THE NEGATIVE EFFECT OF CONCENTRATION AND VERTICAL INTEGRATION ON DIVERSITY AND QUALITY IN VIDEO ENTERTAINMENT

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ABSTRACT

This paper uses an analysis of a comprehensive 20-year data base on the video entertainment product space in a period of massive public policy change (roughly 1985 – 2005) to show that vertical integration and the elimination of source diversity (competition from independent producers) has had a negative impact on product quality and diversity.

- Business practices of vertically integrated media companies indicate a strong incentive to run, rerun, repurpose, repackage and recycle owned content, even when it is inferior or attracts a smaller audience because it is more profitable than producing new content or purchasing content from unaffiliated entities, and
- A close look at the timing and nature of performance declines suggests that vertical integration associated with declining quality and audiences.

Although the Internet presents an alternative distribution mechanism, the vigorous effort to vertically integrate distribution and content production, as well as the efforts of traditional media content companies to rerun content on the Internet, suggests that traditional media/communications firms may successfully capture the new technologies, as they have done in the past. Understanding how recent deregulatory policies fostered concentration and failed to deconcentrate the video product space by purportedly introducing more competition (including the introduction of new technologies like cable and satellite and broad deregulatory policy changes), provides a cautionary note in a chorus of optimistic projections.

The database includes measures of quantity, quality, source and outlet of product for television and movies.

- TV: prime time programming, first fun syndications, ratings and Emmys.
- Movies: domestic and foreign theatrical box office, home video sales and rentals, Oscars and Golden Globe awards.
- At the intersection of the two, analysis of over 1000 made-for-TV movies.

From 1990 to 1996 Congress and the Federal Communications Commission shifted policy toward broadcast TV and cable in sharply opposite directions.

Vertical and horizontal restraints on broadcast were eased with the elimination of the Financial and Syndication rules, the granting of must carry/retransmission rights, the lifting of the ban on multiple station ownership in the largest and most important media markets, and an increase in the allowed national reach of (O&O) stations.

In contrast, vertical restraints and horizontal limit were imposed on cable including program access rules, limitations on the percentage of programming that could be owned and horizontal limit on national reach.

These policies radically altered the market structure of the video entertainment product space in distinct stages.

- Independent producers, who were uniquely successful in bringing diverse and innovative content to TV, were excluded from the dial, with unaffiliated production of scripted content all but disappearing from both prime time and first run syndication.
- Competition from satellite (triggered by the cable program access rules) stimulated cable to expand its capacity, which it could not fill (in part because of the vertical restraint on ownership), so studios and broadcasters (armed with must carry-retrans rights) rushed in to expand their output.
- Ultimately, the end of Fin-Syn made it possible and rational for broadcasters and movies studios to merge and every major studio became vertically integrated with a major broadcaster or large multiple system operator.

Five vertically integrated entities (NBC/GE/Universal, ABC/Disney, CBS/Viacom/Paramount, Fox, Time Warner) came to dominate both TV and Movies, where two dozen had been. The market shares and purchasing practices of these vertically integrated video entities indicate a tight oligopoly.

- Every measure of output – prime time and syndicated programming, programming and writing budgets, cable carriage TV viewership, theatrical box office, and home video – indicates that four entities control over 60 percent of the market (the big five account for 75 to 80 percent).
- Qualitative and quantitative analyses of product acquisition practices show that this dominance rests on a clear pattern of self-dealing and favoritism , first for affiliated content and second, where self-supply is insufficient, for product from other members of the oligopoly.
- The exercise of monopsony power has squeezed prices paid for cable movie content to a bare minimum and driven movie product into narrowly defined niches, where the vertically integrated entities are the only outlets available.

Independents has produced disproportionately higher quality with greater diversity of content in prime time, but the change in policy resulted in their elimination from these highly valued TV time slots and audiences declined.

The negative effects of the elimination of competition have outweighed the hoped for positive effects (synergies and efficiency gains) of vertical integration, yet policymakers are being pressured to extend the failed policies to the new distribution platform. .

I. INTRODUCTION AND OVERVIEW

THE UNIQUE IMPORTANCE OF THE VIDEO INDUSTRIES

This paper examines the swift and massive horizontal consolidation and vertical integration in the video entertainment industry after key policy changes in the 1990s: the repeal of the Financial Interest / Syndication rules and the enactment of both the Cable Act of 1992 and the Telecommunications Act of 1996. The analysis of the economic impact of horizontal concentration and vertical integration can be found across many areas of economic activity, but the unique nature and role of video entertainment raises additional, perhaps even greater concerns in non-economic areas. Television and movies, the former in particular, are fundamental to democratic discourse. Television is the dominant medium in terms of time spent on entertainment and news and information gathering.[1] It is overwhelmingly the choice for national campaign advertising. Entertainment on television can be cultural, educational or political. Theatrical releases have a prominent role in the pubic discourse as well, which films such as *Fahrenheit 9/11 Crash* and *The Passion of the Christ* have demonstrated in recent years.

Television and movies play an important part in the marketplace of ideas. A nation that prides itself on freedom of speech and diversity, while simultaneously issuing exclusive licenses to private firms to broadcast content faces a dilemma. The issuance of a handful of broadcast licenses in each market in America creates a privileged class of speakers through government action. Local governments issue franchises to cable TV operators, which are even more scarce than broadcast licenses on a city-by-city, county-by-county basis.

How one promotes diversity with such a small number of electronic voices, without dictating what content broadcasters should air, becomes a major source of concern. If those very valuable and powerful government-granted platforms for reaching the public become the core of a tight oligopoly that dominates other areas of expression, the concern is compounded.

If dictating content is ruled out by First Amendment free speech concerns, but policy makers continue to strive for diversity, then the primary option is to build media market structures that disperse the opportunity to speak as much as possible within the confines of the granting of licenses and franchises. The principle on which this approach stands is simple. By ensuring a wider opportunity to put content before the public, diversity and discourse are stimulated without dictating the substance of the content supplied.

THE IMPACT OF PUBLIC POLICY ON THE VIDEO SECTOR

For much of the twentieth century, the Congress and the Federal Communications Commission pursued this goal of diversity by simultaneously dispersing ownership of both production and distribution of content. The number of media outlets that could be owned by a

[1] Cooper Mark, *Media Ownership and Democracy in the Digital Information Age* (Palo Alto: Stanford Law School Center for Internet and Society, 2003).

single entity was restricted to one within a market (the local television multiple ownership rule).[2] .Holders of broadcast licenses could own and operate (O&O) stations that reached no more than 25% of the nation's television households. The broadcast networks filled out their national networks by entering into affiliation agreements with stations they did not own or operate. There were extensive rules that governed the relationships between the affiliated stations and the networks.[3] The amount of content aired in prime time that any given network could own was limited as well by the Financial Interest and Syndication Rules (Fin-Syn) and the Prime Time Access Rules, [4] as well as a consent decree in a case brought by the Department of Justice [5] FCC regulations also prevented Broadcast license holders from owning other types of media outlets – e.g. newspapers and cable TV systems (cross-ownership limits)[6] or restricted in cross media ownership (e.g. radio)[7] The result was a substantial dispersion of ownership of content.

At the end of the 1980s, policies to disperse ownership in broadcast television were in place. Though they had been debated intensely throughout the 1980s, the policies remained to limit holders of broadcast licenses to one to a market. Fifteen years ago, theatrical movie studios and broadcast television were almost entirely separate while cable television was just developing as a primary outlet. In each of these markets, there was a substantial independent sector. Major studios provided about one third of product shown on network prime time television while the networks themselves accounted for just 15%. Non-majors studios, known as "independents," supplied nearly one half. One set of independents sold movies to broadcasters. Another set sold series and other programming. A few produced and sold both.

In the 1990s, the primary policies to promote diversity of ownership of content in broadcasting were eliminated or cut back. The Financial Interest and Syndication Rules (Fin-Syn) that governed prime time programming were repealed and the consent decree was also vacated – allowing networks to own as much programming as they wanted. This opened the door to mergers with studios. A second policy (the 1992 Cable Consumer Protection Act) also gave broadcasters the right to carriage on cable systems (must-carry/retransmission). This gave them a key lever to gain access to cable subscribers.[8] The limits on multiple station ownership were relaxed in the Telecommunications Act of 1996 – allowing them to own two stations in the nation's largest and most important markets. This gave network owners greater leverage over

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[2] 47 C.F. R. 73.355(b), the duopoly rule, lifted the ban on multiple station ownership, but 47 C>F.R. 73.658(g), the dual network rule, restricted the combinations of television stations, to disallow dual or multiple networks to involve a combination between ABC, CBS, Fox, or NBC. Citations are to the rules currently being reviewed, which generally relaxed the restrictions on cross ownership in the 19990s and are the latest in the evolving regulatory structure.
[3] 47 C.F. R. s 73.3555(e)
[4] The two rules have always been closely linked see Amendment of Part 73 of the Commission's Rules and Regulations with Respect to Competition and Responsibility in Network Television Broadcasting, 23, FCC 2d 282 (1970). Amendment of Part 73 of the Commission's Syndication and Financial Interest Rule, 47 FR 32959 (1982), as they were in the court case that led to their ultimate expiration, see Shurz Communication Inc. v. FCC 982 F. 2d 1043, 1049 (7th Cir. 1992).
[5] Identical consent decrees were entered against the three major networks, which followed the Fin-Syn rules closely. These were vacated when in the early 1990s, as the Fin-Syn rules were allowed to expire...
[6] 47 C.F. R. s 73.3555(d), cross-ownership of broadcast states and newspapers, prohibits the common ownership of a daily newspaper and a broadcast station in the same market.
[7] 47 C.F.R. 73.3555(c), the radio-television cross –ownership rule,
[8] Cable Television Consumer Protection and Competition Act of 1992, Pub. L. No. 102-385, 106 Stat. 1460 (1992).

syndication by giving them a strong bargaining position in large markets. The terrain of the American media landscape was dramatically altered by these policy changes as the broadcasters moved quickly to use these three new sources of leverage in the video market. A vertically integrated, tight oligopoly emerged in the commercial video entertainment product space.

