between the parties. However, there are enough rates available in the public domain to give a good indication of the fees paid by BDUs in the U.S., as the next table depicts:

**Table 1: Range of Retransmission Fees Paid (\$USD)**

<b>Companies</b>	<b>Examples of over-the-air broadcast signals</b>	<b>Range of fees paid (\$USD)</b>
<b>Large media conglomerates</b>		
Disney	ABC owned stations	0.70 – 0.85
Viacom	CBS* owned stations	0.45 – 0.60
News Corp	Fox owned stations	0.60 - 1.00
<b>Large station groups</b>		
Cox Broadcasting	Atlanta WSB-TV (ABC)	0.40
Hearst-Argyle	Boston WCVB (ABC)	0.30 – 0.65
Gannett	Buffalo WGRZ-TV (NBC)	0.75 – 1.00
Sinclair	Baltimore WBFF (Fox)	0.50 – 1.00
Nexstar	Washington WHAG (NBC)	0.11 – 0.30
<b>Other networks</b>		
WB	WB owned stations	0.25 – 0.30
UPN **	UPN owned stations	0.25 – 0.30

Sources: American Cable Association FCC Filings, 2002-2005, Multichannel News, Arlen Communications Report on Retransmission Consent

\*De-merged since this rate was published

\*\*Now owned by CBS Corporation, soon to merge with WB

As noted earlier, the rates charged vary according to the size and capacity of the BDU. The American Cable Association estimates that smaller cable operators end up paying the dominant media conglomerates at least 30-55% more per signal per subscriber, compared to larger BDUs<sup>10</sup>. Thus, smaller BDUs with less to offer pay more than BDUs with higher capacity and higher overall subscriber totals.

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<sup>10</sup> ACA Comments, FCC MBB Docket No 05-255, September 19, 2005 p.6

## 2.3 Trends in Form and Amount of Retransmission Consent Payments

While in-kind payments were long the dominant forms of payment for BDUs, recent evidence indicates that cash-for-carriage appears to be forming an increasingly larger component of the deals struck – regardless of the size and shape of the BDU and broadcaster. Direct and immediate cash payments are increasingly viewed as attractive to current and potential investors of broadcaster groups, as their CEOs have seized on retransmission consent payments to generate incremental revenue at little or no marginal cost to them.

The payment of these rates per subscriber per month and the in-kind payments from BDUs large and small are expected to contribute significant revenues to the broadcasters in the future as evidenced by some of the following examples over the last couple of years. The following media releases outline the value of some larger retransmission consent deals established in 2005:

- Nexstar Broadcasting Group Inc. will earn in excess of \$40 million over three years, most of it in cash, from its most recently negotiated retransmission consent deals with approximately 145 cable operators, covering approximately 4 million cable subscribers;<sup>11</sup>
- Bear Stearns anticipated that Sinclair Broadcast Group Inc. will receive about \$20 million in cash and advertising support from retransmission consent in 2005<sup>12</sup>;
- CBS Corp. was estimated to have earned \$30-40 million in retransmission consent dollars allocated to them by Viacom for CBS's retransmission agreements that helped Viacom increase distribution, increase wholesale fees, and increase the number of new cable networks distributed<sup>13</sup>;

According to some analysts and broadcasters, the size of these deals will grow significantly over the next three to five years, potentially doubling or even tripling

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<sup>11</sup> "Nexstar Pulls In \$40M from Retrans Deal" Linda Moss, *Multichannel News*, Jan 19, 2006

<sup>12</sup> *Ibid*

<sup>13</sup> *Ibid*

in total value. Recent evidence to back up this claim of increasing payments costs includes:

- Sinclair Broadcasting Group has stated that its retransmission revenues could increase to as much as \$80 to \$100 million by 2006, and predict that in time rates could increase as high as \$4.30 per subscriber per month;<sup>14</sup>
- Bear Stearns believes CBS could be earning as much as \$150 million per annum by 2010 in retransmission fees<sup>15</sup>;
- The CBS CEO has recently claimed that CBS will receive hundreds of millions of dollars from retransmission consent deals in 2008 and 2009<sup>16</sup>;
- Small cable companies claim WMAZ-TV (Macon, Georgia) owned by Gannett Company Inc. had been seeking a fee of \$0.75 a month per subscriber, this year from the operators, escalating to \$0.85 in 2004 and \$1.00 in 2005<sup>17</sup>
- Disney/ABC has said that although now it is charging up to \$0.75 a signal, these signals really should be valued at \$2.00.<sup>18</sup>

In addition to growing fees and anticipated revenues, some broadcasters and BDUs are now striking retransmission deals for accessing broadcaster stations on an “on-demand” basis, e.g. via IPTV broadband networks, thus expanding the sources of retransmission payments. In its first major retransmission deal since CBS split from Viacom, CBS and Verizon recently signed a major deal rumoured to be cash-based.<sup>19</sup>

The transition to cash payment deals now at the expense of other sources of revenue is not necessarily a smooth one as illustrated by the case of Nexstar Broadcasting Group, Inc. (“Nexstar”). Over the last few years, this large station

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<sup>14</sup> *‘Extensions granted in retrans talk’ by Linda Moss, Multichannel News 1/6/2003*

<sup>15</sup> *Ibid*

<sup>16</sup> *‘Moonves Predicts Nine-Figure Retrans Pot’ Broadcasting and Cable, March 6 2006*

<sup>17</sup> *Extension Granted, Multichannel News*

<sup>18</sup> *NCTA’s Letter to Federal Communications Commission, in response to RM 11-203 filed by ACA, April 2005*

<sup>19</sup> *‘CBS, Verizon Ink Retrans Pact’ Linda Moss, March 20, 2006, Multichannel News*

group has been demanding high rates and tough terms for consent deals. However, many cable systems, including medium sized Cox Communications and Cable One Inc, were unwilling to agree to such difficult terms. So agreements were not reached and these systems dropped Nexstar's signals. The lack of agreement cost Nexstar up to 70,000 subscribers, resulting in a several million dollar reduction in advertising revenues. Yet Nexstar persisted, and the short-term sacrifice and uncompromising stand has paid off – last year Nexstar's total consent renewals negotiated in 2005 totaled approximately \$40 million in 'contracted cash' over the span of the agreement.<sup>20</sup>

There is also a consumer impact of the transition to cash-for-carriage deals in the U.S. First, there is reduced choice for subscribers. As some broadcasters are denying consent until they can reach the deal most favourable to them, certain cable companies have had to drop certain signals they have carried in the past. Because all costs are on the increase, any savings from the dropping of signals is not passed on to consumers.

Second, in some cases, increased retransmission payments demanded by ever more powerful media conglomerates and station groups are increasing consumer prices. Many cable companies have cited the increasing fees demanded in the recent rounds of negotiations with broadcasters as leading to increases of \$5.00- to \$6.00 per subscriber per month in the pricing of their basic service.

This overview of the U.S. retransmission consent practices and trends provides a basis for assessing the potential impact in Canada in the future in terms of rates charged by broadcasters and the impact on BDU pricing structure for basic services.

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<sup>20</sup> "Nexstar Pulls In \$40M from Retrans Deal" Linda Moss, *Multichannel News*, Jan 19,

### **3 Possible Proxies: Claims Made by U.S. Broadcasters**

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This section examines the first implication of a possible signing of the WBT – that U.S. stations would be granted signal rights and Canadian BDUs would require consent from these stations in order to retransmit their signals. We argue that the most logical proxy for estimating the amount of possible claims by U.S. and Canadian broadcasters for retransmission consent would be developed from the U.S. experience. However, we explain how practices as evolved over time in the U.S. would be adapted in a negotiation between Canadian BDUs and American broadcasters.

While we have concluded that the U.S. experience is the most useful proxy, we acknowledge that there are other possible proxies. We describe them and give reasons why we consider that they are not as valid. These proxies are: distant signal copyright fees currently paid for the retransmission of programming in distant signals, relative audience tuning to U.S. stations, and specialty-TV wholesale rates.

#### **3.1 U.S. Retransmission Consent as a Proxy for Canada/US Agreements**

The practice of negotiating retransmission consent in the U.S. is likely the most appropriate proxy for assessing the value and type of retransmission considerations that could be claimed by American broadcasters for two key reasons:

- If the WBT is ratified, U.S. broadcasters will be granted the same signal rights internationally as they are currently granted domestically;
- Canadian BDUs would be seeking retransmission consent from the same broadcasters and corporations from which American BDUs currently obtain consent.

Despite these similarities, however, there are several key issues specific to the Canadian regulatory system and the market which must be taken into account in

order to evaluate how the proxy might be applied to the Canadian situation. Mostly, these differences contribute to a situation where Canadian BDUs would have a much-reduced negotiating power with the broadcasters, compared to their counterparts in the U.S. In the discussion below, we describe the key constraints affecting the negotiating position of Canadian BDUs: regulatory restrictions, lack of opportunities for in-kind payments, low value of Canadian market for advertising on the U.S. stations, and the important legacy value of U.S. network affiliates.

### **3.1.1 Constraints in Providing In-Kind Considerations:**

One major difference between how American BDUs currently pay American broadcasters and how Canadian BDUs could satisfy the claims by American broadcasters (should there be WBT ratification) is the lack of opportunities to provide in-kind considerations. There are various reasons why Canadian BDUs cannot easily develop in-kind payments such as the carriage of affiliated networks on their distribution system, the placement of affiliated networks in more favourable packages, and by bartering advertising space.

#### **CRTC Regulations Restrict In-kind Payments:**

Certain regulations would restrict the ability of Canadian BDUs to satisfy the in-kind payment claims from American broadcasters, including;

- Only specialty networks on the authorized list of foreign services can be carried, and those are restricted to genres not available from Canadian specialty services;
- There are restrictions on the packaging arrangements for U.S. services, e.g. U.S. superstations can only be carried on premium service tiers (typically the pay movie networks);
- BDUs cannot sell advertising, whereas in the U.S., cable operators can sell local advertising time on the so-called “local availabilities” (or “local avails”) of signals they carry.

### **Little Opportunity for Supportive Promotion:**

There may be some scope for a number of BDUs to give special marketing effort to the services and packages the BDU currently provides. However, it is unlikely that such marketing investment would significantly bring down retransmission consent costs, as this consideration is not one of the more valuable in-kind payments in the U.S. Also, the larger BDUs have more opportunities to promote U.S. stations than small cable systems in the U.S. The problem is that there is an opportunity cost for such promotion, which means that less may be claimed in retransmission right fees but more would be paid in promotion costs – so, it is a rough wash.

#### **3.1.2 Canadian Subscribers of Little Value to U.S. Broadcasters:**

As discussed previously, extending the reach of American signals in Canada is not typically valuable to American broadcasters. There are a few instances where border stations in the U.S. can sell their airtime to Canadian advertisers aimed at Canadian markets, and these stations look to the Canadian market for significant airtime sales on programming that draws a significant audience. However, even in those instances this potential is limited partly because of the disincentive to advertisers arising from section 19 (1) of the *Income Tax Act*. The opportunity is particularly dampened by simultaneous substitution practices in Canada. In former times, the Canadian market was valued for its advertising revenue base. However, aside from a couple of notable examples, e.g. the Fox border station near Toronto and KVOS in Bellingham near Vancouver, the advertising market in Canada for these stations is not very valuable.

#### **3.1.3 Limited Ability to Drop U.S. Local Signals**

U.S. network signals carried by border station affiliates were the *raison d'être* of the rapid growth of cable in Canada and their carriage was authorized by the CRTC as a means of driving the expansion of home-grown, Canadian programming services. The major local networks (also known as 4+1, i.e. ABC,

CBS, NBC and Fox plus PBS) are included in virtually every basic standard package offered by Canadian BDUs in English-language markets.<sup>21</sup>

While most of the popular U.S. programming is now carried on Canadian channels, there is still a strong attachment to the brands of the U.S. affiliates. The carriage of the basic service is even the norm for Canadian DTH providers, although they were only relatively recently established in Canada. In fact, local U.S. border stations remain highly popular in Canadian markets because of their local sports focus (e.g. the Buffalo Bills, an NFL team), local advertising (for cross-border shopping), and news (e.g. Fox news).

