"FOR A FEW DOLLARS MORE": Pay Television and the Public Interest

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EXECUTIVE SUMMARY

I CONCLUSIONS

a) INTRODUCTION

This report is designed to provide a preliminary analysis of some of the more salient policy issues raised in consideration of pay television. Pay television does not exist in a vacuum. If it is introduced in Canada, it must be viewed as part of a total mass communications system. Above all else, this consideration has governed our analysis.

In a sense, all television is "pay-TV". What is now proposed is essentially "fee-television" for profit: service of a type available on "free" TV, but differentiated because of such factors as newness of production and lack of commercial interruptions. Our research indicates that at least initially, pay television, as it has now been proposed, will not offer programming substanially different from regular television. The programming mix will probably be different, but the type of programming will not.

b) APPROACH TO ANALYSIS

We have analysed a variety of current proposals and possibilities for the development of pay television in Canada. In examining the question of pay television, we have distinguished between those merits and drawbacks which are extrinsic. Assessment of intrinsic merit was based on: an education of pay television's potential contribution to the variety of Canadian media; and on an examination of actual audience demand for the new service to establish whether this demand is a reflection of a nationally-based sentiment, or simply a demand developing in a few major urban centres. We also examined the apparent assumption that American development of pay television service implies an automatic parallel development in this country.

Evaluation of the extrinsic merits attributable to introduction of pay television involved examination of the following issues:

a) will pay television, in the form in which it is presently proposed, be an interim step in the replacement, over time, of the present mixed system by a predominantly pay system?

b) will pay television, as it is presently proposed, be an interim step in the development of a system where dedicated channel television would be used for specialized services and "free" television for general services?

c) should pay television be looked at principally as a means of developing a revenue base for the Canadian program production industry?

d) if so, should the policy be one of maximum development of the revenue base?

c) PUBLIC INTEREST CRITERIA

Our intent has been to examine the question of pay television on the basis of the value criteria of the public interest. Our premise has been that the public interest requires that existing Canadian broadcasting services not be damaged by the introduction of pay television; that services which are now "free" not be siphoned off by pay television; that public sector broadcasting (CBC/Radio-Canada) and public interest broadcasting be strengthened; that the cost for the product which the consumer receives be reasonable; that the livelihood of existing movie distribution and exhibition systems not be unduly harmed; that a reasonable Canadian content quota for pay television be established; and that the greatest possible share of pay television revenues be channelled back into the Canadian program industry to promote an improvement in the quality of Canadian programming. These are the major criteria we have used in assessing whether, and how, pay television should be introduced to Canada.

d) CURRENT PROPOSALS

After analysing existing proposals, we concluded that none of those presently on record sufficiently address issues relating to the public interest. Our conclusions, based on an analysis of these proposals, are as follows:

1) There is sufficient concentration of ownership within both the cable television industry and the private broadcasting industry to suggest the danger that their control of a pay television network would tend to lead to effective ownership of the system by a small group of established interests.
2) None of the proposals from the private sector makes sufficient provision for lack of damage to public sector or public interest broadcasting in Canada.
3) If one extends the premise of many of the existing proposals, it appears that strong, almost dependent ties might be established between Canadian pay television operators and American program packagers. The semi-monopolistic nature of the program packaging industry in the United States (dominated largely by Home Box Office, a subsidiary of Time-Life, Inc.) raises questions about control which might be exerted by interests outside this country. Our concern is particularly appropriate in light of established government concern as expressed in Bill C-58.

4) None of the current proposals adequately covers the question of a parallel French service.

5) While regulatory guidelines would be necessary for and have been assumed by most private proposals, nevertheless, a pay television service which is privately owned may be particularly vulnerable to increasing advertiser pressure for access to the new market created by pay television, and the problem of "siphoning".

6) None of the suggested models for ownership (with the possible exception of a broadcaster-owned model) sufficiently addresses the problem of the relationship of pay television to the total communications system. Guarantees that program production for the "free" sector will be maintained at least at the present level and even augmented substantially, must be incorporated into any pay television model.

(i) Pay Penetration and Revenues

We analysed the potential impact of pay television, in terms of its possible penetration rates and revenues. The results were as follows:

1) It was concluded that the 25% penetration rate figure for mature American pay television systems could not be used for the Canadian situation without the use of statistical controls to account for

differences between the American and Canadian media environments. Our findings indicate that Canadian penetration rates are likely to be only 10 to 20% during the first two to five years of pay-TV operation in Canada.

2) Even using the optimistic assumption that all Canadian cable systems with over 1,000 subscribers were to carry pay television, the new system's total maximum revenue after a build-up period, would be approximately $45.75 million annually.

(ii) Impact on Existing Broadcasting Systems

The impact of the introduction of pay television on existing broadcasters was assessed by calculating their potential loss of advertising revenues attributable to decline in audience.