THE EMERGENCE OF A VERTICALLY INTEGRATED VIDEO OLIGOPOLY

Over the course of a decade, the content aired on prime time network television, TV syndication, basic and pay cable channels, and theatrical movies came to be dominated by a handful of vertically integrated entities. Dozens of independent entities that produced video content were replaced by a handful of firms that own major movie studios and television production units, hold multiple broadcast licenses and own the dominant cable networks. The role of independent producers has been squeezed across all distribution platforms.

By two widely accepted economic measures of market concentration, the Herfindahl-Hirschman Index (HHI) and the market share of the top four firms (the 4 Firm Concentration Ration or CR-4), the video market has become a concentrated, vertically integrated, tight oligopoly.

The vertically integrated major studios and broadcasters now account for over 75% of broadcast prime time television programming while independents account for less than 20%. The few independents that get on prime time television produce reality shows, not scripted programming. As a result, independents have been virtually shut out of the lucrative syndication market, now accounting for just 18% of all first run syndication programming hours and none of the programming hours for shows that have gone into syndication over the last two years.

The economic terrain of cable television has also changed for independents. The vertically integrated media companies own 24 of the top 25 cable channels. The independents' share of pay cable programming also continues to decline as a percentage of programming, dropping by some 15% since the late nineties. Independent product was also squeezed out of syndication. Independent product is increasingly consigned to the far less visible and less financially rewarding basic cable channels where license fees are much lower and in many cases inadequate to cover production costs. Additionally, product placed on basic cable does not have the same potential to realize foreign sales that pay cable product enjoys.

The business practices used to accomplish this dramatic shift in the flow of content in the video product space exhibit characteristics that clearly fit the pattern of abuse of market. By controlling distribution and vertically integrating into production, five the dominant broadcasters firms have become gatekeepers who favored their affiliated content, restricted access of independents to the market, and imposed onerous terms and conditions on independent producers, which has further shrunk the sector.

This oligopoly engages in a number of predatory business practices that foreclose the market to independents by leveraging their vertical market power and self-supplying product. They exercise their market power as buyers of content (monopsony power) with two practices that are especially damaging to competition from independent producers. The first is that networks often demand that they be given an equity participation in an independently developed television series in order for it to be placed on the primetime schedule. The second is that basic cable channels owned by members of the oligopoly will not pay license fees that are commensurate with the production values they demand in independently produced TV movies.

The key elements of the video entertainment product space fit a pattern that the literature on industrial organization describes as the exercise and abuse of market power. These elements include:

Market structure and market power

- Market shares that have risen to the level traditionally defined as a source of concern about concentration setting the stage for the abuse of market power.
- Substantial barriers to entry in the industry.
- A history of anticompetitive practices.

Vertical Integration

- Barriers to entry increased by vertical integration.
- The foreclosure of markets to unaffiliated producers through favoritism of affiliated upstream production and the subsequent exit of upstream product suppliers from the market.
- Parallelism and reciprocity among the dominant firms in the oligopoly.
- A rush to integrate and concentrate across the sector.

Monopsony (buyer) Power over independent producers.

- The imposition of prices that squeeze unaffiliated producer and terms that shift risk onto those producers.
- Indications of a decline of quality in product attendant on the abuse of monopsony power.
- Flooding of downstream outlets with integrated product.

The Internet has just begun to be used as a means of redistributing video product that was originally released through one of the other outlets. However, there are also clear indications that it may not deconcentrate the commercial video sector. Already, the networks are multicasting current primetime programming through their websites and Internet protocol television (IPTV) channels are coming on line. Internet video on demand services (VOD) such as Cinema Now and Movielink are gaining visibility and subscribers as broadband service penetrates deeper into the consumer market, but it is the same content producers who dominate.

POLICY IMPLICATIONS

Whether or not Congress anticipated the powerful effect that the policy changes of the 1990s would have on diversity of ownership of programming is unclear. Although the FCC has created records on these issues in its subsequent proceedings, the courts have remanded several of its rules,[9] leaving them in flux and Congress included a provision that requires frequent review of the rules.[10] The FCC continues to have the authority to implement restriction on media ownership to accomplish the goals that Congress has set in legislating media policy,[11] with the exception of the national multiple ownership rule. To the extent that Congress continues to embrace the goal of diversity, the current situation and how the policy changes of the 1990s created it are what matters now. Moreover, since Congress ordered the FCC in the Telecommunications Act of 1996 to periodically review its rules, the FCC could conclude that the rule changes it implements with agency discretion have harmed diversity, a goal that Congress continues to embrace, and re-institute policies that successfully promoted source diversity in the past or it could seek new politics that will promote source diversity in the future.

This paper shows that the current policies are not promoting independent production of video content on the major television platforms. Understanding the impact of past rule changes is the first step in the process of re-examining the decline of sources diversity on television. That is the subject of this paper. While the purpose of this paper is not to recommend specific policy changes, it is clear that if policymakers still believe in source diversity, then a change in policy that directly alters the structure and conduct of the vertically integrated oligopoly is necessary.

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[9] Indeed, all of the major structural rules written in the late 1990s have been remanded by the court (broadcast multiple station limits, cable horizontal limits, newspaper cross ownership) or overridden by Congress (national cap).

[10] The 1996 Act provided for a biennial review (*Telecommunications Act of 1996,* Pub. L. No. 104-104, 110 Stat. 56 (1996). This was later extended to four years (*FY2004 Consolidated Appropriations Act* (Public Law 108-109, 118 Stat. 3 et seq. Section 629) and the prohibited the FCC from further reviewing the national cap.

[11] As with the other rules overturned by the courts, in the case of the Fin-Syn rules, while the courts rejected the specific FCC rule (*Schurz Communications Inc. v. FCC* 982 F. 2d 1043 (7th Cir. 1992), it did not preclude the writing of an alternative rule. To date, the FCC has elected not to do so.

II. DEFINING THE PRODUCT SPACE AND ANALYTIC APPROACH

THE OBJECT OF STUDY

This is a study of the industrial organization of the video entertainment sector – theatrical movies, all forms of television and the sale and rental of tapes and DVDs – in the United States. Because the sector is complex, I adopt the following definitions. The sector consists of six primary channels for the distribution of content:

- **theatrical movie** releases,
- **prime time** airing of movies and series on broadcast television,
- **syndication** on broadcast television in non-prime time slots of both movies and series,
- movies and series aired on **pay cable**,
- movies and series aired on **basic cable** networks,
- **Home Video –** i.e. sale/rental of video for viewing on VCR and DVD players.

I refer to the overall sector made up of the six distribution channels as the **video entertainment product space.**

The nature and relationship between these channels has changed over time. Terms of art once applied have stuck; even though they may no longer technically describe the distribution channel (see Exhibit II-1). Theatrical distribution of movies has been around the longest, with the commercial industry stretching back to the early part of the 20^{th} century. Television emerged in the 1950s and 1960s. Cable arrived in the 1970s and 1980s. Distribution of video tapes began in the 1980s and exploded with the advent of DVDs in the early 2000s.

Exhibit II-1: Production and Exhibition of Video Product

	Production	
	Simultaneous	Delayed
Exhibition		
Public		Theatrical Release
Shared Private	Live TV	Pre-recorded TV/Movies
Private		Home Video

Traditionally, television was divided between broadcast and cable to reflect the different means of delivery. Broadcasters sent signals over the air from TV transmitters (stations) that were licensed by the FCC. Cable signals were sent from a head end through a wire, the laying of which was franchised by a local entity. Today, although broadcast signals are still available over-the-air, most American households (80% to 90%) get the broadcast product through the cable wire or from satellites.

Prime time on broadcast TV was always a focal point of policy because of the huge audience and resources it commanded. Prime time was controlled by the networks, which also held licenses to operate TV stations in the largest markets. They created national networks by affiliating with independent license holders in markets where they did not hold broadcast licenses directly. The major networks – ABC, NBC and CBS, reach virtually every home in America. Fox is a national network as well, although it may be available in somewhat fewer homes.

Although cable has always been a subscription service, it split into two different distribution channels when pay cable services, like HBO, developed the ability to charge a premium for programming. Basic cable became increasingly advertiser supported, mimicking broadcast television.

Historically, one could draw a clear line between production of content by movie studios and exhibition – the presentation to the public of product – in theaters. The distinction breaks down with live television – the broadcast is simultaneously produced and distributed. Television also changes the nature of the exhibition from a public space to a private space, although it is still shared in the sense that programming is watched simultaneously, but separately, by large numbers of people. The sale/rental of videos (and the recording of programming) for home viewing (referred to as Home Video) extended the change from a public to a private experience by allowing people to choose when to watch.