Many subscribers value affiliate networks so much that BDUs place a second set of 4+1s from other time zones. This time-shift feature is quite popular for digital subscribers (all of DTH and those cable subscribers taking digital). It is the view of BDUs that the 4+1 local, distant (wherever used as part of the basic service), and time shifted services are highly valued by BDU subscribers. While Canadian broadcasters simulcast the high-appeal U.S. shows, the perceived brand power and legacy position of U.S. stations carried by BDUs would make it difficult to stop distributing them. Thus, the negotiating power of Canadian BDUs is weakened. If BDUs were to drop the brand name networks from the U.S. (one or more of them), they would fear serious consequences – in the form of disconnects, churn and even migration to the grey or black markets.

Canadian BDUs might have some options to bring in an alternative line-up of 4+1 where the loyalty to local U.S. affiliates is less pronounced. In those cases in theory, Canadian BDUs have the choice of which U.S. affiliates they could carry. However, this choice is often limited because of the technical costs of bringing these services to the cable head end or DTH uplink centre.

This situation would be different from the plight of small cable systems in the U.S. who complain that there is a lack of a fair market of alternatives. They claim that U.S. regulations and affiliation contracts restrict the ability of affiliated stations to grant carriage to MSOs outside their region. However, it remains to be seen whether a true marketplace would develop for Canadian BDUs, or whether a few major U.S. companies would hold out for very good deals rather

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<sup>21</sup> There are some legacy packages which do not contain the 4+1s, but the majority of those subscribers choose to pay extra to receive the 4+1s services. These subscribers will be migrated over time to standard basic packages.

than cut better deals for some Canadian BDUs. U.S. networks may also impose the same affiliation contracts restricting the ability of BDUs to negotiate between stations of the same affiliate.

### **3.1.4 Overall Assessment of Negotiating Position**

Just because BDUs such as Rogers, Shaw, Vidéotron and Bell-ExpressVu and Star Choice are big companies in Canada, it does not follow that they could use big-firm leverage on individual border stations in the U.S. In 1976 when Bill C-58 (by which section 19 of the *Income tax Act* was introduced) was debated in the House of Commons these border stations banded together to mount a lobby against the legislation – to no avail on their part. Today, however, these border stations are mostly under the ownership of large media conglomerates or large station groups, some of which are larger than the Canadian BDUs. It is not single stations or even a loose confederacy of single stations that would face Canadian BDUs; it would be large sophisticated enterprises negotiating a retransmission rights deal for a number of their properties. Two examples of border stations illustrate this point:

- WGRZ-TV Buffalo is owned by Gannett Company Inc. – a large station group operating 21 television stations in the U.S.
- WUHF in Rochester, New York is owned by Sinclair Broadcasting Group – a large station group operating a total of 58 stations.

In comparing to the U.S. situation, then, even the larger Canadian BDUs might hold roughly the equivalent negotiating power to small cable systems in the U.S. in striking retransmission deals. Like the small cable operators these BDUs are limited in their ability to offer in-kind payments.

There is some evidence in the U.S. to suggest that larger cable operators and DTH providers are able to strike discounted rates due to the sheer number of subscribers they carry. Therefore, the larger Canadian BDUs might be in a different position compared to small cable in the U.S., as they may be able to obtain bulk rates from U.S. broadcasters. In view of this larger subscriber base for larger Canadian BDUs, some bulk rates could be applicable.

The limitations cited earlier would likely be more important than bulk rates in determining the terms of the transaction. The retransmission consent agreements struck would be primarily cash-for-carriage, and the rates could be comparable to those paid by the small cable operators, although at the lower end of the spectrum of rates.

It is this relative bargaining position of Canadian BDUs that should be kept in mind in transposing the retransmission consent fee rates from the U.S. to Canada.

## **3.2 Alternative Retransmission Consent Proxies**

We have made the case for the value of the U.S. experience as a suitable proxy. However, it is useful to review briefly alternative proxies to demonstrate that despite the difficulties in converting a U.S. experience to a Canadian situation, there are no plausible alternatives. The alternatives assessed are: distant signal copyright fees, relative audience tuning, and specialty-TV wholesale rates.

### **3.2.1 Distant Signal Copyright fees**

According to the *Copyright Act* in Canada, anyone who legally retransmits a “distant signal” is required to pay royalties to the owners of the programming contained within the signal. A distant signal is defined in the *Copyright Act* as a signal that becomes ‘distant’ for any area more than 32 kilometres away from the original station’s Grade-B contour *Canadian Copyright Act, section 31(2)(d)*. These royalty payments go to collectives representing the programming rights holders, e.g. producers, distributors, and broadcasters.

In 1990, under file 1989-1, a tariff of \$0.70 per subscriber per month (for systems with 6,000 or more subscribers) was set, based on a calculation using the monthly wholesale rate of the U.S. specialty service, A&E. This service wholesale rate was used as a proxy to determine the royalties tariff to be paid, as the content of A&E was a rough approximation of the content contained in distant signals, and because the rate was determined by the market rather than by regulation. The rate per month was reached by discounting the A&E rate and assuming an average of 4.5 distant signals per subscriber.

These fees, however, are royalty payments for the owners of the content transmitted rather than the broadcasters transmitting the signals. To the extent that broadcasters receive a share of these fees, it is in their role as program rights holders, not broadcasters *per se*. Current distant signal retransmission payments are made to rights collectives that represent the owners of the content. The proposed WBT would grant broadcasters the rights to their signals – but not the content within the signals. Even though the value of the signal is essentially in the content it carries, as the WBT does not grant ownership of the content, it cannot be valued in the same way as the rights to content.

In a study conducted for the Department of Canadian Heritage in 1994, Gerry Wall concluded that the value of the signal lay in the *compilation* of the signal *and not the content* of the signal; the broadcasters' role and thus earned value was in compiling the signal. As the broadcasters license much of their foreign and Canadian content from programming suppliers and only own some of it, arguably the only component of the signal which may currently not be compensated for is their actual compilation of the signal.<sup>22</sup> This principle is reflected in the allocation of distant signals royalty payments, as the value of this compilation by BDUs is taken into account.

In sum, whereas distant signal fees are paid to the actual rights holders of the content, retransmission consent payments are compensating for the signal but not the content. Therefore, distant signal fees are not a good proxy for the application of retransmission consent fees.

### **3.2.2 Relative Audience Tuning**

Tuning could be considered as one measure of value in determining the rate charged by broadcasters for each signal, as advertising is sold on this basis.

There are two major reasons why relative tuning would not serve as an adequate proxy. First, specific tuning levels do not appear to influence the rates that U.S. stations demand from BDUs in the U.S. While there is a general appreciation of

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<sup>22</sup> Study on the Protection of Broadcasters' Signals, July 1994, Gerry Wall, *Wall Communications*, P ii

the value of a network affiliate vs. an independent broadcaster, there is little reason to believe that tuning would play into negotiations with BDUs.

Second, Canadian regulations regarding simultaneous substitution negatively impact tuning for American channels within Canada. This policy requires that American signals carrying the same content as Canadian channels at the same time are replaced by the Canadian signal – which then gets credit for the tuning from both spots on the channel line-up. It is probable that U.S. broadcasters would dismiss the existence of simultaneous substitution as an argument and focus on the network brand and popular programming that is not simulcast.

Another factor to consider is that overall tuning to conventional Canadian television, bulked up by simultaneous substitution, is several times higher than for U.S. stations in English Canada. If tuning were the key factor, any conversion of the U.S. retransmission consent rates to a possible right for Canadian broadcasters would bring the claims by Canadian broadcasters to an unrealistically high level.

### **3.2.3 Specialty-TV Wholesale Rates**

We do not believe that wholesale rates for specialty channels, paid on a per-subscriber basis, are a relevant proxy for the retransmission rates for over-the-air broadcasters. The specialty-TV channels in Canada have acquired the rights to the programming for packaging into a signal and retransmission to subscribers by BDUs. Conventional broadcasters have not acquired programming rights for retransmission, only for over-the-air broadcasting. While specialty-TV services sell advertising, their principal source of revenue is the wholesale fee charged to BDUs. Because of the different rights and economic structure, then, the wholesale rates structure is not viewed as an appropriate proxy.

However, the discounting of English and multilingual channels carried by BDUs in the French-speaking market could be relevant to the retransmission fees claimed from BDUs for the Francophone or bilingual markets. American broadcasters are also willing to discount specialty channels to this extent for French-language viewers, so there is little reason to believe they would not be willing to discount retransmission fees of signals to the same extent.

Thus, while wholesale rates cannot serve as a direct proxy to determine the value of a retransmission right, we have factored the importance of discounting French- and English-language signals into the calculations of actual rates in Section 5.

### **3.2.4 Choosing the U.S. Experience as a Proxy**

In view of the problems of alternative proxies, we return to the U.S. retransmission consent regime as a rough illustration as to what could happen in Canada should retransmission rights be granted to foreign and domestic broadcasters. We recognize that the size and scale of the U.S. market and the regulatory structure are different from Canada. It is not always a good proxy for the Canadian market. However, there are usually useful lessons to draw from examining the U.S. market, as long as there is due consideration for the differences in conducting the analysis.

Failing any viable alternative proxy, then, we have constructed a possible Canadian approach that takes into account the experience in the U.S. The caveat is that this approach assumes the existing regulatory structure in Canada. However, as noted above that structure would very likely be challenged by BDUs and by the public leading to major changes in regulations as a trade-off.

## 4 Possible Proxies: Claims Made by Canadian Stations

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As has been discussed in Section 1, should the WBT be ratified it is possible that the Canadian government would implement a similar regime in which Canadian broadcasters have a similar right to claim payments from BDUs. In this section, we evaluate current payment regimes and arrangements which could serve as proxies to estimate the type and valuation of claims by Canadian broadcasters. Again we emphasize that the sponsors of this report do not endorse or accept the start-up of such a regime in Canada for Canadian broadcasters.

### 4.1 Impact of Regulatory Differences

There are two key factors which severely constrict the negotiating position of Canadian BDUs in arriving at a payment structure: the existing priority carriage regulation and obligations to carry Canadian pay and specialty-TV services. Each is briefly discussed in turn.

- **Priority carriage:** As previously discussed, it is assumed that priority carriage would remain in place within a retransmission consent regime. This existing provision would significantly alter the application of a U.S.-style consent regime within Canada. In the U.S., BDUs carry stations under either a must-carry provision or a retransmission consent provision, whereas in Canada, BDUs would be required to carry a station as well as acquire retransmission consent. In this situation, there would be no real negotiation between the BDU and the broadcaster. A dispute resolution system would likely be required as a means to adjudicate the rates (if not the Copyright Board itself).
- **Distribution regulations:** Considering U.S. retransmission practices as a proxy, Canadian BDUs would theoretically have some options for paying for consent besides cash payments. Since major Canadian station groups also own analog and digital specialties, there could be some trade-offs in terms of carriage of these affiliates (say, for Category 2 digital specialty services), or carriage on a higher penetration tier (say, for Category 1 digital specialty services). However, BDU distribution regulations already provide protection for placement, tiering, and wholesale rates for Canadian specialty-TV services – except for Category 2 digital specialty services.

- **New digital migration rules:** These rules will create a more market-based approach to the carriage of Canadian specialties, and BDUs could conceivably have more negotiating room *vis-à-vis* Canadian broadcasters. For example, with wholesale rates, the transition regulations offer some protection for Canadian specialty-TV services for several more years, but they will be winding down during the period in which retransmission consent would be negotiated. However, the post-migration environment will still see the application of the dispute resolution measures by the CRTC. The experience of the BDUs indicates that there would not be as much negotiating flexibility as in a true marketplace. While the carriage of Canadian specialty-TV services would be a factor in negotiations, the separate CRTC process would limit any leverage BDUs might possess.
- **Promotional spots on local avails:** Although they are not permitted to sell airtime in the “local avails” advertising slots of U.S. specialties distributed in Canada, BDUs can instead insert certain promotional content. At least 75% of these spots must be made available for use by licensed Canadian programming services, promotion of the community channel, and for unpaid Canadian public service announcements. A maximum of 25% of the commercial availabilities may be made available for the promotion of discretionary programming services and packages, among other offerings. Within these constraints, it is possible that Canadian BDUs will have limited capacity to offer this promotion space in exchange for retransmission consent. However, considering the number of other uses for which these local avails are needed, this opportunity would form a very minimal potential consideration to broadcasters to promote licensed and discretionary services.