Results of this analysis indicates that each of the two existing English-language national networks will lose between one and four hours of viewing per week from each person in a home subscribing to pay television. At an estimated 4.5¢ per viewer-hour for advertising revenue, a pay-TV system operating in Toronto, Hamilton, and Vancouver, would cause a revenue loss of between $1.3 million and $3 million for CBC and CTV broadcasters in those areas.

(iii) Hardware Costs

A preliminary investigation of costs suggests that, under an ownership pattern in which the pay television network owns all system equipment including decoders, a nation-wide distribution system utilizing satellite channels in conjunction with local delivery by cable, would not necessarily be less viable than a tape/cable distribution system covering only major centres. However, for a variety of structural reasons, privately-owned pay television systems similar to those currently proposed, might be unlikely to initiate such a system without regulatory encouragement.

Total estimated capital costs for pay television vary substantially according to which type of "decoder" technology is employed. Since decoders represent the major part of capital investment, total capital costs for a Canada-wide system were projected to range between $7.5 million and $23.9 million, depending on the type of hardware used.

The total proportion of costs at the local level -- the amortization of descramblers (including interest charges), billing costs, installation costs, sales commissions, etc. -- would amount to between 17% and 40% of pay television's gross revenue depending on the type of descrambler technology employed.

(iv) Canadian Content

Under most existing proposals, a certain percentage of gross revenues (usually 15%) is to be devoted to Canadian programming. Methods of distributing this revenue range from a grant to the Canadian program production industry collectively to individual commissioning and co-production of programs. Our analysis has related the percentage of revenues devoted to Canadian programming to the actual amount of Canadian content which could be produced.

1) If maximum annual revenues are approximately $45.75 million, a "tap" of 15% would yield $6.86 million for Canadian program production. The most optimistic projections for pay penetration might yield up to $8 million for Canadian production.
2) The actual amount of money available for Canadian production in the first few years of pay television will probably be lower than the projected $6.86 million. If satellite distribution is not employed and the signal is available only in major centres, revenues devoted to Canadian production in the first year could be as low as $1 million.
3) Using the most optimistic revenue projections, only about 7% of programming time (assuming constant repeat ratios) could be filled by Canadian content in the first year. In subsequent years, this

figure could rise to approximately 17%. Under some existing proposals, only about 3% of programming time in the initial stages would be filled by Canadian content. These figures assume that the introduction of pay television will occur in an unconstrained fashion, but regulatory guidelines could improve the ratio of Canadian to foreign programming. In the absence of a special subsidy, French-Canadian production would be expected to occupy an even lower percentage of programming time on a parallel French-language pay system (due to the lower gross revenues of such a system).

4) There exists a danger that a pay television network might undertake a "packaging agreement" under which an American distributor would provide American programming at a reduced cost in exchange for suitable Canadian material. While this would effectively reduce the cost of American programming for the Canadian pay television operation, it could significantly reduce potential benefits to the Canadian film production industry.

e) GENERAL CONCLUSIONS

Our analysis of existing pay television proposals and consideration of the general question of the introduction of pay television to Canada has led to the following conclusions:

1) The high cost of technology and the limited availability of cable channel space suggest that "pay-per-program" modes of operation are less likely to be viable in Canada in the initial stages of pay television development. In any event, an early pay-per-program model could be expected to concentrate on mass appeal programming not dissimilar to that which would be provided on a "pay-per-channel" basis. The development of new technologies within the next decade may alter this situation. With its projected low penetration rates and the limited availability of channels, it would appear that pay television is an inappropriate delivery system for minority services.

2) Pay television, initially, or even after it reaches the first plateau of subscriber build-up, is unlikely to make much of a dent in Canadian program production and program financing problems.

3) There is little evidence to suggest that existing proposals for the development of pay television in Canada (even if modified) meet our public-interest criteria regarding the amount of Canadian content which could be provided, extension of service throughout the country, provision of an adequate French-language service, and "broad-gauged" support of all aspects of the developing independent Canadian film and video production.

4) Initial organizational and ownership patterns of pay television could strongly influence future developments in "in-home entertainment" in Canada. Immediate introduction of pay television services using only existing technology could hinder the application of improved technologies as these are developed.

II GENERAL RECOMMENDATIONS

We offer the following recommendations concerning the structure of pay television and the process under which such a structure might evolve:

1) Most immediate and apparent is the need for a period of public policy development and consultation on a much expanded basis. The regulatory requirements for pay television must be examined by Parliament, following the issuance of a government "White Paper" and the opportunity for broad discussion and consultation with both the public and industry. Such legislation must be phased to encompass a number of "defensive" considerations (e.g., to eliminate the threat of unlicensed pay television operations) and to provide for essential test-bed analysis. Pay television should only be permitted in Canada following its examination in an experimental situation.