ANALYTIC APPROACH: STRUCTURE, CONDUCT PERFORMANCE

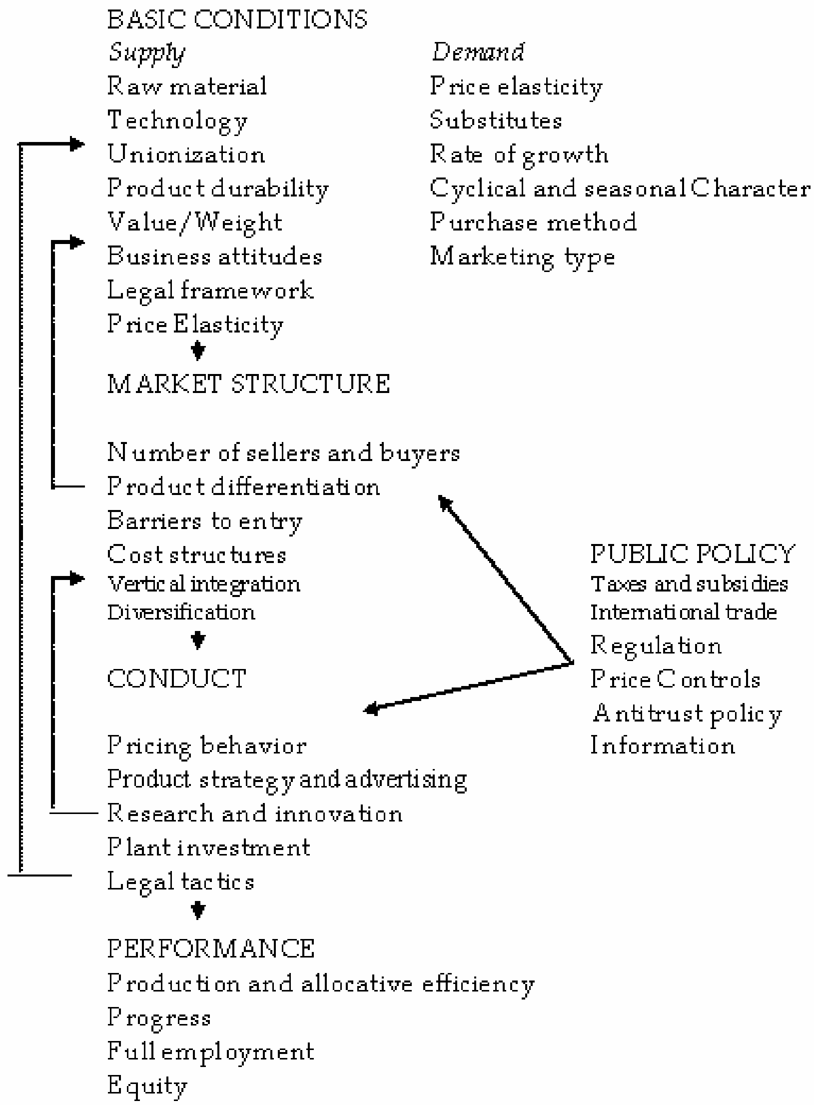
The paper applies a framework of analysis known as the structure-conduct-performance paradigm (see Exhibit II-2), [12] which has been the dominant approach to analyzing industrial organization analysis for over three-quarters of a century. The premise is simple. The analysis seeks to identify the conditions that determine the performance of markets. It starts with basic conditions. On the supply-side these include factors such as technology, product durability, business attitudes and the legal framework. On the demand side factors such as price elasticity, cyclical/seasonal patterns, and purchasing methods are included. These interact with characteristics of the market structure, such as the number and the size of sellers and buyers, product differentiation, cost structures and vertical integration (the relationship of production and distribution), to determine the conduct of the market participants. The key types of conduct include pricing behavior, product strategy and advertising, and legal tactics. Conduct determines performance, traditionally measured in terms of pricing and profits, but increasingly viewed as quality and the nature and speed of innovation.

One of the key features of the structure-conduct-performance paradigm is that it recognizes the importance of public policy. Policies, such as antitrust enforcement, regulation, or taxation and subsidization, can directly affect structure and conduct, thereby altering performance.

[12] Scherer, F. M. and David Ross, Industrial *Market Structure and Economic Performance* (Boston, Houghton Mifflin: 1990); Shepherd, William, G., *The Economics of Industrial Organization* (Prentice Hall, Engelwood Cliffs, N.J., 1985).

Exhibit II-2:

The Structure-Conduct-Performance Paradigm



SOURCE: Scherer and Ross, F. M., and David Ross, *Industrial Market Structure and Economic Performance* (Houghton Mifflin Company: Boston, 1990), p. 5.

Horizontal Market Power

The characteristic of market structures that receives most public policy attention is horizontal market power. The concern is that if markets become concentrated – i.e. where a few players have a large market share – competition is dulled. Rather than compete to produce the best product at the lowest price, one large entity may be able to set prices up or otherwise affect output, without a sufficient response from others to discipline such behavior. With small numbers of competitors, they may accomplish the same thing by consciously paralleling each other's behavior. Thus, the Department of Justice (DOJ) and the Federal Trade Commission (FTC) defines market power as "the ability profitably to maintain prices above competitive levels for a significant period of time… Sellers with market power also may lessen competition on dimensions other than price, such as product quality, service or innovation."[13]

Pure and perfect competition is rare, but the competitive goal is important.[14] Therefore, public policy pays a great deal of attention to the relative competitiveness of markets as well as the conditions that make markets more competitive or workably competitive. Knowing exactly when a market is "too" concentrated is a complex question. The DOJ/FTC calculate an index called the Herfindahl-Hirschman Index (HHI) to categorize markets (see Exhibit II-3). This index takes the market share of each firm, squares it and sums it.

Exhibit II-3:
Describing Market Concentration for Purposes of Public Policy

DEPARTMENT OF JUSTICE MERGER GUIDELINES	TYPE OF MARKET	EQUIVALENTS IN TERMS OF EQUAL SIZED FIRMS	HHI	4-FIRM SHARE (%)
	Monopoly	1	4250<	100
		Firm with 65% or more		
	Duopoly	2	5000<	100
		5	2000	80
HIGHLY CONCENTRATED			1800 OR MORE	
	Tight Oligopoly	6	1667	67
MODERATELY CONCENTRATED				
UNCONCENTRATED	Loose Oligopoly	10	1000	40
	Atomistic Competition	50	200	8

Sources: U.S. Department of Justice, *Horizontal Merger* Guidelines, revised April 8, 1997, for a discussion of the HHI thresholds; Shepherd, William, G., *The Economics of Industrial Organization* (Prentice Hall, Englewood Cliffs, N.J., 1985), for a discussion of 4 firm concentration ratios.

The DOJ/FTC consider a market with an HHI above 1000 to be concentrated. This is the equivalent of a market with fewer than the equivalent of 10-equal sized firms. It considers a market with fewer than the equivalent of approximately 5.5-equal sized firms (HHI = 1800) to be

[13] Department of Justice/Federal Trade Commission, *Merger Guidelines* (1997).
[14] Scherer and Ross, p. 16…17

highly concentrated. Markets with an HHI between 1000 and 1800 are considered moderately concentrated.

Many economists also describe markets in terms of the market share of the top four firms and Shepherd describes these thresholds in terms of four-firm concentration ratios as follows:[15]

> Tight Oligopoly: The leading four firms combined have 60-100 percent of the market; collusion among them is relatively easy.
>
> Loose Oligopoly: The leading four firms, combined, have 40 percent or less of the market; collusion among them to fix prices is virtually impossible.

Although the overlap is not perfect, there is a close correspondence between these two approaches. A highly concentrated market is called a tight oligopoly.[16] A moderately concentrated market is called a loose oligopoly.

Vertical Integration and Leverage

A second key characteristic of many industries is the extent of vertical integration. In many industries the act of producing a product can be readily separated from its distribution and sale. Production is referred to as the upstream, distribution and sale are referred to as downstream.

Vertical integration occurs when both activities are conducted by one entity. Because vertical integration involves the elimination of a (presumably market) transaction between two entities it has been the focal point of a great deal of analysis. Economic efficiencies are frequently claimed for vertical integration due to the elimination of transaction costs. Others fear inefficiency and potential abuse of the ability to leverage vertical market power that can result from excessive or unjustified vertical integration

The classic concern is that distributors of content, who are also producers, favor their own content at the expense of the content of unaffiliated producers. Exclusive and preferential deals for the use of facilities and products are a concern.[17]

Vertical integration may become the norm in the industry, making it difficult for unintegrated producers to survive. One major concern about vertical mergers is that the industry undergoes a rush to integration and consolidation. Being a small independent firm at any stage renders a company extremely vulnerable to a variety of attacks.[18]

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[15] Shepherd, p. 4.

[16] Shepherd, p. 4.

[17] Perry, Martin, "Vertical Integration: Determinants and Effects," in Richard Schmalensee and Robert D. Willig (Eds.) *Handbook of Industrial Organization* (New York: North-Holland, 1989), p. 247. The first firms to integrate into neighboring stages reduce the number of alternative sources for other firms at either stage. This "thinning" of the market can increase the costs of market or contractual exchange. Subsequent integration by other firms then becomes more likely

[18] Scherer and Ross, pp. 526-527. Oligopolies often settle down into behavioral patterns in which price competition atrophies, even though some or all sellers suffer from excess capacity. Non-price rivalry then becomes crucial to the

> Vertically integrated entities may capture the market for inputs, making it difficult for independent entities to obtain the factors of production necessary to produce product. When all production at a level of an industry is "in-house," no market at all exists from which independent firms can buy inputs. If they face impediments or delays in setting up a new supplier, competition at their level will be reduced. The clearest form of this is the rise in capital a new entrant needs to set up at both levels.[19]

Also, with vertically integrated entities dominating a sector, reciprocity and forbearance rather than competition may become the norm. Concern arise that not only will the dominant firm in the industry gain the leverage to profitably engage in anti-competitive conduct, but also the dynamic processes in the industry will clearly shift toward cooperation and coordination rather than competition. The issue is not simply collusion, although that is clearly a concern.[20] Beyond collusion, a mutual forbearance and reciprocity occurs as spheres of influence are recognized and honored between and among the small number of interrelated entities in the industry.[21]

A related concern about vertical integration that arises from the observed behaviors is that it can create or reinforce barriers to entry into the industry. By integrating across stages of production, incumbents may force potential competitors to enter at both stages, making competition much less likely. "[V]ertical mergers may enhance barriers to entry into the primary

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distribution of sales. One form of nonprice competition is the acquisition of downstream enterprises, which all else (such as prices) being equal will be purchased from their upstream affiliates. If acquisition of this sort deflects significant amounts of sales, disadvantaged rivals are apt to acquire other potential customers in self-defense, and reciprocal fear of foreclosure precipitates a bandwagon effect in which the remaining independent downstream enterprises are feverishly sought; Shepherd, p. 290. Triggering: If there are 10 nonintegrated firms and only one of them integrates, then little affect on competition might occur. But if this action induces the other 9 to do the same, the ultimate impact of the first "triggering" move may be large. Any increase in market power is magnified.

[19] Shepherd, pp. 289-290.

[20] Perry, p. 247. The *Guidelines* do recognize three major competitive problems of vertical mergers in concentrated industries. First, forward mergers into retailing may facilitate collusion at the manufacturing stage by making it easier to monitor prices or by eliminating a "disruptive buyer."

[21] Asch, Peter and Rosalind Senaca, *Government and the Marketplace* (Dryden Press, Chicago: 1985), p. 248. Now we consider the big picture, rather than market-by-market effects. Imagine an extreme situation, with five big diversified firms extending into all major sectors. They coexist in parallel, touching one another in hundreds of markets. Whatever their effects on each market might be, they pose a larger problem of spheres of interest, or diplomatic behavior replacing competition …

Reciprocity is an exchange of favors. Reciprocal buying is one form of it. At its simplest, firm A buys from firm B because of some purchase that B makes from A …

Reciprocity: The large conglomerate may have numerous opportunities for reciprocal buying arrangements.