These regulatory differences point to the adoption of a rate structure that is more cash-for-carriage based than for U.S. broadcasters. It also points to some considerable protection of the broadcaster negotiating position by the regulator, despite the migration to an all-digital platform.

## 4.2 The National Carriage of Local Signals

In the U.S., DTH providers as well as cable operators offer local signals to their subscribers. DTH providers have the scale to afford satellite spot beams to distribute local signals directly into the relevant market area. Local signals are not available across the country as are the Canadian stations carried by Canadian DTH providers.

In Canada, however, a key advantage that cable and in particular DTH providers bring to subscribers is the carriage of several (or many) local Canadian signals across the country. DTH providers carry up to 10 local signals per large station group across the country, and consider this not only necessary in order to serve a national market, but also a major competitive factor in the struggle for BDU subscribers. This marketing strategy means DTH operators carry about 40 signals affiliated with Canada's largest English-language station groups as well as ten or more additional signals from independents, and make those signals available to subscribers anywhere in the country. DTH also offers approximately 15 French-language signals owned and operated by TVA, TWS, and SRC. If claims from DTH providers were made by station groups per signal per subscriber for those who can actually receive each signal, the fees would be significantly higher than their American DTH counterparts are obligated to pay.

While cable operators in Canada do not carry as many conventional Canadian signals as their DTH competitors, they have responded with a sizable offering to compete against DTH. Thus, Canadian cable operators carry more conventional stations than their U.S. counterparts, and consequently face higher total fees for retransmission consent rights.

If a fee structure that was similar to the U.S. one prevailed for Canadian broadcasters, the total amount of fees would be substantially greater than the case of the U.S. Given some law of diminishing value for incremental affiliates to Canadian broadcasters, it is likely that some discounting would be negotiated. In the next section we will assign and rationalize various discount rates for specific classes of broadcast signal. As well, it may be possible for DTH operators to adopt corrective measures and negotiate, with the Canadian Association of Broadcasters (CAB), a drop in the number of regional signals on basic.

### **4.3 Impact on Negotiations with Canadian Broadcasters**

We have described how Canadian BDUs carry relatively more Canadian broadcast services in order to improve the BDU offering for time shifting and other local services. These practices have led to the negotiation of carriage terms and payments between BDUs and broadcasters, without consideration of a retransmission consent regime.

We have also explored the potential for BDUs to provide in-kind payments in a retransmission consent regime by way of wholesale rates and promotion arrangements to improve penetration rates with respect to the specialty-TV services affiliated with broadcast station groups. The new digital migration regulations could provide more negotiating room for BDUs.

In both cases it remains to be seen how the retransmission consent could be layered on to the existing regulations, regulatory processes, and agreements with the broadcasters. In view of the popularity of Canadian stations, including the U.S. network programming that they air, it is clear that the stations are very valuable to BDUs. At this point it is not clear that any added flexibility for Canadian BDUs to negotiate because of carriage of many Canadian specialties would make a significant difference in the amount claimed in retransmission rights payments.

In the next section, we provide estimates of the fee rates to be concluded and calculate the total amount of fees that would ensue.

## 5 Estimate of Total Fee Claims

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As noted above, we conclude that the current U.S. retransmission consent regime – specifically the practices and fees paid – is the most appropriate proxy for estimating the total fees which would be commanded by both U.S. broadcasters as well as Canadian broadcasters from Canadian BDUs.

Based on this proxy, as well as the differences and additional considerations highlighted above, we have developed a range of assumptions to calculate how the proxy might be applied and to estimate the total fees potentially charged by American and Canadian stations carried by Canadian BDUs.

In the first stage, on the assumption that most considerations will be cash claims, we sought to estimate what base rate per subscriber, per signal, per month might be charged by American and Canadian BDUs. Second, we applied a series of discounts to the base rate, taking into account a number of assumptions based on current evidence seen in the U.S. and some of the considerations highlighted in Sections 3 and 4.

Third, we prepared estimates for the subscriber reach of each conventional broadcast signal available to Canadians; in other words, we estimated the number of Canadian BDU subscribers that are able to receive each broadcast signal. These estimates were based on data supplied by Mediastats, and other statistics we obtained from Statistics Canada and the CRTC. Finally, we applied monthly retransmission fee rates to each of these signals to determine the total annual level of retransmission fees that Canadian BDUs would have to remit to broadcasters for retransmission.

## **5.1 Claim Type**

Currently, within the U.S. retransmission consent regime, there is evidence that payments made by BDUs to broadcasters are a mix of types – in-kind payments, such as advertising bartering, as well as cash payments. However, evidence also suggests that broadcasters are increasingly demanding cash payments. This is particularly the case with smaller cable operators in the U.S., who are less able than the large BDUs to make in-kind payments.

As the time frame of the potential introduction of a retransmission consent regime is three years hence (2009), we estimate that by that time cash payments will dominate in the U.S. market. Also, we have established that Canadian BDUs have virtually no ability to make in-kind considerations to U.S. broadcasters, and a limited ability to make such payments to Canadian broadcasters. Therefore, we believe it a reasonable assumption to make that U.S. and Canadian broadcasters would primarily claim cash payments should a retransmission consent rights be given to U.S. and Canadian broadcasters at that time.

Currently in the U.S. these cash payments are charged on a per-signal per-subscriber per-month basis. We assume that claims by American and Canadian broadcasters from Canadian BDUs would be in the same form.

## **5.2 Two Scenarios: Conservative and Aggressive**

In order to estimate the total fees which would be claimed from Canadian BDUs under a retransmission consent regime for foreign and domestic broadcasters, we have made a series of assumptions about how such a regime would be implemented in Canada, and how agreements would be struck between broadcasters and BDUs.

However, we acknowledge that there are significant unknowns as to how a retransmission consent regime and claim negotiations between foreign and domestic broadcasters would be concluded with Canadian BDUs. Market forces such as technological shifts, regulatory developments, and changes in company ownership structures, among others, could all influence future negotiations and practices.

For this reason, we have developed two scenarios. One is a more conservative scenario which we take as our primary case in developing the model and assessing the total impact on the market. The second scenario depicts the results of a more aggressive negotiating stance by broadcasters in the U.S. and Canada, should our low-scenario assumptions about the market prove to be overly conservative.

- Within the **U.S.** broadcaster consent regime, we use a lower base rate in the conservative scenario compared to the aggressive scenario; however, we applied the same discounts to each scenario.
- Within the **domestic** regime, we assume the same base rate for the two scenarios, yet apply fewer discounts in the aggressive scenario (i.e. the average amount claimed for each signal is assumed to be higher).

The reasons underlying the assumptions for conservative and aggressive scenarios are explained below.

### **5.3 The Proxy Rate for Retransmission Consent Fees**

In this section, we identify what we believe to be valid proxy rates, based on a series of assumptions as discussed earlier. We express caution that this rate in no way reflects the position of Canadian BDUs, but rather an analyst's estimate based on U.S. experience and applying that to Canada.

#### **5.3.1 Base Rate charged by U.S. Broadcasters**

##### **Conservative scenario:**

Based on the U.S. retransmission consent regime as a proxy, we have factored in the following considerations to arrive at an estimated base rate potentially charged by U.S. broadcasters:

- Based on research of rates that have been disclosed, rates currently charged range from US\$0.11 to US\$1.00;

- The higher end is typically paid by smaller cable companies in the U.S. The American Cable Association has used US\$0.75 as an estimate of what all small to medium sized cable operators are being charged by broadcasters;
- We have estimated that Canadian BDUs will have marginally better negotiating power compared to small cable companies in the U.S.;
- U.S. broadcasters currently demand payment from U.S. BDUs in U.S. dollars. Accordingly, whatever rate selected as a proxy for the U.S. was converted to the same value in Canadian currency.

We estimate, therefore, that a conservative approximation of a reasonable base rate would be **US\$0.50** per signal per subscriber per month. It is recognized that rates and terms will differ, but to simplify the calculations, the US\$0.50 cents rate is estimated as an average across all broadcasters. We express caution that this rate in no way reflects the position of Canadian BDUs, but rather an analyst's estimate based on U.S. experience and applying that to Canada.

**Aggressive scenario:**

As mentioned above, this scenario assumes BDUs start from a negotiating position roughly similar to that of small cable companies in the U.S. for the reasons discussed in Section 3. Therefore, in the aggressive scenario we estimate that the rate charged could go as high as **US\$0.75** per signal per subscriber per month.

### 5.3.2 Base Rate charged by Canadian Broadcasters

However, as already discussed, we expect that in Canada BDUs will be able to make greater amounts of in-kind considerations to Canadian broadcasters than to those in the U.S. This may serve to reduce the overall amount of cash claimed – but we still assume the majority of claims will be cash to broadcasters in both countries.

#### **Conservative scenario:**

Based on the U.S. retransmission consent regime as a proxy, we have factored in the following considerations to arrive at an estimated base rate potentially charged by Canadian broadcasters:

- Canadian distribution regulations and priority carriage limit the leverage of Canadian BDUs in striking deals with domestic broadcasters;
- However, the large number of affiliated specialty-TV services would allow Canadian BDUs to make a greater level of in-kind payments to Canadian broadcasters compared to the opportunities to do so with respect to U.S. broadcasters;
- This leverage would be expressed in the discounting of amounts claimed by the large number of affiliate stations carried by BDUs, particularly DTH operators;
- Canadian broadcasters would seek payment from Canadian BDUs in Canadian dollars.

We estimate, therefore, that a conservative approximation of a reasonable base rate would be **C\$0.50** per signal per subscriber per month. Because it is in Canadian currency, this rate is less than the U.S. base rate used. Once again, we emphasize that this rate in no way reflects the position of Canadian BDUs, but rather an analyst's estimate based on U.S. experience and applying that to Canada.

### **Aggressive scenario:**

In the scenario where Canadian broadcasters would take a more aggressive stance, we do not believe that rates would go significantly higher than the base rate highlighted. As highlighted previously, all of the major Canadian English-language conventional broadcasters are part of ownership groups that also hold specialty-television services. Canadian BDUs could offer preferred carriage to specialty services in exchange for better retransmission rates. Therefore, even for the aggressive scenario we assume a single base rate of **C\$0.50** to be reasonable.

Where the scenario differs from the conservative one is in the potential discounting of that rate for incremental stations. In the aggressive scenario, we assume that broadcasters would tend to hold close to the rate for all or most of their stations, as discussed below.

#### **5.3.3 Discounts applied to the fee rate**

We have described the assumptions as to the base rate for claims to broadcasters in both the U.S. and Canada. We also developed a system of discounts to reflect a possible variation in the rates that would prevail following negotiations. These discounts were applied for a number of reasons, but primarily build on assumptions addressed in our assessment of how the U.S. proxy might be applied to a regime within Canada, as well as between Canada and the U.S. We express caution that this rate in no way reflects the position of Canadian BDUs, but rather an analyst's estimate based on U.S. experience and applying that to Canada.

Table 2 summarizes the system of discounts applied both to U.S. signals as well as Canadian signals. A short description follows as to the rationale for these discounts.