2) If and when pay television is introduced to Canada, it should be closely linked to evolving patterns of "free" (broadcast) television, particularly television under the auspices of public agencies (CBC/Radio-Canada, and provincial educational networks).

3) The impact on the existing system of the creation of additional broadcasting/ communications networks should be minimized. Ownership and revenue re-cycling must be designed to strengthen and supplement existing services. The present argument that devoting a percentage of pay-TV revenues to the Canadian program production industry will offset damage to the existing broadcasting services is not sufficient rationale for the introduction of pay television at this time.

4) Cable systems, as such, should not participate in pay television ownership, network operation, programming, or profits. Rather, cable systems should be looked on as delivery systems interfacing with subscribers, and should be required to provide such service (via a rental of facilities) to the pay television network.

In the long-run, this is part of a policy evolution leading to cable (and ultimately its analogues, e.g., fibre-optics) being regarded and regulated as common-carriers under public-utility provisions. We strongly urge that the present co-mingling by cable companies of carrier responsibilities and ownership/programming responsibilities not be expanded (particularly at the national network level), either directly or through their indirect control of holding companies.

5) We urge that decisions on a "single gateway" for foreign (largely American) programming via a satellite-link be deferred until the basic outlines of a pay television network is established, we urge that the "single gateway" be incorporated in its organizational structure.

6) It is necessary to seek a financial base for Canadian program production in a wider area than pay television per se, and to see that revenue is made available not only for production of pay television's Canadian programming requirements, but also, on an augmented basis, for other parts of the broadcasting communications system (network television, local programming, community channels, and in-theatre motion pictures).

7) Any pay television system which is licensed should, from its inception, be required to carry a significant proportion of Canadian content. If a system cannot build significant Canadian content into its initial schedule, there is reason to doubt seriously the wisdom of encouraging the development of the system.

8) An experimental pay television test-bed should be established in a small-sized metropolitan area. Created under licensing and regulatory conditions which would not

imply long-term commitment for ownership and operation of the system, the test-bed would allow for evaluation of various technologies and assessment of the social and cultural impacts of the new service.

III RECOMMENDED STRUCTURE FOR PAY TELEVISION

Based on our research findings and pre-determined public/interest criteria, this study group sees some merit in the following proposal for the structure of pay television in a post-experimental phase:

1) A pay television authority should be established, either as an independent public agency or as a consortium of public and private over-the-air broadcasters. In either approach, the distinction should be maintained between the programming function of the authority and cable or other distribution of the signal.

2) In the broadcast-consortium model, the publicly-owned broadcasters would retain majority ownership. Provisions might be made to allow for participation by provincial broadcasting/communications bodies (e.g., educational television) providing majority ownership remains in the hands of CBC/Radio-Canada or any future derivatives of CBC/Radio-Canada.

3) If the consortium alternative is adopted, actual administration of the pay television authority should be engaged in by executives of the authority who are not otherwise employees of any of its constituent organizations.

(i) Functions of the Pay Television Authority

4) The pay television authority should be responsible for:
   a) networking of pay television and arrangements for local distribution via cable and/or other delivery systems;
   b) arrangements with local delivery systems on a rental-of-facility basis;
   c) ownership of all hardware specifically related to pay television (e.g., "decoders");
   d) commissioning Canadian programming for the pay network;
   e) acquisition of foreign programming for the network;
   f) any after-sales of Canadian material produced for the network.

(ii) Signal Delivery

5) Provisions should be made requiring cable companies to provide one pay channel (two, if necessary for English and French service) through rental to the pay television authority. The rental charge should be based on a formula derived from the cost of service plus a profit margin to be determined.

(iii) Profits

6) In the first five years of post-experimental operation, profits to the system should be restricted to not more than 10% of revenues per year. After the first five years, as the system matures, the profit restriction should be periodically reassessed.

(iv) Support of Canadian Program Production

7) After servicing of debt, system development, and system operating charges, the first charge against revenues of the pay television authority should be the financial support of Canadian production for the system. Differences between revenues and costs of developing and operating the system (including regulated profits) should be channelled directly into a Media Development Fund. A significant proportion of these funds should be used to purchase programming from independent Canadian production houses for use by the broadcasting networks.

(v) Canadian Content

8) A schedule of Canadian content on the pay television network should be implemented and regulated by the CRTC.

(vi) Media Development Fund

9) In the process of this investigation, it became evident that the expansion and improvement of both Canadian program production and Canadian broadcasting demands a financial base substantially greater than that which pay television alone can provide. In order to address this priority, therefore, we recommend that the principle of "those who benefit shall pay" be extended to all cable companies and their subscribers, through a direct tap on cable systems and their subscribers.

10) Revenues for the Media Development Fund should be derived from:

   a) a $10 average surcharge levied directly on all cable television subscribers;
   b) a tax of five percent of cable television revenues;
   c) the surplus of revenues from pay television, on introduction of the service.