Mutual forbearance: More generally (it is sometimes claimed) large firms treat each other with deference, avoiding competitive confrontation whenever possible industry if entrants must operate at both stages in order to be competitive with existing firms and if entry at both stages is substantially more difficult than entry at one stage".[22]

Monopsony Power

A third economic concept that plays an important part in the video entertainment product space is that of monopsony power. Monopsony power is the flip side of monopoly power. Monopoly power is the power of a seller to dictate prices, terms and conditions as a seller of goods and services to the public. Monopsony power is the power of downstream buyers of inputs they use to dictate the price, terms and conditions on which they will buy. If the upstream suppliers lack alternatives, they may be forced to accept terms that give them a price that is too low or impose conditions that force them to bear extra risk. The downstream buyers have market power over the upstream sellers of the product. This can result in the production of fewer or inferior products for sale downstream.

> By reducing its demand for a product, a monopsonist can force suppliers to sell to it at a lower price than would prevail in a competitive market... If the price is suppressed they will reduce output to a level that once again equals their marginal costs. In any event, both price and output will fall below the competitive level when the buyer is a monopsonist. Some productive assets will be assigned to products that would have been the supplier's second choice in a competitive market. As a result, monopsony allocates resources inefficiently just as monopoly does.[23]

Although monopsony has not been the focal point of much antitrust action, it is more likely in precisely the type of sector like the video entertainment product space, where inputs are specialized.

> Monopsony is thought to be more likely when there are buyers of specialized products or services. For example, a sports league may exercise monopsony (or oligopsony) power in purchasing the services of professional athletes. An owner of a chain of movie theaters, some of which are the sole theaters in small towns, may have monopsony power in the purchase or lease of movies. Cable TV franchises may exercise monopsony power in purchasing television channels that will be offered to their subscribers.[24]

THE UNIQUE PROBLEM OF VERTICAL INTEGRATION IN ADVERTISER SUPPORTED VIDEO DISTRIBUTION

The nature of advertiser supported broadcasting creates a unique problem in the vertically integrated video space. Broadcasters' claims that they just provide consumers with the content that they want ignores the fundamental structure of the industry and the nature of profit

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[22] Perry, p. 247.
[23] Hovenkamp, Herbert, *The Law of Antitrust: An Integrated Handbook*, Hornbook Series (West Group, St. Paul, 2000), p. 14.
[24] Sullivan and Grimes, p. 138.

maximization within that structure. There are market imperfections on both the supply and demand sides that undermine this claim, which are amplified by vertical integration.

Consumer "demand" for broadcast television programming is filtered through three very imperfect markets and defined by decades of conditioning in those markets. The three markets are the market in which audiences are sold to advertisers, the market in which programming is sold to broadcasters, and the market in which ratings are sold to advertisers and broadcasters. The imperfections in each of these markets lean against independent production and diversity. The target audience is narrow and the meters are biased toward that narrow segment. The production of programming is biased toward self-supply.

Demand for programming is not the consumer demand plain and simple, but consumer demand filtered through the lens of the advertiser demand. Supply is not just the best combination of quality and price, but the combination of quality and price filtered through the profit maximizing implications of airing self-owned programming.

Demand-Side: Who's Demand for What? Advertising restricts what get aired.

Broadcasters maximize profits by selling advertisers the viewers they want at the lowest cost. The profit maximization dictates what is aired to a significant degree. Rating services, which straddle the advertiser-broadcaster-audience markets, tend to be monopolistically organized to lower transaction costs. The metering technology compounds the unrepresentativeness of the "audience" that drives the choices of advertisers and broadcasters, as repeated disputes over who gets counted attest. The traditional problems of measuring audiences have been compounded by the challenge of valuing eyeballs in digital distribution.

Advertising restricts the shape of what is seen.[25] Programming that is not supported cannot survive. Advertisers pay for specific types of consumers under specific conditions. They generally want 19 to 34 year old males in a buying mood. This dictates the types of programs that are put on the air. Broadcasters choose the programs they think will attract the audiences the advertisers want. Broadcasters cater to this specific audience, even though a larger audience could be achieved. They deliver specific types of programming that advertisers want, even though a larger audience could be found with different types of shows.

The targeting of products to audiences to satisfy advertisers has a potent effect on what gets aired. Advertisers want specific people in specific state. The buying mood requires that the audience be passive, receptive, responsive and susceptible to the message. Critical thought and controversy are the last thing the advertisers want. The audience must not be agitated, offended, of differentiated.

Programming takes on characteristics to create the desired state in the desired audience, or to avoid the unwanted characteristics. Advertisers favor programming that is homogeneous, noncontroversial, bland intellectually (but perhaps titillating), light (avoiding facts and data) and upbeat. Whether their own products are represented or discussed, they want the conversation to be positive and uncritical.

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[25]Baker, C. Edwin, *Advertising and a Democratic Press* (Princeton: Princeton University Press, 1994)

Of course, when their own products are the subject, as in an investigation or press release, their interest is heightened. They will strive for positive treatment and stretch the facts (if not the truth). They will settle for uncritical treatment or silence, if they cannot get positive treatment.

A recent, unique study by an FCC economist, aptly titled "Why is this Show So Dumb"," was designed to "address the heretofore empirically unexplored distortion in programming. Advertisers and viewers ay value different programming, and the market-provided programming may not maximize social surplus."[26] The underlying theory being tested was the hypothesis that "advertisers want programming that will put viewers in a receptive mood, and hence not be too depressing."[27]

The trade off for broadcasters becomes choosing between "richness and reach. The limitations that advertisers place on richness also limit the broadcaster's reach, leaving significantly large groups of viewers that prefer richer content going un-served by the broadcasters' program offering."[28] They find the distortion of programming to be a market failure.

> One such market failure is the distortion of programming stemming from advertisers' preferences. Advertisers prefer programming content that best "frames" their advertising. Such content tends to be light and 'unchallenging. Viewers who prefer darker and more challenging content will go under-served. Using a unique data set, we found that advertisers pay a premium for sitcoms and programs with younger casts, while news programming and police dramas receive a discount. [29]

Supply-side: Self-Dealing Distorts What Gets Aired.

On the supply-side, the argument is straightforward, allowing vertical integration changes the incentives for the firm, which now maximizes profit not by producing the best product, but by carrying the maximum amount of self-supplied product. Simply put, it is more profitable to run an owned program than it is to buy an independently produced program, even if the independently produced product is somewhat superior. Moreover, with integration across different platforms and ownership of multiple outlets within platforms, it is more profitable to repurpose and rerun an owned program than to produce a new one.

Broadcasters prefer to own the programs, so they can control the content and the cost. They prefer their own programs, even if they are inferior and attract smaller audiences. It is

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[26] Brown, Keith, and Roberto Cavazos, "Why is This Show so Dumb? Advertising Revenue and Program Content of Network Television," *Review of Industrial Organization* (2005) 27, p. 19.
[27] Id. at 19, citing Anderson, Simon and Stephen Coate (*Market Provision of Public Goods: The Case of Broadcasting*, NBER Working Paper 7513, 20000 and Sunstein, Cass, *Private Broadcasting and the Public Interest: Noted Toward a Third Washy*, University of Chicago, 1999.
[28] Brown and Cavzaos, p. 33, citing Evans, Phillip B and Thomas Wurster, "Strategy and the New Economics of Information," in Phillip B. Evans and Thomas Wurster (Eds.) *Harvard Business Review,* September 1, 1997.
[29] Brown and Cavazos, p. 33.

difficult for independent ideas or independent producers to break through this triangle of advertisers, producers and audiences.

They prefer to rerun and repurpose the shows they already own and have produced, rather than pay for new shows, even though new shows would attract a larger audience, since shows already in the can deliver higher profits even with smaller audiences. As they become vertically integrated, they do more than just rerun on broadcast and repurpose on cable. They also repackage and recycle the brands for non-TV revenue for both non-video product sales as well as non-TV video (DVD) sales and rentals. "[T]he saturation of multiple markets with branded products means less air time, cable time, shelf space and the like for nonbranded products… While a boon to transindustrial conglomerate, saturation narrows the number of choices that corporate menus present us."[30]

Cross platform saturation of brands and franchise products reinforces the tendency to accept smaller audiences. Not only is it more profitable to rerun and repurpose a self-produced in hand product, even though its ratings may be lower than a new product, the "conglomerate may be willing to tolerate lower rating from a series representing a new brand in a franchise."[31] It may be more profitable from a strategic point of view to run with products that fit into or reinforce brand strategies, even though there might be other products that would attract larger audiences.