### **Discounts for U.S. Broadcasters:**

We applied the following discounts to signals in the U.S. for both the conservative and aggressive scenarios:

- **Foreign-language signals:** For the U.S. signals and throughout the calculations we applied a discount of 50% for English-language signals available in predominantly French-language markets, and vice versa. This discount reflected the current practice in the Canadian specialty television wholesale market, where BDUs in French-language markets typically obtain 50% discounts on the wholesale rates for English services.
- **Border markets:** We applied a discount of 10% to the rates for U.S. signals in the three major border markets (Golden Horseshoe, Greater Montreal, and Vancouver/Victoria). We believe that BDUs will be able to negotiate lower rates with some of these broadcasters, because they derive some revenues from advertising sales in Canada, and therefore value the reach BDUs can grant them in Canada. We recognize that some U.S. stations rely more on Canadian advertising than others, so the 10% discount is a rough approximation of an average.
- **PBS affiliates:** Throughout our calculations we applied a retransmission-fee rate of zero to PBS affiliates. In the U.S., non-commercial stations such as PBS cannot be carried under the retransmission consent provision, only under must-carry; and so, they cannot demand retransmission fees. While PBS affiliates do not have must-carry status in Canada, we do not believe that they would demand retransmission fees from Canadian BDUs, because it would likely jeopardize their carriage position and Canadian fundraising prospects.

We did not apply discounts in the U.S. to additional signals, as explained below:

- **Second set of 4+1 U.S. Signals:** Many Canadian digital subscribers have access to a second set of U.S. television signals, primarily for time shifting. However, we did not apply any discounts for the second U.S. signals, as it did not appear that there would be any significant differences in negotiating with the first and second signal originators.

- **HD Signals:** Some digital subscribers subscribe to the HD signals for U.S. broadcasters which are in essence additional signals of the same network. However, it is likely that all American broadcasters will convert to HD transmission by 2009 or soon afterwards. Therefore, the concept of a separate set of HD signals will disappear as all U.S. broadcasters will be broadcasting in HD in a few years. Therefore, we did not separately account for HD signals in the model and no fees were attributed to these signals.

#### **Discounts for Canadian Broadcasters:**

A major tenet of this system of discounts we applied within Canada was that additional signals of the same television network would be discounted from the rate for the first signal. With the growth in the number of subscribers to DTH, and the growth in digital cable and time shifting among digital subscribers, many Canadian BDU subscribers today have access to several signal feeds of the same television network. While these feeds contain different local content (e.g., local news); they do offer similar program schedules. As such, we hold the view that additional signals are of less value than the first signal, and thus have calculated fees claimed based on this discounting. We believe that these will be discounted in Canada for the following reasons:

- DTH providers carry most local signals nationally, whereas in the U.S. local signals are delivered by DTH only to those in that specific locality;
- Because of an agreement with respect to equivalency, Canadian DTH providers must carry an equal number of CBC, CTV, CanWest Global, etc. local stations, e.g. if they carry ten local signals affiliated with one Canadian network, they must carry ten signals affiliated with every network;
- Cable providers carry several Canadian signals in order to remain competitive, although not as many as DTH operators.

The result is that the number of broadcaster signals carried by a Canadian BDU is far greater than an American BDU. Within the U.S. market, U.S. broadcasters sometimes apply bulk discounts in exchange for extending their signal to a greater number of subscribers. Partly for this reason, we assume that Canadian broadcasters would apply discounts for the sheer number of signals carried by Canadian BDUs.

In the calculations of possible claims from Canadian BDUs by American broadcasters, we presented two scenarios based on two different rates to take into account two possibilities for how the regime might develop. In contrast in the Canadian environment, we believe the area of greater uncertainty lies in the amount of discounting that will be agreed to by Canadian broadcasters. Hence the difference between the conservative and aggressive scenarios lies in the discounting and not in the 50 cent/sub basic fee we have posited. The following discounts for additional signals are made in each scenario:

- **Aggressive scenario:** We discounted by 20% the second through fifth signal of the same television network (i.e., CBC, CTV, Global, TVA, etc.). In effect, we assumed that there is value in having at least one feed from each region of Canada, even though there is little difference in the programming. If a subscriber had access to more than five feeds, then these additional signals were discounted by 90%. We saw little incremental value for a BDU subscriber to have more signal feeds than regions.
- **Conservative scenario:** We restricted the 20% discount to only the second signal of each television network. Each additional signal was subjected to a 90% discount. In this case, we assumed that most of the value was in having access to one additional signal from another region. A subscriber does not need a third or additional time window for the same programming.
  - In addition, we also discounted the second networks of large broadcast groups – CH and A-Channel – by 50% in relation to their related primary networks. While the second networks are distinct signals with distinct schedules, in many cases, the programming is largely identical, except for local news.

In addition, we applied the following discounts in both scenarios:

- We discounted Canada's ethnic-language broadcasters by 50% to reflect their more limited audience reach;
- We applied a rate of zero to the religious broadcast services.

The following table summarizes the system of discounts incorporated into the fee calculations, both for American and Canadian signals.

**Table 2: Assumptions for Retransmission Rates and Rate Discounts**

Origin of signal	Category	Conservative scenario	Aggressive scenario
U.S.	First signal	<p>Base rate: <b>US\$0.50</b></p> <p>Discounts applied to rate:</p> <ul style="list-style-type: none"> <li>▪ 50% to signals in French-language markets</li> <li>▪ 10% to U.S. signals in three major border markets†</li> </ul> <p>Zero-rated:</p> <ul style="list-style-type: none"> <li>▪ PBS</li> </ul>	<p>Base rate: <b>US\$0.75</b></p> <p>Discounts applied to rate:</p> <ul style="list-style-type: none"> <li>▪ 50% to signals in French-language markets</li> <li>▪ 10% discount to U.S. signals in three major border markets</li> </ul> <p>Zero-rated:</p> <ul style="list-style-type: none"> <li>▪ PBS</li> </ul>
	Extra signals (regional signals)	<p>Base rate: <b>US\$0.50</b></p> <p>Discounts applied:</p> <ul style="list-style-type: none"> <li>▪ 50% to signals in French-language markets</li> </ul>	<p>Base rate: <b>US\$0.75</b></p> <p>Discounts applied :</p> <ul style="list-style-type: none"> <li>▪ 50% to signals in French-language markets</li> </ul>
Canada	First signal	<p>Base rate: <b>C\$0.50</b></p> <p>Discounts applied:</p> <ul style="list-style-type: none"> <li>▪ 50% to English signals in French markets and vice-versa</li> <li>▪ 50% discount to ethnic stations in both language markets</li> <li>▪ 50% discount to second networks – CH, A-Channel, OMNI-2</li> </ul> <p>Zero-rated:</p> <ul style="list-style-type: none"> <li>▪ Religious broadcasters</li> </ul>	<p>Base rate: <b>C\$0.50</b></p> <p>Discounts applied:</p> <ul style="list-style-type: none"> <li>▪ 50% to English signals in French markets and vice-versa</li> <li>▪ 50% discount to ethnic stations in both language markets</li> <li>▪ <u>No</u> discount for second networks</li> </ul> <p>Zero rated:</p> <ul style="list-style-type: none"> <li>▪ Religious broadcasters</li> </ul>
	Extra signals (regional signals)	<p>Base rate: <b>C\$0.50</b></p> <p>Discounts applied:</p> <ul style="list-style-type: none"> <li>▪ Second signal: 20% off the rate on the first signal</li> <li>▪ Additional signals: 90% off the rate on the first signal</li> </ul>	<p>Base rate: <b>C\$0.50</b></p> <p>Discounts applied:</p> <ul style="list-style-type: none"> <li>▪ Second, third, fourth, fifth signals: 20% off the rate on the first signal</li> <li>▪ Additional signals: 90% off the rate on the first signal</li> </ul>

### 5.3.4 Calculation of Total Claim Estimates

To estimate the level of retransmission fees that would be claimed by broadcasters if such a regime were adopted, we first identified the subscriber reach of each conventional broadcast signal available to Canadians, i.e. the number of Canadian BDU subscribers that are able to receive each broadcast signal. These numbers were based on data supplied by Mediastats, and other statistics we obtained from Statistics Canada and the CRTC. We then applied monthly retransmission fee rates to each of these signals to determine the total annual level of retransmission fees that Canadian BDUs would have to remit to broadcasters for retransmission.

When we combined the reach statistics and retransmission rates, we generated estimates within both the conservative and aggressive scenarios for the level of retransmission fees that would be assessed on Canadian BDUs.

If Canadian BDUs were required to remit retransmission fees for the U.S. signals that they distribute, we estimate that the annual claims would be approximately **C\$380 million**<sup>23</sup>. This is based on the conservative scenario, but in the aggressive scenario, retransmission fees leaving the country in response to claims by U.S. broadcasters for retransmission consent could run as high as **C\$570 million**. Both these figures are based on subscriber reach statistics as of September 2005 – and so do not reflect the growth in BDU subscribers and digital subscribers, in particular, that may occur over the next several years.

If Canadian broadcasters negotiated retransmission fees with Canadian BDUs, we estimate that the annual claims within the conservative scenario would be approximately **C\$722 million**. This figure could rise as high as **C\$1.0 billion**, based on the assumptions taken within the aggressive scenario.

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<sup>23</sup> The figures presented in this impact analysis should be viewed as constant dollar estimates. They are based on 2006 prices. If the WBT is ratified it is likely to be implemented in 2009 at the earliest. The actual level of fees is likely to be higher, when one considers that price inflation over the next few years.

**Table 3: Estimates of Retransmission Claims**

	<b>Conservative scenario (C\$ millions)</b>	<b>Aggressive scenario (C\$ millions)</b>
U.S. signals	379.9	569.9
Canadian signals	722.0	1,009.6
<b>Total</b>	<b>1,102.0</b>	<b>1,579.5</b>

Source: Nordicity Group analysis based on data from Mediastats, Statistics Canada, and CRTC.  
 Note: Some totals may not add due to rounding

We note that these estimates are conservative largely because they are based on subscriber reach statistics as of September 2005, and so, do not reflect the growth in BDU subscribers, and digital subscribers in cable in particular, that will occur over the next several years. We also note that faced with this level of claim from broadcasters, it can be assumed that many aspects of the regulatory structure would change. It is probable that BDUs would seek regulatory changes or equivalent trade-offs through negotiation as a consideration for any payments demands made of them by broadcasters

**Table 4: Conservative Scenario: Estimates of Retransmission Claims 2006**

	<b>U.S. signals (C\$ millions)</b>	<b>Canadian signals (C\$ millions)</b>	<b>Total (C\$ millions)</b>
<u>Cable</u>			
First signal	189.3	360.8	550.2
Extra signals	<u>94.5</u>	<u>58.8</u>	<u>153.2</u>
Total	283.8	419.6	703.4
<u>DTH</u>			
First signal	64.1	193.1	257.2
Extra signals	<u>32.0</u>	<u>109.3</u>	<u>141.4</u>
Total	96.1	302.4	398.6
<b>Grand total (cable+DTH)†</b>	<b>379.9</b>	<b>722.0</b>	<b>1,102.0</b>

Source: Nordicity Group analysis based on data from Mediastats, Statistics Canada, CRTC, and Convergence Consulting.  
 † We did not include estimates for the impact of retransmission fees on MMDS or IPTV. These categories of BDUs would also be subject to retransmission fees, but as of September 2005, they accounted for only 1% of Canadian BDU subscribers, so are not material in terms of overall impact at this point.

Note: Some totals may not add due to rounding

**Table 5: Aggressive Scenario - Estimates of Retransmission Claims 2006**

	U.S. signals (C\$ millions)	Canadian signals (C\$ million)	Total (C\$ millions)
<u>Cable</u>			
First signal	284.0	401.5	685.5
Extra signals	<u>141.7</u>	<u>120.7</u>	<u>262.3</u>
Total	425.7	522.2	947.8
<u>DTH</u>			
First signal	96.1	209.8	306,.0
Extra signals	<u>48.1</u>	<u>277.6</u>	<u>325.7</u>
Total	144.2	487.4	631.6
<b>Grand total (cable+DTH)†</b>	<b>569.9</b>	<b>1,009.6</b>	<b>1,579.5</b>

Source: Nordicity Group analysis based on data from Mediastats, Statistics Canada, CRTC, and Convergence Consulting.  
 † We did not include estimates for the impact of retransmission fees on MMDS or IPTV. These categories of BDUs would also be subject to retransmission fees, but as of September 2005, they accounted for only 1% of Canadian BDU subscribers, so are not material in terms of overall impact at this point.