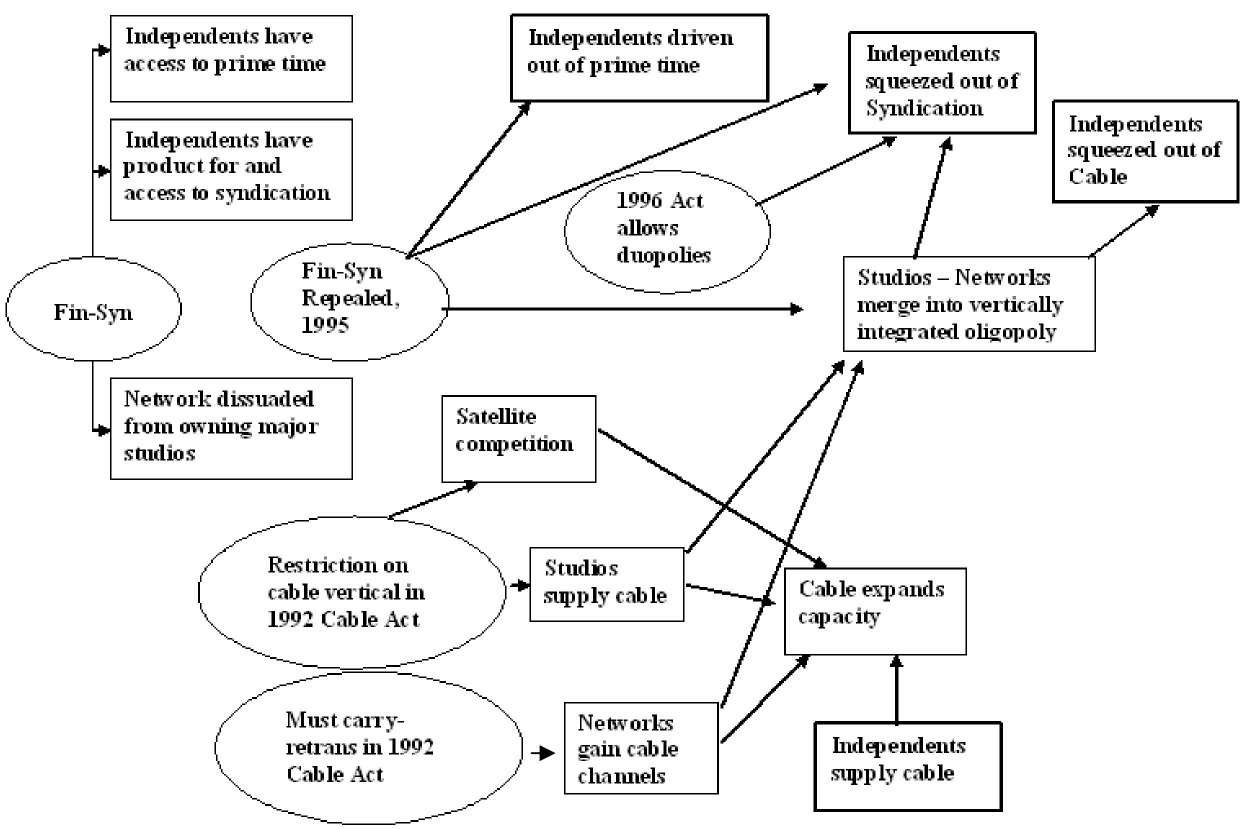
[30] Meehan, Eileen R., *Why TV is not Our Fault* (New York, Rowman and Littlefield, 2005), p. 111.
[31] Id., p. 111.

III. PUBLIC POLICY AND THE EMERGENCE OF A VERTICALLY INTEGRATED OLIGOPOLY IN VIDEO ENTERTAINMENT

THE REPEAL OF FINANCIAL AND SYNDICATION RULES TRIGGERS HORIZONTAL CONCENTRATION AND VERTICAL INTEGRATION

Exhibit III-1 identifies the key policy changes (ovals) and the structural and conduct changes that followed (rectangles) in the 1990s. The primary policy that triggered the vertical integration in the industry was the repeal of the Financial and Syndication Rules by the Federal Communications Commission. In retrospect, it is quite clear that the Financial and Syndication rules, which restricted the amount of broadcaster-owned programming in prime time, had a major effect on the diversity of not only the broadcast television market, but television in general. When the rules were eliminated in the mid-1990s, broadcasters moved to replace the lion's share of independent programming with content they produced. Self-dealing became the predominant mode of operation, which led to the merger of networks and studios.

Exhibit III-1:
The Impact of 1990s Policy Changes on Independents in the Television Market



The impact was more profound than the direct effect on prime time for an ironic reason. At the time that the Fin-Syn rules were relaxed, restrictions on vertical integration in the cable industry were implemented. Cable operators were restricted in the percentage of capacity on their systems they could fill with programming they owned. In the Cable Consumer Protection Act of 1992 they were also required to make their own programming available to competing delivery systems (the program access rules). As a result of the improved access to programming, satellite competition, which had been anticipated in the 1984 Cable Act, finally increased its market share. Satellite was a digital technology with greater capacity than cable. The cable industry responded by deploying its own digital capacity. Thus, just as the broadcast space was closing, the cable space opened for the major studios (majors) and independents. Given their structure, cable operators could not provide nearly all the programming that a 24/7 channel required. The studios, which had been prevented from integrating with broadcasters, funded and supplied programming for cable channels. A substantial market for independent movie production opened up.

Majors and independents were not the only beneficiaries of the 1992 Cable Act. The Act also gave the broadcasters a wedge into the cable platform, with the must carry/retransmission rules. Cable operators needed to carry the major broadcast networks to make their basic subscription packages attractive to the public. Without the networks, they would b slow to gain subscribers. The Cable Act of 1992 gave the broadcasters bargaining power over the cable operators. They could insist on a high fee for their national networks or they could negotiate for carriage of other programming. Must-carry and retransmission were government granted rights of carriage, means of ensuring access to audiences. The broadcasters chose to bargain for more channels on cable systems, rather than charge for their broadcast networks.

The 1996 Telecommunications Act reinforced this process. The Act allowed the FCC to lift the ban on horizontal concentration in the television industry. Broadcast licenses had been limited to one per entity in each market. The 1996 Act allowed the FCC to award more than one license per market after it had considered its impact on the industry. The FCC chose to allow duopolies in markets in which there would be at least eight "voices" in the market after the merger of two stations. Generally, the largest markets were opened to duopolies under the reasoning that diversity would be preserved in those markets.

For independents that sold product into TV syndication, this change had the opposite effect. By allowing the broadcast networks to own two stations in the most important markets – especially New York, Chicago and Los Angeles – a second major outlet was pulled into the tightening, vertically integrated core. The new owners of the second station now had a great deal of content of their own, since over the course of a decade, every major network acquired one of the major studios. Vertical integration became complete. Syndication was more difficult because access to the most important markets became much more difficult.

THE RESPONSE TO POLICY CHANGES

Within less than a decade after repeal of Fin-Syn and the passage of the 1996 Telecommunications Act, the process of vertical integration and horizontal consolidation was complete (se Exhibit III-2).

Exhibit III-2: Mergers, Acquisition and Product Launches in the Creation of the Vertically Integrated Video Oligopoly

	Disney/ABC	Time Warner	Viacom/CBS	G.E-NBC	News Corp
1993	Disney acquires Miramax Films	Turner acquires Castle Rock & New Line			News Corp. reacquires New York Post
1994		Time Warner acquires CPP/Belwin	Viacom acquires Paramount / acquires Blockbuster		
1995			CBS launches UPN		
1996	Disney acquires ABC	Time Warner acquires Turner	CBS acquires Infinity Broadcasting		
1997			CBS acquires American Radio Systems		News Corp. acquires New World Communications / acquires Burnham Broadcasting
1999			CBS acquires King World / CBS buys Outdoor Systems billboard group / Viacom	NBC acquires 30% of Paxon	News Corp. acquires Hearst Book Group
2000		Time Warner acquires Times Mirror magazines from Tribune Company			
2001	Disney acquires Fox Family from News Corp.	AOL acquires Time Warner	Viacom acquires BET		News Corp. acquires Chris-Craft-United Group / sells Fox Family to Disney
2002		AOL Time Warner buys out AT&T's stake in Time Warner Entertainment, creating TimeWarner Cable system		NBC acquires Telemundo / acquires Bravo (from Cablevision)	
2003				GE acquires Vivendi Universal Entertainment	News Corp. acquires stake in DirecTV
2005			Viacom acquires DreamWorks / CBS & Viacom Split (but Sumner Redstone still controlls majority votes in both		
2006	Disney acquires Citadel Broadcasting (Disney 52%) / Disney acquires Pixar	creation of CW Network with CBS (50%) / Time Warner acquires all of Adelphia's cable systems	creation of CW Network with Time Warner (50%)		

Five firms have come to own major studios, broadcast networks and cable TV channels while holding television station licenses as well (see Exhibit III-3).[32] The names are familiar to all in both the television and the theatrical movie space. All of the entities have a presence in each of the major video entertainment areas – network television, cable television and movie production. These firms account for five of the seven studios that produce motion pictures – known as the majors[33].

The 1990s policy changes triggered a series of acquisitions and product developments over the course of the decade that created a vertically integrated oligopoly in the television industry. Most directly, the networks could monopolize access to audiences in prime time broadcast television, foreclosing the streams of revenue that sustain production of all forms of content.

Each of the big three networks merged with a major studio and acquired cable programming over the course of the 1990s. Fox had taken a different path to vertical integration. After being rebuffed in an effort to acquire Warner studio, News Corp. acquired Twentieth Century Fox and a number of television stations in major markets, both in 1985. Since the late 1970s, Twentieth Century Fox had been one of the least active of the major studios in providing television programming. Fox's focus through the 1990s would not be on original programming as traditionally defined for prime time. It would focus on sports in programming and broadcast duopolies. Interestingly, Fox was vertically integrated but remained below the threshold for being subject to the Fin-Syn rules. For the big three networks who were subject to the rules, the repeal of Fin-Syn made mergers between networks and studies profitable, as self-supply was now allowed

[32] The depiction and data are for the early 2000s. While there have been some changes in the direction of deintegration that movement is not complete and its implications are not yet clear. CBS/Viacom have become partially separated. CBS/Viacom still share the same President and CEO and each of the two potential entities is vertically integrated, with production and distribution facilities. Similarly, Fox and Liberty are still intertwined by substantial ownership of shares. These situations may change the landscape somewhat, but the distribution the separate entities would have would reflect the legacy of vertical integration. Thus, we may see these entities unwind toward true, deintegration and independence, although the history of Liberty teaches that spin-offs and pull-backs are entirely possible. Moreover, whether these developments will constitute a true opening of the field to independents, or simply use contracts to replace the integrated flow of content also remains to be seen. Nor is it clear that the parts that have been broken up will not use their remaining partially integrated assets (production and distribution) to reintegrate across the entire space (Grove, Martin A., "CBS' Moonves Smart to Eye Movies," *Hollywood Reporter.com*, July 7, 2006). The effects of any real de-integration, if it comes about, will play out over time.

[33] These changes did not take place instantaneously, but unfolded over a number of years for several reasons. When a policy change takes place, it frequently takes a period of time for regulators to implement legislated requirements. Parties will frequently litigate such changes and move slowly until the legal terrain is clear. Further, existing business relations must unwind. Contracts run their course and new models are developed. Finally, because many of these policies are highly visible political decisions, market participants try to avoid triggering a political reaction with extreme moves.

Exhibit III-3:
The Vertically Integrated, Video Entertainment Oligopoly

Parent	Television Property	Cable/Satellite	Film Production
News Corp.	35 TV Stations reach 39% of U.S. Households 9 duopolies – NY, LA, Chic. Minn. D.C. Dallas, Phoenix Orlando, Houston Fox Network	Fox News, Fox Movie FX, FUEL, Nat. Geog. Speed, Fox Sports, Regional Sports, College, Soccer DirecTV	20th Century Fox, Fox Searchlight, Fox Television S, Blue Sky Studios
General Electric	27 TV stations reaching ~30% of U.S. households 6 duopolies through Telemudo – NY, LA, Chic., SF, Dallas, Miami NBC Network 30% of Paxson	CNBC, MSNBC, Bravo, Sci-Fi, Trio, USA	Universal
Disney	10 TV stations reaching X% of U.S. households ABC Network	ESPN, ABC Family, Disney Channel, Toon Disney SAOPnet, Lifetime A&E	Walt Disney Touchstone Hollywood Buena vista Pixar Miramax
CBS/Viacom	17 TV stations reaching 39% of U.S. households CBS Network CW King World	Showtime MTV, Nickelodeon BET, Mick at Night TV land, Noggin Spike TV, CMT Comedy Central, Flix The Movie Channel Sundance	Paramount Paramount Home
Time Warner	CW Network	HBO, CNN, Court TV, Road Runner New York News 1 Time Warner Cable 14.5 million subscribers	Warner Bros. Studios, TV Home Video Domestic Pay-TV Telepictures, Hanna- Barbera Witt-Thomas,

Source: Columbia Journalism Review, *Who Owns What,* August 22, 2006.

Market Structure

Vertical Integration

Note that each of the entities has a presence in all of the key areas of video product production and distribution (see Exhibit III-4) . Each owns studios that produce video product

Exhibit III-4: Vertically Integrated Video Oligopoly Domination of Television and Movie Production and Distribution (Circa 2001-2003)

	TELEVISION							MOVIES/DVD (U.S. Revenue)	
	Subscribers*		Writing Budgets		Programming Expenditures		Share of Prime Time	Box Office	Video
	# Million	%	$ Million	%	$ Million	%	%	%	%
FOX/LIBERTY	1250	21	236	19	3803	9	3	11	10
TIME WARNER	925	15	206	17	7627	18	10	22	20
CBS/VIACOM	910	15	45	12	9555	22	28	8	7
ABC/DISNEY	705	12	132	11	6704	16	21	20	22
NBC/Universal**	720	12	159	13	3879	9	21	12	15
Subtotal	4315	75	772	72	31568	74	83	73	74
TOTAL	6000	100	1225	100	43212	100	100	100	100
HHI	**1179**		**1084**		**1226**		**1775**	**1213**	**1258**
FOUR FIRM CR	**63**		**61**		**65**		**70**	**65**	**67**

Notes: and sources: * Subscribers includes broadcast and cable homes passed. ** Universal added to NBC to project post-merger market. Federal Communications Commission, In the Matter of Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming, CC Docket No. 00-132, Seventh Report, Tables D-1, D-2, D-3, D-6, D-7; Television Market Report: 2001 (Washington, D.C.: BIA Financial Network, 2001); Comments In the Matter of 2002 Biennial Regulatory Review –MB Docket No. 02-277, MM Dockets 02-235, 01-317, 00-244, January 2, 2003, Bruce M. Owen and Michael G. Baumann, "Economic Study E; Concentration Among National Purchasers of Video Entertainment Programming," Comments of Fox Entertainment Group and Fox Television Stations, Inc., National Broadcasting Company, Inc. and Telemundo Group, Inc., and Viacom; Comments of the Writers Guild of America Regarding Harmful Vertical and Horizontal Integration in the Television Industry, Appendix A. Federal Communications Commission, In the Matter of Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992 CS Docket No. 98-82, CS Docket No. 96-85, MM Docket No. 92-264, MM Docket No. 94-150, MM Docket No. 92-51, MM Docket No. 87-154, January 4, 2002; ; Federal Communications Commission, Program Diversity and the Program Selection Process on Broadcast Network Television, Mara Epstein, Media Ownership Working Group Study 5, September 2002, pp. 26. David Waterman, Hollywood's Road to Riches (Cambridge: Harvard University Press, 2005), pp. 21, 25.

for both television and theatrical release. Each has a substantial ownership of television distribution. The four national broadcast networks are represented here. The broadcasters have substantial ownership of TV stations. The fifth entity, Time Warner, is a major cable operator.

As a result of the recent Adelphia acquisition and exchange of cable systems with Comcast, Time Warner dominates the two entertainment centers in the U.S., New York and Los Angeles. It also has a share in the new broadcast network, CW, to which its production operations are providing content. Each of the five also has substantial cable offerings. Indeed 24 of the top 25 cable channels, as measured by homes passed, are owned by these five entities. In terms of actual viewers, as opposed to homes where programming is available, these five entities account for the vast majority – as much as 85 percent of prime time viewing.

Horizontal Concentration

Reflecting this concentration of subscribers, viewers and facilities, these five, vertically integrated entities have come to dominate the domestic U.S. video entertainment product space (see Exhibit III-4). They accounted for about three quarters to four-fifths of the output of the video product in terms of writing budgets, programming expenditures, hours of prime time content, and domestic theatrical box office or video sales/rentals. In each case, the HHI is in the concentrated range and the four firm concentration ratio is in the tight oligopoly range.[34]

The networks have concentrated their control over TV stations in the largest markets.

First, as shown in Exhibit III-5, the four major broadcast networks concentrated their station ownership in the top twenty five markets. The big four networks (CBS/Viacom, Fox/Newscorp., ABC/Disney; NBC/Universal), still constrained by the national cap on station ownership, own about 10 percent of the commercial, full power television stations in the nation. However, they own about 30 percent of the stations in the top twenty-five markets. They achieve their high level of national coverage by concentrating on the larger markets.

The coverage numbers in Exhibit III-5 count UHF stations at full value, since most such stations have carriage on cable systems and their signal strength is no longer an impediment to coverage. However, the coverage numbers in Exhibit III-5 do not count duopolies, so they underestimate the prominence of big four in the major markets. The big four networks have almost two dozen duopolies in the top twenty five markets. They also tend to be the highest rated stations.

I have noted that the decision to allow broadcasters to hold multiple licenses in a single market contributed to the difficulties of independents gaining access to the syndication market. The network owners would use their internally produced content on the television stations in the largest markets, squeezing the space available to unaffiliated producers. About 75 duopolies were created soon after the ban on holding multiple licenses was lifted (see

[34] The two potential changes in the sector mentioned above in note 37 (the CBS/Viacom Split, and the Liberty Media changes) would not change this basic finding. Each of the measures of concentration would likely remain in the concentrated tight oligopoly range, but the identity of the leading firms might change a bit.

Exhibit III-5: Concentration of National Networks on Major Markets

	Number of Stations		% of Stations in Top 25	National Reach (% of Pop.)
	Total	**Top 25 Markets**		
Big 4 Networks	**110**	**78**	**71**	**37.8**
Next 4	**138**	**77**	**44**	**45.2**
3rd 4	**125**	**34**	**27**	**20.2**
Next 4	**116**	**23**	**20**	**13.11**
Next 4	**84**	**14**	**8**	**9.4**

Source: William M. Kunz, *Culture Conglomerates* (New York, Rowman and Littlefield, 2007), p. 88

Exhibit IV-6). The national networks concentrated their duopoly acquisitions in the top ten markets, even though owning multiple stations within a market did not count against the national cap on how many homes they were allowed to reach. These markets account for about 30 percent of all the TV households in the country and almost 40% of all the TV revenues in the country. The big four market share in the top three markets was particularly high. These three markets alone account for about 15 percent of the population and almost 20 percent of TV revenues in the nation.

Exhibit III-6:
Big 4 Network Duopolies and Market Share in Top 10 Markets

Designated Market Area	Number of Big 4 Duopolies	Market Share Big 4 Duopolies	Total Market Share of Big 4
New York	2	44	77
Los Angeles	3	62	79
Chicago	2	40	73
Philadelphia	1	25	57
San Francisco	2	37	56
Boston	1	28	42
Dallas	3	59	59
Washington D.C.	1	27	52
Atlanta	0	0	24
Detroit	1	24	42

Source: BIA Financial, *Television Market Report,* 2003

This gives the big four network owners a disproportionate clout in the video market because these entities control multiple outlets in the most important markets. It is not only prime time programming that they control, but also syndication. Lacking content, because they are banished from prime time, independent producers, to the extent the have content, such as movies, confront the same handful of vertically integrated firms in the syndication market, who have a strong incentive to favor their own content. By gaining large market shares in the largest markets they get disproportionate leverage over the syndication market.