Note: Some totals may not add due to rounding

The annual level of claims could rise in real dollar terms (by a rate faster than inflation) for a number of reasons. One reason would be retransmission fee rate increases. However, we have no way of predicting how broadcasters will adjust their rates in the future. The annual amount of retransmission claims could also grow due to increases in the number of subscribers to BDU services.

Following the introduction of DTH services in Canada in 1997, the Canadian BDU market experienced strong growth in the number of subscribers.<sup>24</sup> Since 2002, however, growth has stabilized somewhat.<sup>25</sup> In 2004, the number of Canadian BDU subscribers grew by 1.5%.<sup>26</sup> Subscriber growth is likely to be modest in coming years; 87% of Canadian households already subscribe to Canadian BDU services.<sup>27</sup>

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<sup>24</sup> Statistics Canada, Service Bulletin: Broadcasting and Telecommunications, October 2005: Cable, satellite and multipoint distribution systems, 2004; p. 1

<sup>25</sup> *Ibid*

<sup>26</sup> *Ibid*

<sup>27</sup> *Ibid*

Real growth in annual retransmission claims could also occur as more Canadians migrate to digital BDUs services. Digital BDU services offer increased bandwidth and carriage capacity that permits time-shifting and the addition of other distant signals to subscriber packages. There are currently around five million digital BDU subscribers, and the total is growing by about 250,000 subscribers per quarter. Forecasts indicate that there could be an additional 2.5 to 3.0 million digital subscribers by the time a retransmission fee regime were to be implemented in 2009. As such, the initial level of fees may actually be higher because more stations would be available to digital subscribers. What is more, the annual level of claims would grow on a real-dollar basis as the Canadian BDU industry completes the conversion to 100% digital subscription in the early part of the 2010s.

The growth in digital subscribers, and the take-up of time-shift signals that comes with it, could mean that annual retransmission claims made by U.S. stations could be around **C\$448** million by the time a regime is implemented around **2009**, based on the conservative scenario. This amount could rise to **C\$787** million by **2014**, based on a higher retransmission rate and the assumptions made within the aggressive scenario.

Considering Canadian signals, the going-in levels of annual retransmission claims could be over **\$850** million in **2009** in the conservative scenario. With growth in digital subscribers and limited discounting by broadcasters, this amount could rise to **\$1,490** million by **2014**, as calculated within the aggressive scenario.

The forecasted figures for 2009-2014 are summarized in the tables on the next page.

**Table 6: Forecast of Retransmission Claims (millions of Canadian dollars\*)  
– Conservative Scenario**

	2006	2007	2008	2009	2010	2011	2012	2013	2014
U.S. Signals	380	401	424	448	464	482	495	508	516
Canadian Signals	722	766	807	850	878	911	934	958	972
Total	1,102	1,166	1,232	1,298	1,342	1,393	1,429	1,466	1,488

Source: Nordicity Group analysis

\* Figures are meant to be in constant 2006 dollars and do not include the effect of inflation over the forecast period.

Note: Some totals may not add due to rounding

**Table 7: Forecast of Retransmission Claims (millions of Canadian dollars\*)  
– Aggressive Scenario**

	2006	2007	2008	2009	2010	2011	2012	2013	2014
U.S. Signals	570	613	649	684	708	735	755	775	787
Canadian Signals	1,010	1,095	1,175	1,255	1,311	1,373	1,420	1,462	1,490
Total	1,579	1,708	1,824	1,939	2,019	2,108	2,175	2,237	2,277

Source: Nordicity Group analysis

\* Figures are meant to be in constant 2006 dollars and do not include the effect of inflation over the forecast period.

Note: Some totals may not add due to rounding

## **6 The Impact of Retransmission Fees on BDUs, Consumers, and Broadcasters**

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This stage of the impact analysis involved estimating the price increases that would be required to compensate for the retransmission consent claims. We then assessed the possible adverse reaction of subscribers to increased prices without any change in the service. This analysis entailed the development of price elasticity tools based on empirical data.

We then examined the impact of potential subscriber disconnects and/or downgrading of their services on BDUs. Following that analysis, we focused on the impact on subscribers as consumers, and then assessed the impact on broadcasters and pay/specialty-TV services.

## 6.1 Impact of Price Increases on Consumer Behaviour

Consumer behaviour following price increases can be examined on an economic basis through analysis of price elasticity. The elasticity of demand is a crucial element in the model we constructed for assessing the impact of retransmission consent on Canadian BDUs. For most goods and services, a rise in price leads to drop in the quantity demanded. The elasticity of demand determines whether or not the drop in quantity demanded will offset any price increase, and thereby lead to a drop in total revenue for the firm imposing the price increase.

When the demand for a product is **elastic**, a price increase will lead to decrease in quantity demanded, such that total revenues fall. Where demand elasticity is elastic, it is likely because consumers have the option of purchasing substitutes. When the demand is **inelastic**, a price increase will actually lead to an increase in total revenues. When demand is inelastic, it is likely due to the fact that consumers have very few alternatives.

In the modeling of the impact of retransmission fees on BDUs, our interest was not so much in the elasticity of demand for cable-television services versus DTH services, *per se*, but rather the demand for Canadian BDU services, or the industry elasticity of demand. In other words, we were interested in consumers' decision to switch between Canadian BDU service of any type and the available alternatives – the use of over-the-air antenna reception or grey-/black-market satellite services.

In the model, we applied the following two assumptions regarding subscriber responses to the initial retail price increase caused by the imposition of retransmission fees.

1. The industry elasticity of demand for Canadian BDU services is equal to -0.3. This means that for every 10% increase in the real-dollar price of Canadian BDU's basic-tier services, **3%** of subscribers would choose to **disconnect** from the BDU, and resort to over-the-air reception or the grey or black markets.
2. Approximately **20%** of subscribers with discretionary services would not be able to tolerate the rate increase brought on by retransmission fees; they would **reduce their spending** on other BDU services on a dollar-for-dollar basis.

The demand elasticity assumption was based on limited research of available studies of demand elasticity in Canadian BDU services. In Appendix 1, we discuss this research and its applicability to our analysis.

The second assumption regarding the reduction in spending rather than disconnection altogether was developed following discussions with Canadian BDUs regarding their own observations of subscriber reaction to significant rate increases.

## 6.2 Estimated Subscriber Price Increase

If BDUs were faced with increased costs due to retransmission consent fees claimed by broadcasters of up to \$1,579 million per annum, they would have no choice but to pass as much of this cost on to subscribers as possible. In our calculations, therefore, we assume that Canadian BDUs will seek to pass 100% of the new costs on to subscribers. This does not take into account that BDUs would most likely not make the same decisions if faced with retransmission costs. Some may pass less than 100% of the costs on to consumers, and choose to absorb the costs elsewhere. Others would mark up the price by greater than 100%, in order to sustain the margins that are expected by the financial community. However, for the purpose of our calculations, we have assumed a 100% pass-through to consumers.

Our modeling indicates that the impact of retransmission fees could result in a price increase for Canadian consumers of up to **\$19.34** per month – depending on whether the subscriber was a DTH or cable (and analog vs. digital within cable) subscriber. This estimate is based on the price increase of a Canadian DTH basic package within the aggressive scenario, assuming high U.S. signal rates and low discounting by Canadian broadcasters. With basic-tier DTH packages currently selling for approximately \$30.00 per month, retransmission fees would, in effect, bring the total monthly DTH subscriber bill to **\$49.34** within the aggressive scenario, and even as high as **\$42.14** within the conservative scenario.

As noted above, these price increases exclude any mark-up that the DTH providers may apply to the price increase. In the normal course of events BDUs try to sustain a percentage margin on any cost element, and it could be argued

that retransmission consent regimes are no exception. However, for the purposes of analysis, we assumed BDUs would simply go for a straight pass-through.

The price increase of a basic DTH package will be significantly higher than of a basic cable package due to the greater number of Canadian signals DTH carries compared to cable. For a basic digital cable package, the price increase within the aggressive scenario would be **\$40.33**, a full **\$9.03** less than DTH would experience.

Under the aggressive scenario, a subscriber to analog cable services would experience a monthly rate increase of **\$7.51** for their basic-tier services. Basic-tier packages currently retail for about \$25.00 per month, so the increase amounts to a 30% increase in cost to the subscriber.

As one can see from the figures above, different segments of customers will experience different levels of price increase due to retransmission fees. This differential price increases will likely lead to subscriber movement among Canadian BDUs. Because DTH subscribers face the greatest price increase, many who live in urban areas where cable television is also available are likely to switch to cable from DTH. DTH subscribers living in rural and remote areas where alternative BDU services are not available may have to resort to grey or black market services.

To arrive at an estimate of the potential number of disconnects from Canadian BDUs, i.e., subscribers who would resort to over-the-air or grey or black market services, we applied the elasticity assumption to the smallest price increase – the increase imposed on basic analog cable subscribers. For most households in Canada, this is the last option in Canadian BDUs services. If the price of basic analog cable rises too high, then they will disconnect from Canadian BDU services. If retransmission fees were imposed on American and Canadian signals, then an industry elasticity of demand equal to 0.3 implies that 9% of subscribers will disconnect. The 9% estimate is derived by multiplying the 30% price increase by the elasticity of 0.3. With approximately 10 million subscribers to Canadian BDU services, this translates into as many as 900,000 disconnected households.

The assumption regarding the downgrading of services by subscribers was applied in the same manner for both the impact of the U.S. retransmission fees

and the Canadian retransmission fees. While the percentage rate (**20%**) was the same, the dollar impact rose in step with higher dollar impact associated with the imposition of Canadian retransmission fees.

**Table 8: Average Impact on Basic-Tier Subscriber Rates**

	Conservative scenario (C\$)			Aggressive scenario (C\$)		
	Analog cable	Digital cable	DTH	Analog cable	Digital cable	DTH
U.S. signals	\$2.07	\$2.07	\$2.12	\$3.11	\$3.11	\$3.19
Canadian signals	\$3.96	\$5.82	\$10.02	\$4.40	\$8.22	\$16.15
Total	\$6.03	\$7.89	\$12.14	\$7.51	\$11.33	\$19.34

Source: Nordicity Group analysis based on data from Mediastats, Statistics Canada, and CRTC.

## 6.3 Impact of Retransmission Fees Claimed from BDUs

### 6.3.1 Impact of American Broadcasters' Claims on EBITDA

If the Canadian government were to ratify the WBT retransmission, fees claimed by U.S. broadcasters could range from C\$379.9 million (for the conservative scenario) to C\$569.9 million (for the aggressive scenario). These estimates are based on the existing subscriber count.

Assuming that Canadian BDUs do not apply any further mark-up to the subscriber price increases caused retransmission fees, then we estimate that Canadian BDUs could experience a reduction in EBITDA (earnings before interest, taxes, depreciation and amortization) of between C\$119.8 million and C\$177.9 million.

- Canadian BDUs will experience lost revenues of between C\$146.6 million and C\$217.0 million due to disconnected subscribers;
- Subscriber downgrades will result in additional lost revenues of between C\$60.6 million and C\$90.9 million;
- These disconnects and subscriber downgrades contain variable costs saved such that Canadian BDUs could avoid costs of between C\$87.3 million and C\$129.9 million;

- The disproportionate impact of retransmission consent on DTH would also upset the competitive balance among BDUs.

These EBITDA financial impacts are summarized in the following table.

**Table 9. Financial Impact of Retransmission Fees Claimed by U.S. Broadcasters**

Item	Conservative Scenario (C\$)	Aggressive Scenario (C\$)
<b>Calculation of net retransmission fees</b>		
Initial amount of retransmission fees assessed on subscribers	379.9	569.9
<u>Less:</u> Fees avoided due to lost subscribers	9.5	21.1
<u>Equals:</u> Net fees due from remaining subscribers	370.4	548.8
<b>Reduction in BDU EBITDA</b>		
BDU revenues lost from disconnected subscribers	146.6	217.0
<u>Add:</u> BDU revenues lost due to subscriber downgrades	60.6	90.9
<u>Less:</u> Costs avoided by BDUs	87.3	129.9
<u>Equals:</u> Reduction in BDU EBITDA	119.8	177.9

Source: Nordicity Group analysis based on data from Mediastats Inc., Statistics Canada, CRTC.