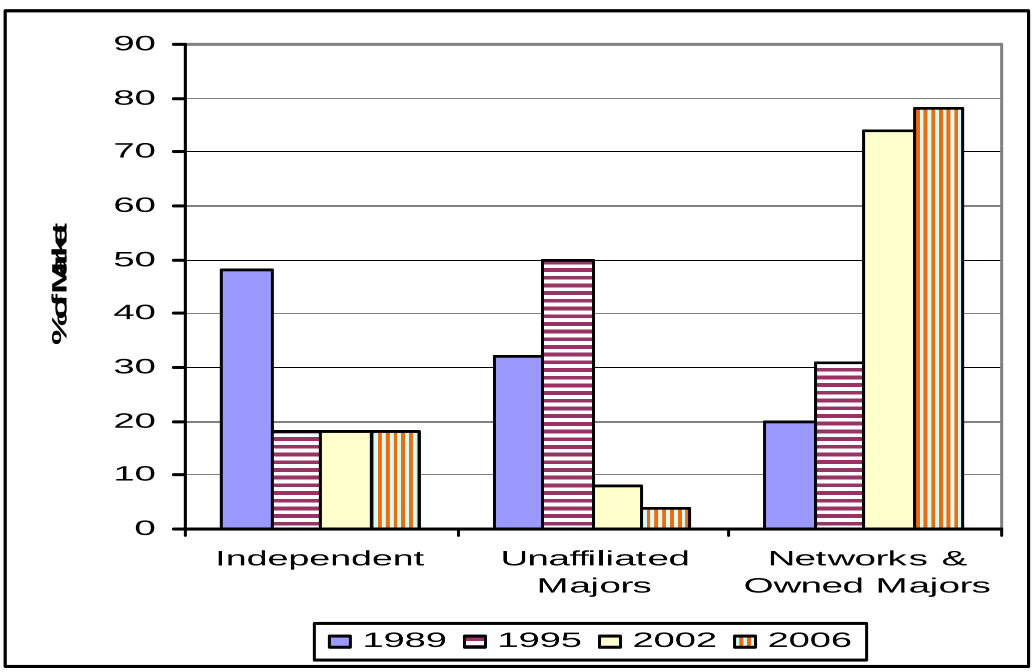
IV. DOMINATION OF THE TELEVISION PRODUCT SPACE

BROADCAST/NETWORK TELEVISION

Prime Time

The central empirical fact at the core of the narrative of the 1990s is the dramatic and swift change in the ownership of prime time programming after the repeal of the Fin-Syn rules (see Exhibit IV-1). Studies of prime time programming just prior to the repeal of the Fin-Syn rules find that the networks owned around 15 percent of shows aired in prime time. Major studios owned about one-third and independents accounted for about a half. Within five years, the role of the independents had been dramatically reduced – to less than one-fifth of the programming. Networks had grown to almost 40 percent. The major studios still accounted for around 40 percent. The mergers of the networks and studios followed and the vertically integrated entities came to dominate prime time, accounting for over three quarters of the programs. In 1989, fifteen entities produced 2 percent or more of the programming on prime time. By 2002, that number had shrunk to five. The programming produced by independents in 2006 was largely reality shows, not scripted programming, as had been the case in the past.

Exhibit IV-1:
Prime Time Market Shares



Source: 1989-2002 calculated from Mara Einstein, *Media Diversity: Economics, Ownership and the FCC* (Mahwah: Lawrence Erlbaum, 2004), p. 169; 2006 based on Baseline Research, *Fall Television Schedule: 2006-2007 Season.*

Traditional measures of market concentration used in economic analysis reinforce this observation. As Exhibit IV-2 shows, the prime time market moved very quickly from an unconcentrated competitive market (CR4=34%; HHI=541) to a tight oligopoly (CR4=74%) well up into the moderately concentrated range (HHI=1596). If the calculations are based only on series, i.e. excluding movies, the concentration is even greater. Within a decade after the repeal of Fin-Syn, the market was a highly concentrated (HHI=2070) tight oligopoly (CR4=84).

Exhibit IV-2:
Concentration of Prime Time Programming

Year	Four Firm Concentration	HHI	Four Firm Concentration	HHI
All Prime Time Hours			Series only	
1989	35	541	40	703
1995	47	776	57	1165
2002	74	1596	84	2070

Source: Calculated from Mara Einstein, *Media Diversity: Economics, Ownership and the FCC* (Mahwah: Lawrence Erlbaum, 2004), p. 169.

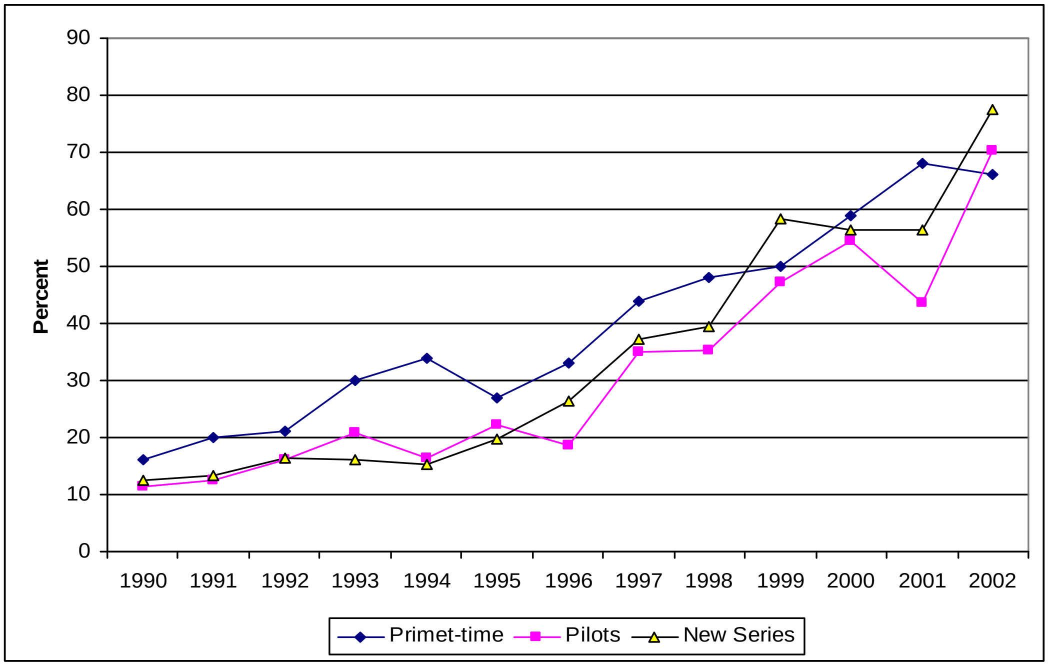
New Shows and Pilots

Exhibit IV-3 shows the pattern of ownership by the networks of prime time programming, new shows and pilots. we observe a modest increase in network ownership in the early 1990s, as the Fin-Syn rules were partially repealed, debated and litigated. With final repeal of the rules in 1995, we see a rapid and steady increase in network ownership.

The pattern has persisted, as an analysis of the 2006-2007 season shows (see Exhibit IV-4). The networks get over half of their programming internally. The four major networks also buy programming from one another. Overall, independents account for less than one-fifth of prime time programming. On the four major networks, the independents account for about one-seventh.

Exhibit IV-3:

Network Ownership of Prime-Time Programming 1990-2002



Source: Calculated from Mara Einstein, *Media Diversity: Economics, Ownership and the FCC* (Mahwah: Lawrence Erbium, 2004), p. 171; William T. Bielby and Denise D. Bielby, "Controlling Prime Time: Organizational Concentration and Network Television Programming Strategies," *Journal of Broadcasting & Electronic Media,* 47: 4 (2003), p. 588.

Exhibit IV-4:
Primetime 2006-2007 Programming
(Percent of Hours)

	Self-Dealing	**Internal Big-5 Dealing**	**Sony**	**Independents**
ABC-Touchstone	52	20	5	25
CBS-Paramount	57	38	0	5
NBC-Universal	67	14	5	14
FOX-20th Century	52	29	6	13
CW-Warner/ Viacom	53	0	7	40
Total	57	21	4	18

Source: Baseline Research, *Fall Television Schedule: 2006-2007 Season*

Syndication

Syndication has been studied less than prime time, but the available data suggests a similar pattern (see Exhibit IV-5). Although there is less self-dealing, the five networks dominate the syndication market because of a large amount of internal dealing. Particularly interesting to note is the lack of recent independent shows in syndication. Having been forced out of prime time, independents simply do not have series to place as product in syndication.

Exhibit IV-5:
Self-Dealing and Internal Dealing in First-Run Syndicated Programming (2004)

TYPE OF TRANSACTION	**HOURS** **All Shows**	 **Shows Less Than 2 Years Old**
Self-Dealing (Subsidiaries of Big 5 syndicating to themselves)	32%	61%
Internal Dealing (Subsidiaries of Big 5 syndicating to unaffiliated Big 3 station groups)	41	16
Independents syndicating to Big 3 Station Groups	18	0

Sources and Notes: Calculated from Goro Oba and Sylvia M. Chan-Olmstead, "Self-Dealing or Market Transaction?: An Exploratory Study of Vertical Integration in the U.S. Television Syndication Market," *Journal of Media Economics*, 19 (2), 2006, p. 113. Big 3 station groups are CBS/Viacom, Fox and ABC Big 5 syndicators are King World, Paramount, 20th Century Fox, Buena Vista, WB and Universal. Other Major is Sony (Columbia). Independents are "other." There are 22.5 hours per week of first-run syndicated programming in the 9am to 8pm day part analyzed (77 hours).

The foreclosure of the broadcast/network television market, particularly for 1st run series, is reinforced by a complete lack of pilots coming from independents. Interviews with independent producers done for this paper reveal that since there is little chance that they will get on the air, they have abandoned this market.

CABLE

The leveraging of retransmission rights to gain carriage has been an often told and well-documented story that does not need to be repeated here. Data clearly show that broadcasters are disproportionately likely to get carriage,[35] as does the anecdotal evidence of carriage battles in which broadcasters prevailed.[36]

A different element of the vertically integrated video conglomerates that is embedded in Exhibits III-2 and III-3, above, but which needs highlighting, is the critical role that repurposing content from broadcasting to cable plays. Broadcasting, with its much larger audience, is where brands and franchises are made. Vertically integrated owners can than use their marquee broadcast programming to launch national cable channels. The examples involve the launch of the most prominent national cable networks – Fox-FX- *X-Files*; Warner-TNT-*ER*; CBS-Spike- *CSI*, NBC-Bravo, *West Wing*; NBC-USA-*Law & Order*, ABC-Family-*Alias;* ABC-ESPN- ABC Sports.[37]

Independent programmers do not have this possibility. In other words, the cable space may look crowded and like an opportunity for entry, but the playing field is not level. The vertically integrated firms with broadcast product and retransmission rights dominate the field of general, national cable programming.

The evidence compiled in the Cable A la Carte Proceeding[38] and the Adelphia merger is testimony to the remarkable cross-platform dominance that has resulted from the mix of policies adopted in the early 1990s. The dominance of the cable dial by the big five can be seen in a variety of ways. First, they assemble "program suites" that cover the major demographic groups and product categories (see Exhibit IV-6).

This has enabled them to capture audiences on both platforms (see Exhibits IV-7). Dominating the top 25 cable networks (see Exhibit IV-8); they can then dominate the cable advertising revenue. As discussed above, these five entities have a 70 to 80 percent market share of everything video – prime time hours, cable subscribers, cable viewers, programming budgets, writing budgets, theatrical sales, and DVD sales and rentals.