Note: Some totals may not add due to rounding

### 6.3.2 Impact of Canadian Broadcasters' Claims on EBITDA

If the Canadian government were to extend the provision of WBT to Canadian broadcasters, based on the existing subscriber base, retransmission fees due to Canadian broadcasters could amount to between C\$722.0 million (conservative scenario) and C\$1,009.6 million (aggressive scenario).

Assuming that Canadian BDUs do not apply any further mark-up to the subscriber price increases caused retransmission fees, then we estimate that Canadian BDUs could experience a reduction in EBITDA (earnings before interest, taxes, depreciation and amortization) of between \$208.5 million and \$247.7 million.

- Canadian BDUs will experience lost revenues of between \$265.9 million and \$294.5 million due to disconnected subscribers.

- Subscriber downgrades will result in additional lost revenues of between \$112.0 million and C\$154.9 million.
- The above reductions will allow Canadian BDUs to avoid costs of between \$169.4 million and C\$201.7 million.

**Table 10: Financial Impact of Retransmission Fees Claimed by Canadian Broadcasters**

Item	Low Scenario (C\$ millions)	High Scenario (C\$ millions)
<b><u>Calculation of net retransmission fees</u></b>		
Initial amount of retransmission fees assessed on subscribers	722.0	1,009.6
<u>Less:</u> Fees avoided due to lost subscribers	51.3	82.6
<u>Equals:</u> Net fees due from remaining subscribers	670.7	927.0
<b><u>Reduction in BDU EBITDA</u></b>		
BDU revenues lost from disconnected subscribers	265.9	294.5
<u>Add:</u> BDU revenues lost due to subscriber downgrades	112.0	154.9
<u>Less:</u> Costs avoided by BDUs	169.4	201.7
<u>Equals:</u> Reduction in BDU EBITDA	208.5	247.7

Source: Nordicity Group analysis based on data from Mediastats Inc., Statistics Canada, and CRTC.

Note: Some totals may not add due to rounding

### 6.3.3 Combined Impact of Retransmission Fees Claimed by Broadcasters

If the Canadian government were to require Canadian BDUs to negotiate retransmission consent with American and Canadian broadcasters, then, we estimate that the total amount of fees claimed could amount to between \$1,102.0 million (conservative scenario) and \$1,579.6 million (aggressive scenario).

Assuming that Canadian BDUs do not apply any further mark-up to the subscriber price increases caused retransmission fees, then we estimate that Canadian BDUs could experience a reduction in EBITDA of between \$328.3 million and \$425.6 million. These estimates also assume that there are no other changes in the regulatory system.

**Table 11: Financial Impact of Retransmission Fees Claimed by U.S. and Canadian Broadcasters Combined**

Item	Conservative Scenario (C\$ millions)	Aggressive Scenario (C\$ millions)
<b><u>Calculation of net retransmission fees</u></b>		
Initial amount of retransmission fees assessed on subscribers	1,102.	1,579.5
<u>Less:</u> Fees avoided due to lost subscribers	60.8	103.7
<u>Equals:</u> Net fees due from remaining subscribers	1,041.	1,475.8
<b><u>Reduction in BDU EBITDA</u></b>		
BDU revenues lost from disconnected subscribers	412.4	511.4
<u>Add:</u> BDU revenues lost due to subscriber downgrades	172.6	245.8
<u>Less:</u> Costs avoided by BDUs	256.7	331.6
<u>Equals:</u> Reduction in BDU EBITDA	328.3	425.6

Source: Nordicity Group analysis based on data from Mediastats Inc., Statistics Canada, and CRTC.

Note: Some totals may not add due to rounding

There are also a couple of contextual points to make with respect to elasticity of demand. First, over the next few years Canadian incumbent telephone companies will be establishing IPTV delivery capacity. In addition, more programming is likely to become available through the Internet. As new entrants to broadband video programming delivery, they will likely be price aggressive. Therefore, as retransmission consent is being introduced (assuming that it would be implemented), the Canadian market would be quite price competitive. Thus, the effect on profitability might be greater than anticipated as BDUs decide to absorb some of the new costs in face of competitive pressure.

Second, Canadian BDUs represent the regulated component of the industry. In 5-10 years, the downloading of video programming from a variety of sources over broadband networks will have progressed substantially. While it is not clear what regulatory regime it will be under, if any, it does represent a potential bypass of the BDU delivery system in Canada. The impact of retransmission consent could lead to a faster deterioration of the competitiveness of BDUs in a new broadband world.

## 6.4 Retransmission Fees Impact on Consumers

The impact of a retransmission consent regime and the fees claimed by U.S. and Canadian broadcasters within such a regime will be felt by consumers as well as BDUs. Price increases, impacting those particularly in rural areas, and the loss of choice experienced by subscribers if signals are dropped are among the impacts a retransmission consent regime could have upon consumers.

### 6.4.1 Price Increases

As discussed above, Canadian subscribers face a **one-time increase in monthly** rates of a minimum of **six dollars** (for basic analog cable within the conservative scenario). Almost all of this increase will be assessed on the basic tier. So, it will be akin to a regressive tax. It will likely hurt most those who can afford it the least, if we assume that subscribers to the basic tier are less able to afford the higher tiers. What is more, it will have the greatest impact on the segment of subscribers who are likely the most price sensitive, those who cannot afford to pay more.

At the high end of the potential price increases – up to **\$19** for DTH subscribers – it represents a staggering increase for no addition in service or in services. While affordability may be less of an issue, the increase is 37% over the current basic package. It is almost akin to a “sin” tax meted out by governments who seek to discourage consumption. At that level it is fair to speculate there could be some organized reaction to the price increase. Indeed, at a minimum it would have a significant impact on the competitive balance as between DTH and cable, and in the extreme could threaten the very viability of DTH providers and BDU competition. Such an outcome would then mushroom to impact about 2.5 million Canadian TV households.

### 6.4.2 Loss of Signals and Station Choice

In our impact scenarios we projected that BDUs would retain all the Canadian signals that they now carry. It is possible that this outcome may not arise, despite the fees they could negotiate. The reason lies in the nature of the right. At present, broadcasters cannot legally stop the transmission by BDUs of their signal, even though they may have agreed to a compensation for it. With a retransmission consent right, the broadcaster could be liable to a breach in their

licensing agreements with programming suppliers. Currently, if a broadcaster is licensed for a certain market, but is picked up and transmitted by a BDU across the country, the broadcaster carries no liability if such national transmission is found to be contrary to licences it has with programming distributors. There is no recourse for the programming supplier because the broadcaster has not expressly granted permission for its signal to be carried nationally.

However, under a retransmission consent regime, the broadcaster would be liable as it would be granting permission for such national distribution. If such national distribution exposed the broadcaster to the risk of being liable for violating program licensing agreements, the broadcaster might reconsider granting consent. This position would force BDUs to drop some Canadian signals. While the price increases could be less than if they carried all current broadcasters, consumers would in effect receive fewer services, yet pay more for them.

While this may be similar to what is experienced by U.S. satellite subscribers at present, the loss of national carriage of all local signals would lead to a fundamental shift in the nature of the service DTH subscribers currently receive, resulting in diminished choice for consumers.

If BDUs were seeking to reduce costs in the wake of newly granted retransmission consent rights, a possible option would be to drop U.S. signals to reduce the overall fees claimed by U.S. broadcasters. U.S. signals can, in principle, be dropped or moved to a discretionary tier. BDUs would have to weigh the balance between price increases and a loss of channels in their basic offering. Again, if they made some line-up changes to moderate the price increases, consumers would be receiving less of a service at a higher price.

Overall, retransmission fees could lead to a situation where consumers will be paying significantly higher prices for a lower quality product.

### **6.4.3 Impact on Consumers in Rural Markets**

DTH providers carry as many as ten signals of Canada's major national networks, CBC, CTV, CHUM, and Global in the basic-tier offering. Cable providers, on the other hand, typically only offer a single signal for each Canadian network in their basic tier. However, digital cable customers typically obtain several out-of-market signals as part of the lease of a digital box for time-

shifting convenience, or in some other package. If DTH providers do not change their signal distribution within their basic tier, then their subscribers would face much higher increase in rates than would cable subscribers. In the aggressive scenario, as discussed, this price increase would mean that a basic satellite package would cost as much as **\$9** more than a basic digital cable package per month (\$49.34 for basic DTH and \$40.33 for basic digital cable).

The most serious impact of such a significant price increase would be felt by consumers whose only viable option to receive a good selection of television signals is via DTH providers. Consumers in small rural communities which are not cabled, and where over-the-air signals are weak, cannot turn to other platforms to receive their signals if faced with the large DTH price increases. Even where there is limited over-the-air reception and the availability of smaller cable operators or MMDS services, DTH remains the only way to receive big city-like television service. Therefore, the impact of retransmission fees would be felt much more by rural and small community residents compared to their fellow citizens who happen to live in urban areas.

## **6.5 The Growth of Grey and Black Markets**

By some estimates, there are already one million illegal satellite dishes in Canada<sup>28</sup>. With a retransmission consent regime in place, the number of consumers turning to the grey or black market could increase significantly. The increased cost of multichannel television services to subscribers, the serious impact potentially felt by DTH subscribers in rural areas, the potential reduction in the number of channels carried and the slowdown in BDU capacity that inhibits the carriage of HD signals could all drive this unwanted effect.

Based on demand elasticity research as cited earlier, we estimated that the rate increase associated with retransmission fees – the combined American and Canadian fees – would likely cause as many as 9% of subscribers to disconnect from Canadian BDU services. This means that over **900,000** Canadian households would drop Canadian BDU service altogether. Many of these 900,000 households would be tempted to obtain grey or black market satellite services.

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<sup>28</sup> Statistics Canada, 2005, p.1.

Rural consumers with fewer options for receiving television signals except DTH may be particularly tempted to enter the grey market. The choices they would face would be: to pay significant price increases in order to receive the same, or even reduced, services; to receive only over-the-air television signals, if available; to subscribe to lower capacity cable or MMDS services; or to turn to the grey or black markets to receive their desired programming services at a lower cost.

### **6.5.1 Growth of HD Black and Grey Markets**

A reduction in BDU EBITDA of approximately up to \$426 million per year could reduce the annual borrowing capacity of BDUs up to **\$1.7** billion, based on an approximate debt/EBITDA ratio of 4:1. This hit on BDU financing capacity will reduce the BDUs capacity to make capital expenditures and other long-term investments by this amount. Since BDUs cannot avoid making the investments needed to maintain their infrastructure, their lower capacity to borrow and invest will force them re-examine their investments in new capacity, whether that be for telephony or programming services in full HD.

As the need for increased carriage of HD grows with the penetration of HD display devices, any slow-down of capacity build by BDUs will have a negative impact on Canadian television services moving into HD. Moreover, should HD capacity building in Canada slow significantly, subscribers who have invested in new HD display systems who are keen to view programming delivered in this format could turn to the black and grey markets, or over-the-air reception, to access HD signals. This outcome could lead to a further loss of subscribers within the Canadian system.

## **6.6 Impact on Canadian Broadcasters**

Having addressed the impact of retransmission consent on Canadian BDUs, we now address the impact on Canadian broadcasters, including pay/specialty-TV services. This impact comprises the “windfall” benefits of receiving fees claimed from BDUs, but also the potential negative fall-out for Canadian pay/specialty services. The potential impact varies for broadcaster groups, depending on

whether their assets are skewed relatively toward pay/specialty or conventional television services.

### 6.6.1 Financial Impact of Retransmission Claims

As the estimates developed in Section 5 indicate, a retransmission right for Canadian broadcasters would represent a massive transfer of money on an annual basis from BDUs to conventional broadcasters. Based on the assumptions as to fee rates and various discounting factors explained earlier, we estimate that this transfer to Canadian conventional broadcasters could be between **\$722** million and **\$1,010** million per year. The key assumption, of course, lies in the rates determined through agreement, arbitration, or via the Copyright Board – or whatever mechanism is set in place. The use of the specific rates in this report is neither proposed nor acceptable to Canadian BDUs, but is merely shown to illustrate the impacts as described.

The EBITDA for conventional broadcasters in **2005** was **\$320** million or **15%** of their broadcasting revenues of just under \$2.2 billion. Aside from the costs of negotiation and claims collection, it is assumed that broadcasters would not incur any significant incremental costs in deriving the retransmission fees. As such, we estimate that the full amount of the retransmission fees would likely flow down to their bottom line. Accordingly, if there had been a retransmission regime in place and the claims satisfied at the level we have estimated, it would have increased the EBITDA of broadcasters by about **\$700** million to **\$1** billion. All other things being equal, that would have raised the percentage EBITDA from **15%** to somewhere between **35%** (conservative scenario) and **41%** (aggressive scenario) of broadcasting revenues. Obviously, the profit levels of individual broadcasters and broadcasting groups differ, so that the impact would have been different for each of them.

Since we are discussing a potential measure that would only take effect in three years time, the windfall for these broadcasters could be taken into account in license renewal applications before the CRTC. Consequently, that extra revenue might be applied to a number of expenditure categories rather than merely dropping to the bottom line of broadcasters. For example, one of the fastest growing expenditure categories of Canadian conventional broadcasters has been the acquisition of U.S. programming rights. Accordingly, a proportion of the extra revenues could be spent on U.S. programming rights, as U.S. programming

distributors could seek to increase their own revenues by taking advantage of the extra revenues flowing to Canadian broadcasters. Broadcasters have maintained that the prices for such programming are basically inelastic, since there is no viable alternative to the supply of U.S. programming for English language conventional television.

Because BDUs, especially DTH providers, carry so many Canadian broadcasters, there could be an impact on broadcasters in smaller markets. In order to cut costs, BDUs might simply drop some Canadian TV broadcasters from carriage altogether. Such broadcasters would likely be from the smaller markets in Canada. The impact of this kind of action on the agreements that BDUs have with the CAB on behalf of small market broadcasters would need to be addressed.

BDUs carry a range of conventional broadcasters from different time zones to offer their subscribers a time shift feature. Apparently, it is quite popular to BDU subscribers, and is considered as a “poor man’s PVR”. Faced with increased costs for carrying these additional stations, BDUs might rethink their marketing strategies and concentrate more on making PVR functionality a more attractive proposition for subscribers. Broadcasters and advertisers have frequently expressed alarm at the possible impact of PVRs on the viewing of commercials. Whether valid or not, this perception would not be beneficial to the core revenue source of private broadcasters.

We also note that the claims made by Canadian broadcasters could likely lead to strong counter-claims by Canadian BDUs for a discretionary carriage model like that of the U.S. – which would have disproportionate impacts on small markets, less popular Canadian programming, and on broadcasting services. Moreover, BDUs would likely also seek to address retransmission rights claims by reducing their current expenditures on Canadian programming (for example, on wholesale rates) in a manner that would prejudice specialty and pay services. In short, any financial claims by Canadian broadcasters would not simply translate into additional revenues for them, but would lead to significant modifications to current distribution practices.

We have sought to illustrate some of the perhaps unintended consequences in the implementation of retransmission consent rights for Canadian broadcasters. It is maintained that Canadian broadcasters will not likely trap all the possible financial benefits from the implementation of such a regime.

### **6.6.2 Possible Impact on Canadian Programming on Conventional TV**

It might be assumed that the CRTC would demand more of conventional broadcasters in terms of Canadian content to take advantage of the retransmission consent windfall. However, it cannot be assumed that regulatory intervention would be entirely effective in the future. For example, under existing TV policy, conventional broadcasters can choose to meet a number of hours of priority programming on prime time vs. expenditure commitments (and all have done just that). Therefore, extra revenues would not necessarily be transferred to Canadian content. The CRTC could revert back to its former policy or some other equivalent, but changing television policy is a complex undertaking and its eventuality and outcome cannot be guaranteed.

Broadcasters have maintained that they are suffering increasingly from fragmentation and the delivery of content via unregulated communication (e.g. Internet, mobile phones/PDAs, and ipods). Extra cash may help them develop more content and service assets for these alternative distribution systems. However, these properties would likely be in the areas where broadcasters have more investment in programming. In English Canada this means primarily news, information, and sports. Thus, while there may be some extra initiatives in the priority programming areas (children's, documentaries, variety, and drama), it is reasonable to expect that broadcasters would seek to invest where there is a higher likely pay-back for them. In short, there are potential Canadian programming benefits from the potential windfall from retransmission rights, but how much would be directed toward priority Canadian programming is an open question.

### **6.6.3 Impact on Pay, Specialty and Diginet Offerings**

There are direct financial impacts on pay/specialty-TV services that can be forecast if a retransmission consent regime were implemented in Canada. While the stronger ones would survive, the impact would be greater on the less well entrenched or niche services, particularly among the diginets. As well, a retransmission consent regime would be experienced quite differently by different broadcasting groups, depending on the relative balance in conventional vs. pay/specialty properties they own. Inevitably, given a detrimental impact on pay-specialty-TV services, there is a potential negative impact on Canadian content.

Of note, there are a large number of niche diginets in third languages, intended to reach ethnic Canadians. Given the cost increases to subscribers and limited reach of such services, it may well be that third-language services may be dropped by either subscribers or BDUs. Thus, ethnic Canadians may be disproportionately affected by the consent regime.

#### **6.6.4 Financial Impact from Disconnects**

It is anticipated that one consequence of increased costs for the claims for retransmission rights is the reaction of some subscribers – to disconnect entirely, churn out of the Canadian distribution system, or to reduce expenditures on discretionary programming i.e., pay/specialty programming packages to which they subscribe. Any of these consequences would have a potentially significant impact on Canadian pay/specialty-TV services.

Disconnects from Canadian BDUs would deprive all pay and specialty services, whether on basic, extended basic, or a theme package tier. That means a reduction in wholesale fees and tuning that translates into lower advertising revenues. Many of these services rely on the revenues from subscriber wholesale rates, since their niche programming has limited appeal with advertisers. Our model indicates that pay/specialty services would lose between **\$122 million** and **\$151 million** in wholesale fees as a result of subscriber disconnects. The limited advertising revenues of pay/specialty services would also likely drop in the order of 5%; thus raising the revenues losses from disconnects to between **\$150 million** and **\$190 million**.

#### **6.6.5 Impact from Pruning of Discretionary Services**

A reduction in the number of themed packages taken by subscribers would have a substantial impact as well. For example, one subscriber might drop a premium movie package and rely more on VOD (and pay less overall to save on the monthly bill). Another subscriber might drop the lifestyle or other theme package to save in overall payments to the BDU. As presented above, we estimate that 20% of subscribers would act in this way in some form or another. It is true that not all pay/specialty-TV services would be affected by any individual subscriber decision to prune the total services being taken. However, on an across-the-

board basis, our impact model indicates that specialty/pay services would lose another **\$86** million to **\$120** million due to reduced wholesale payments, stemming from BDU subscribers reigning in spending on BDU services to meet higher rates.

Besides this potential financial impact, there is the simple plight of the marginal diginets. In any given package of programming services some are more popular than others to subscribers. A possible initiative of BDUs is to prune their packages of the least popular diginets, whether they are Category 1 or Category 2 services. The impact could be devastating for services struggling to stay alive, whether owned by major broadcasting groups or independents. As well, any new diginets would have an even more difficult time to obtain distribution and successfully launch their services.

As noted above, BDUs will have to reduce their capital expenditures and other long-term investments; the carriage of Category 2 services is one such long-term investment. BDUs often have to make significant up-front investments in carriage capacity, and marketing and promotion to carry a Category 2 service. These types of investments are at risk, if the BDUs have less borrowing capacity. This type of environment will make it even more difficult for domestic Category 2 services to make a business case for carriage. The Category 2 space will be dominated by approved foreign services which have little incremental cost to operate in Canada, and thus do not contribute to domestic content.

Finally, if BDUs carry a diginet which they partially own, they are required to also carry 5 additional diginets which they do not own. Retransmission costs could require BDUs to examine their investment in channels they own, and any withdrawal of these services could add to a loss of carriage for up to five additional channels. This is one more example of the potentially unintended consequences that could have a negative impact on pay/specialty channels.

#### **6.6.6 Overall Financial Impact on Pay/specialty-TV Services**

In total, then, we estimate that revenues for pay/specialty services could be reduced on average by about **\$236** million to **\$310** million, or **12%** to **15%** of total revenues of about \$2,050 million. This impact would not affect all services equally, of course; for example, it would not be a pleasant prospect for diginets who are still looking for profitability. Existing analog services will be facing

enormous challenges over the next few years in the conversion to digital. Already facing a more market-oriented approach that is emerging in this conversion, a lessening of consumer demand induced by a retransmission consent regime would add an additional burden.

#### **6.6.7 Transfer of Economic Benefits from Pay/Specialty to Conventional Television**

While it would seem that a retransmission regime in Canada would simply transfer funds from BDUs/subscribers to broadcasters (after siphoning off hundreds of millions of dollars annually to U.S. broadcasters), there could be a shift within broadcasting that should be noted. Basically, conventional broadcasters would benefit at the expense of pay/specialty-TV services. As we have shown, it is the pay/specialty sector where there is potentially significant harm from the retransmission fees claimed by conventional broadcasters.

Specialty service broadcasters which are also large station group owners (e.g. CHUM, CTV, and to a lesser extent TVA and CanWest Global) might be financially protected because they gain more than they might lose. The caveat to this conclusion is that BDUs might lean on them more for wholesale rate reductions to recover some of the fees claimed. This possible BDU behaviour would be in an environment where BDUs would be re-examining their affiliation agreements anyway in the cable migration to digital.

Large specialty groups with few or no conventional television station assets (e.g. Astral, Corus, and Alliance Atlantis) would not fare well in a retransmission consent regime. Thus, the impact of retransmission consent would be uneven and would constitute a definite advantage for conventional broadcasters. While the plight of any individual enterprise is not the focus of this analysis, this shift does indicate that the impacts will be significantly different depending on what assets are owned by broadcasters.

### **6.6.8 Impact on Canadian Content**

There is an important implication for Canadian content. Pay/specialty service licensees have significant Canadian programming expenditure (CPE) commitments in addition to schedule-based content requirements. Therefore, any reduction in their revenues will directly affect Canadian programming. As we have noted above, the converse is not true for conventional television broadcasters. Under current TV policy regulations any additions to their revenues have no automatic benefit for Canadian programming. Thus, the benefits shift from pay/specialty to conventional has public policy implications with respect to meeting the Canadian content objectives of the *Broadcasting Act*.

Therefore, while conventional broadcasters might benefit from retransmission consent the pay/specialty sector could bear the brunt of the impact. This impact would certainly affect Canada's fledgling digital channels. It would also reduce expenditure in Canadian content, as pay /specialty service licensees have significant CPE commitments compared to conventional television broadcasters.

## **7 Conclusions**

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While any modeling of the impact of future copyright initiatives is fraught with methodological issues, we have sought to take a reasonable approach to this impact assessment. The basic conclusions we reach are driven by the findings arising from the calculations, namely:

1. The potential impact is substantial – the very large outflow of funds to the U.S. and the even larger transfer of money from Canadian BDUs to Canadian broadcasters.
2. With respect to the bargaining positions of Canadian BDUs, we can speculate that the large media enterprises in the U.S. with several years of retransmission consent negotiations experience will do as well in Canada as they do with distributors in the U.S.
3. With respect to Canadian broadcasters, a recent CRTC decision has concluded that Canadian BDUs do not hold the upper hand in negotiations

today. Unless changes were made to the current regulatory structure, there would be no realistic negotiations as Canadian BDUs would have to accept some form of arbitration for retransmission consent. Such arbitration might well conclude in fee claim amounts that are similar to those estimated in this report.

4. As presently constituted, we conclude that DTH providers would be more profoundly affected than cable operators, which could constitute an unfair competitive dynamic in the BDU marketplace. Taken to the extreme, it could cripple the DTH sector and put in jeopardy the service to 2.5 million Canadian households who subscribe to DTH.
5. Under retransmission consent Canadian subscribers would pay from \$6/mo. to \$19/mo. more for their basic service. For those subscribers who can only afford a basic service, these increases amount to a regressive tax.
6. The consumer impact would be most felt by rural Canadians and those living in small communities. If BDUs were able to reduce the carriage of signals to avoid costs, they would still likely be paying more to receive less. We also estimate that there might be about 900,000 subscriber disconnects. These customers might then turn to the grey or black market and reverse the painful progress the distribution and programming industry has made over the last decade.
7. The effect on the bottom lines of BDUs would deprive them of financing that is needed to increase their capacity. Such capacity is required to ensure that Canadian broadcasters can transition to HD and remain competitive with U.S. services.
8. If the claims made by conventional broadcasters were satisfied, their bottom lines could triple, but the impact would be negative for Canadian pay/specialty-TV services. This transfer of economic value could unfairly benefit some license holders at the expense of others.
9. The retransmission consent claims by Canadian broadcasters might contribute to the financing of more Canadian programming, but how much is very unclear. The additional revenues may be applied to higher payments for the rights to U.S. programming, or to the development of

news, information, and sports content – rather than to the CRTC's priority categories.

10. In effect, the retransmission consent regime has a variety of consequences that will damage and convulse the Canadian BDU industry, hit up consumers, transfer major sums to U.S. broadcasters (and likely U.S. programming suppliers), hurt Canadian pay/specialty services, and beef up the grey and black market. The benefits to the Canadian broadcasting system are far less clear.

In this assessment, we have sought to quantify the potential impact of retransmission consent, based on various assumptions about how a WBT might be implemented and holding all factors, regulatory and other, constant. As previously noted, however, it is likely that BDUs would seek fundamental regulatory change in response to any new signal rights.

We have found that the impact in terms of claims by U.S. and Canadian broadcasters is potentially enormous, and carries very major consequences for the Canadian broadcasting system as well as for Canadian TV households. If BDUs passed on the new copyright fees to BDU subscribers, they would see serious double digit basic rate hikes, especially the DTH market sweet spot of rural and small community Canadian TV households. Many would leave the Canadian BDU system and be prey for the grey and black satellite markets. As well, if broadcasters made signal right claims from BDUs, the BDUs would likely seek significant changes to the Canadian broadcasting system, which already affords Canadian broadcasters extensive protections at significant cost and/or commercial limitation to Canadian BDUs.

It is not clear what the impact would be on Canadian programming even if conventional broadcasters benefit from retransmission consent. What is clear is that pay/specialty-TV services would be severely harmed – either by disconnects, dropped services or by substantial wholesale fee reductions. Damaging the pay/specialty services would inevitably affect their ability to fund production of Canadian programming.

In sum, large potential retransmission consent fees claimed could convulse the broadcasting system, ending many years of developing a distribution system that

is highly supportive of Canadian broadcasting and Canadian programming. At this time technology is challenging the foundations of the Canadian broadcasting system. The regulatory changes unleashed by a retransmission consent copyright regime could represent another blow to the Canadian broadcasting system that could deprive Canadian broadcasters of the financial benefits of retransmission rights they now envisage.

## Appendix A: Elasticity of Demand in the BDU Model

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The elasticity of demand is a crucial element in the BDU model. For most goods and services, a rise in price leads to drop in the quantity demanded. The elasticity of demand determines whether or not the drop in quantity demanded will offset any price increase, and thereby lead to a drop in total revenue for the firm imposing the price increase.

When the demand for a product is elastic, a price increase will lead to decrease in quantity demanded, such that total revenues fall. Where demand elasticity is elastic, it is likely because consumers have the option of purchasing substitutes. When the demand is inelastic, a price increase will actually lead to an increase in total revenues. When demand elasticity is inelastic, it is likely due to the fact that consumers have very few alternatives.

For Canadians living in parts of Canada where cable-television services and DTH are available, the demand elasticity for basic-tier services of each is likely elastic. One service is a good substitute for the other, and there are few barriers to switching.<sup>29</sup> Indeed, recent research on the competition between cable and DBS in the U.S. suggest that the elasticity of demand for expanded basic is about -1.5.<sup>30</sup> In other words for every one percent increase in price, the number of subscribers will decrease by 1.5%. The elasticity of demand for discretionary BDU services is even more elastic. Subscribers can find similar programming on the basic-tier to some degree.

In the modeling of the impact of retransmission fees on BDUs, our interest was not so much in the elasticity of demand for cable-television services versus DTH services, per se, but rather the demand for Canadian BDU services. In other words, we were interested in consumers' decision to switch between Canadian

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<sup>29</sup> Consumer investment in terminal equipment, i.e., the purchase of a DTH receiver, can be considered something of a barrier to switching. The consumer will prefer to amortize the up-front cost of acquiring the equipment before making any switch.

<sup>30</sup> Austen Goolsbee and Amil Petrin, *The Consumer Gains from Direct Broadcast Satellites and Competition with Cable TV*, September 15, 2003, p. 1, copy available from University of Chicago, Graduate School of Business.

BDU service of any type and the available alternatives – the use of over-the-air antenna reception or grey/black-market satellite services.

Through our research, we did not uncover any recent estimates of the elasticity of demand for BDU services in Canada. We did however obtain a report that contained estimates for the elasticity of demand for Canadian cable-television services generated by Peat Marwick in the early 1990s, based on data from the 1980s and earlier.

The Peat Marwick estimates would appear to be inapplicable to the current BDU market. However, with closer consideration, the Peat Marwick estimates do, in our opinion, offer a suitable proxy for the modeling of the impact of retransmission fees in today's market.

Peat Marwick's analysis produced the following estimates for the elasticity of demand for cable-television services in Canada, in the absence of competition from American DBS.<sup>31</sup>

- Basic cable services: -0.2 to -0.3
- Pay-TV services: -0.8
- Extended basic services: not reported

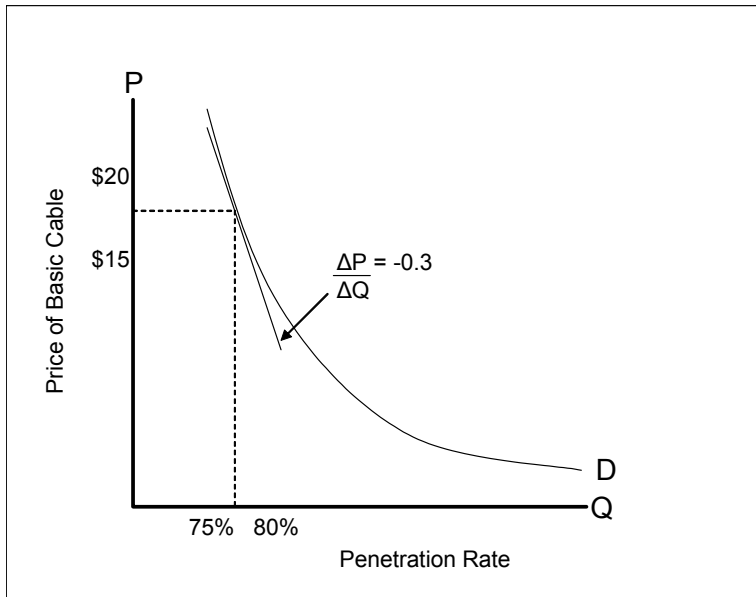
In a subsequent evaluation of Peat Marwick's demand elasticity estimates prepared by Michael Denny and Melvin Fuss, the authors point out that the elasticity estimates in this case are actually point elasticity estimates, which can vary across different levels of pricing and product market penetration.<sup>32</sup> The Peat Marwick estimates correspond with basic services priced in the range of \$15 to \$20 per month; the corresponding penetration rate is 75% to 80%.<sup>33</sup>

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<sup>31</sup> Peat Marwick, 1990

<sup>32</sup> Michael Denny and Melvin Fuss, *The Price Sensitivity of the Demand for Cable Services*, 1993

<sup>33</sup> Denny and Fuss, 1993



We believe these point estimates for the elasticity of demand can still be considered indicative of today's market demand for Canadian BDU services. Today, basic services prices are higher; they are in the range of \$25 to \$30, or about 60% higher than the range at the time of the elasticity estimate. However, consumer prices have also increased by about 50% since Peat Marwick generated its estimate. So, on a real-dollar or constant-dollar basis, the price point is still approximately valid.

The penetration-rate point is also still relatively valid. When the estimates were generated, cable-television penetration was 75% to 80%. Today, 87% of households obtain television signals by way of cable or wireless distribution; 13% rely on over-the-air transmission.<sup>34</sup> The penetration rate is somewhat higher, but not far from the original range. The differential would suggest that one should use the more elastic end of the Peat Marwick estimate, -0.3, but not ignore the estimate altogether.

For our analysis we are interested in the elasticity of demand for Canadian BDU services. One may ask: How can one consider using an elasticity of demand for cable services as a proxy, when DTH plays such prominent role in the Canadian market today. At the time of Peat Marwick estimate, cable-television comprised all of Canadian BDU services; cable-television had a monopoly on the market for

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<sup>34</sup> Statistics Canada, "Cable, satellite and multipoint distribution systems, 2004," *Service Bulletin: Broadcasting and Telecommunications*, October 2005, vol. 35, no. 4, p. 1

distributing television signals. We recognize that the elasticity of demand for cable services in Canada today will be a lot more elastic because of the alternatives available to Canadian consumers in the form of DTH, MMDS and telcoTV. However, for our analysis, we are less interested in how consumers will react to price increase in cable – with the price of DTH held constant. In fact, we are interested in the price sensitivity of all consumers of Canadian BDU services.

Considering all of the above, we have applied Peat Marwick's elasticity of demand estimate of -0.3 to our own analysis, in order to gauge the number of Canadian BDU subscribers who would drop Canadian BDU services and move to the grey or black market or resort to over-the-air reception.

Because of the differing carriage structures of cable and DTH, our modelling suggests that DTH providers and their customers may face a higher increase in basic-tier services on both a dollar and percentage basis. This difference may very well lead some DTH customers to return to cable-television. But these intra-market movements are less relevant to this analysis; our focus is to model the industry-wide impact. As such, we have incorporated in our model the assumption that the number of subscribers to Canadian BDU services will decrease by 0.3% for every 1% increase in the basic-tier rates. So, for every one percent increase in the price of Canadian BDU service, it is reasonable to expect that the number of subscribers will drop by 0.3%.

As part of this modeling of the industry-wide impact we not only needed to consider subscribers who would drop Canadian BDU service, we also needed to consider subscribers who would not drop service, but instead would be forced to re-allocate their expenditure because of this price increase or tax on Canadian BDU services. For this aspect of the impact modeling, we assumed that a certain share of consumers allocate a fixed portion of their income to BDU services. In response to any rate increase that exceed the growth in income, this group will elect to cut back on BDU services rather than cut back on other expenditures. This group of consumers has zero tolerance for a rate increase that exceeds their income growth; they will spend the same amount, but will have to purchase less.

Based on our discussion with BDUs, we established that approximately 20% of subscribers would likely have zero tolerance for the type of rate increase that would accompany the imposition of retransmission fees. With the imposition of retransmission fees, this group of subscribers will choose to decrease their

spending in other areas of BDU services. For digital subscribers, this may mean that they would spend less on pay-per-view services, or that they would drop certain theme packages. For analog subscribers this would probably mean that they shift to a lower and less expensive tier package. The BDUs would recover the retransmission fees from this group of subscribers, but they would lose offsetting revenues in other areas of the offering.

To summarize, elasticity of demand is a crucial part of modeling the impact of any type of price change. For modeling the impact of retransmission fees we were interested in the elasticity of demand for Canadian BDU services. Without access to any recent research and analysis on elasticity in the BDU services market, we considered estimates generated by Peat Marwick in 1990. While these estimates are over 15 years old, and reflect a monopoly cable-television market that is unlike today's competitive BDU market, we found them to be still applicable. As such, we used Peat Marwick's demand elasticity estimate of -0.3 within our own modeling.

Based on our discussions with BDUs, we established that 20% of subscribers would not tolerate the rate increase caused by the imposition of retransmission fees; they would drop other BDU services to offset the increase.