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[35] GAO *Issues Related to Subscriber Rates in the Cable Television Industry, October 2003, Appendix V.* See "Reply Comments of Consumers Union and the Consumer Federation of America," *In the Matter of Comment Request on a La Carte and Themed Tier Programming and Pricing Options for Programming Distribution on Cable Television and Direct Broadcast Satellite Systems*, MB Docket No. 04-207, August 13, 2004, pp. 8-9 for additional references.

[36] Kunz, William M. Kunz, *Culture Conglomerates* (New York, Rowman and Littlefield, 2007), pp. 205-208.

[37] Kunz, pp. 134-135; 194-195.

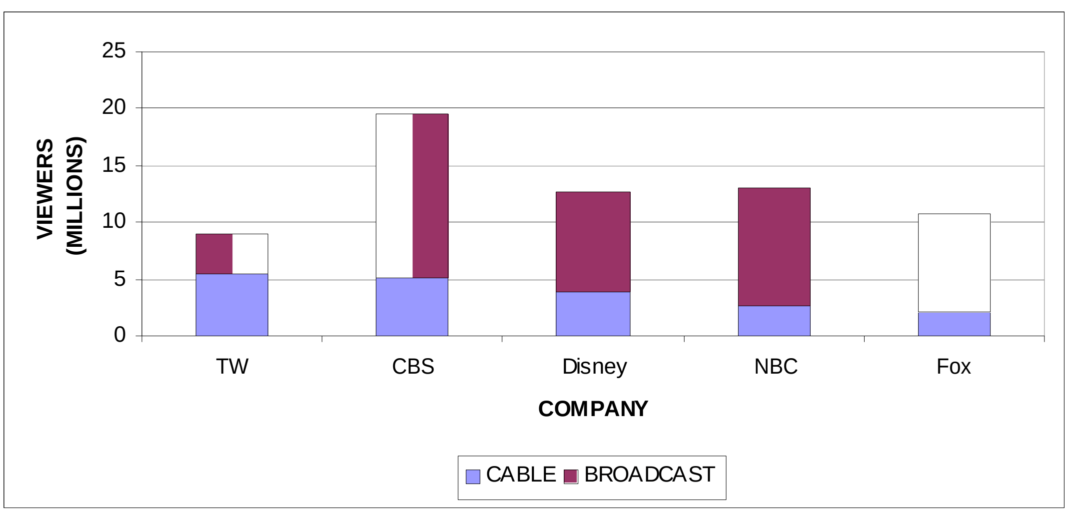
[38] See Reply Comments of Consumers Union, 2004; See Reply Comments of Consumer Federation of America and Consumers Union, *in the Matter of Applications of Adelphia Communications Corporation Comcast Corporation and Time Warner Cable Inc., For Authority to Assign and/or Transfer of Control of Various Licenses,* MM Docket No. 05-192, August 8, 2005.

Exhibit IV-6: Suites of Big Five Programmers Cover Major Types of Programming

	ABC	NBC	CBS	TW	FOX
GENERAL	ESPN Lifetime	USA	NICK	TBS TNT	(Fox Sports)
NEWS	(ABC news)	CNBC MSNBC	(CBS news)	CNN	FOX News
EMERGING MASS	Family	SciFi	TV Land	Court	
OLDER TRENDING	A&E Bravo History			(TCM)	(FMC)
YOUNGER TRENDING	Disney (Toon Dis)		Comedy MTV NickToons	(TOON) FX	
EMERGING NICHE	(LMN) (Soapnet) ESPN2 ESPN Class		BET Jazz CMT Spike VH1 VH1 Class VH1 Count MTV2, MTV Espan MTV Hits Nick Gas Noggins	Oxygen	Speed Nat. Geog

"Comments of American Cable Association," ***Inquiry Concerning A La Carte, Themed Tier Programming and Pricing Options for Programming Distribution on Cable Television and Direct Broadcast Satellite Systems*****, MB Docket No. 04-207, July 12, 2004;**

Exhibit IV-7:
Top Network Suites by Prime Time Household Viewership



Source: Duetsche Bank Securities Inc., ***Walt Disney Company: After Further Review… ESPN Still Has The Leverage Over Distributors*****, October 27, 2003.**

Exhibit IV-8: Top Channels and Shows, 1993-2005

Channel	1993 Rank Subs.	1993 Rank Prime Time	2005 Rank Subs.	2005 Rank Prime Time	Owner
ESPN	1	4	2	12	ABC/Disney
ESPN2			13		ABC/Disney
CNN	2	12	4	7	AOL-TimeWarner
USA	3	1	6	4	Liberty
Nickelodeon	4	6	9	1	CBS/Viacom
Nick at Nite				3	CBS/Viacom
Discovery	5	10	1	14	Liberty
TBS	6	2	9	8	AOL-TimeWarner
TNT	7	3	4	2	AOL-TimeWarner
CSPAN	8		6		Cable Group
MTV	9	13	18	13	CBS/Viacom
Lifetime	10	7	11	6	ABC/Disney
TNN	11	11			CBS/Viacom
Family	12	8	20		ABC/Disney
A&E	13	9	11	8	ABC/Disney
Weather	14		13		
HDLN New	15		18		AOL-TimeWarner
CNBC	16	18			NBC
VH-1	17	20			CBS/Viacom
QVC	18	16	15		COMCAST
AMC	19	19			CABLEVISION
BET	20	14			CBS/Viacom
Cartoon		5			AOL-TimeWarner
SCI-FI	5	5		15	Liberty
TLC			15		Liberty
History				11	ABC/Disney
Disney				5	ABC/Disney
Toon Disney				7	ABC/Disney
Fox News				10	Fox
Spike			9	9	CBS/Viacom
HGTV			18		

Source: Federal Communications Commission, Video Competition, First and Tenth Annual Reports.

TV Movies, the Role Of Cable

The history of prime time programming is primarily a story about television series. While a small number of made for TV movies appear in prime time, the overwhelming majority of programming is series. Interestingly, for independents, the growth of cable in the late 1990s was a story about TV movies.

To analyze the changing patterns of TV movies, I examined all films aired in three four-year periods (see Exhibit IV-9). The first period was before the Fin-Syn rules were in play (1985-1988). The second period was the four years after Fin-Syn was repealed (1995-1998). The third period was after the networks became integrated with studios (2001-2004). I relied on the Baseline database and included only movies that were aired and for which a network and at least one producer was identified. Where a network was listed as a producer, the movie was considered to be produced by the network, even if other producers were identified. This is the critical assumption in the sense that I am assuming, implicitly, that the movie would not have been aired on the network, but for the co-production. Of lesser importance is the assumption that where a network and its major movie studio are both listed as producers, the studio was considered to be the producer. While these distinctions could be interpreted in other ways, the basic patterns in the data would not change much. The key findings about independent producers are quite clear.

Exhibit IV-9: TV Movies Across All Distribution Channels

	Percent of Movies		
	Broadcast	*Basic Cable*	*Premium Cable*
1985-1988 (n=47)			
Independent	40	0	2
Network	47	2	2
Majors	9	0	0
1995-1998 (n=206)			
Independent	33	13	13
Network	17	1	5
Majors	11	0	2
2001-2004 (n=634)			
Independent	7	41	9
Network	5	20	7
Majors	5	5	1

Source: Baseline Beta Studio System Database.

The pattern of broadcast movies follows the pattern we observed for series. The independents played a large role under Fin-Syn, were diminished immediately after repeal of Fin-Syn and then reduced dramatically within a decade. Their share in premium movies grew in the mid-1990s, but was reduced after the integration of the studies. In this category, there was also a shift for independents from HBO to Showtime.

In the most recent period, cable movies have become quite prominent. The numbers of movies produced have increased dramatically. In the mid-1990s, independents aired about 120 movies, 95 of them on broadcast and premium cable. In the 2001-2004 period, they produced over 100 movies on broadcast and premium cable, and over 260 on basic cable. The apparent increase in production, however, is less significant than it appears. There are two different sets of reasons that the expansion has not helped independents greatly. One set has to do with the nature of the business and the distribution channels.

First, broadcast and premium movies have much higher budgets and larger audiences. Thus, the 100 movies produced by independents that aired on broadcast and premium cable probably had a substantially larger total budget and a larger audience than the 260 movies that aired on basic cable.

Second, where studios compete for resources to maintain a production base, the relative output is important. Whereas the independents grew by about 6 percent between the mid 1990s and the early 2000s in the high value spaces, the networks and major studios grew by almost 60 percent. As the networks grew larger and larger, they control more resources in the sector.

Third, placement on basic cable makes it more difficult to tap into other revenue streams – DVD sales/rentals and foreign television – which have become vital to maintaining the program's prominence.

The second set of factors that suggests the growth of basic cable, as an outlet is less important than it appears has to do with the market structure.

First, approximately 80 percent of the basic cable movies are aired on networks that are owned by two of the vertically integrated media corporations – ABC/Disney (ABC family, Disney Channel and Lifetime) and NBC (Sci-Fi).

Second, the genres are highly specialized. These cable networks buy three genres and there is essentially only one buyer for each. ABC Family/the Disney Channel buys family/children-oriented movies. Lifetime buys romances. Sci-fi buys horror films. This is a classic situation for the exercise of monopsony power.

Third, the vertically integrated oligopoly that dominates the other video outlet spaces also thoroughly dominates the TV movie space. The five entities I have identified account for about three-quarters of the distribution of movies one –third through broadcast and premium cable, a little over one-third through basic cable, and another handful of movies on more general networks (A&E, MTV, ESPN, FX, Spike).

ACCESS TO TELEVISION IS CRUCIAL TO THE HEALTH OF INDEPENDENT PRODUCERS

Thus, I have shown that the independents were largely eliminated from prime time broadcasting and relegated to basic cable movies. This places the independents at a severe disadvantage because television and the broadcast space at the core of the vertically integrated oligopoly remain extremely important to the overall market for video product. The broadcast space at the core of the vertically integrated oligopoly is extremely important to the overall market for video product. Where a product is placed in television space strongly affects not only its domestic revenues, but has a large impact on where it will be placed and what revenues it can earn in the international arena. By foreclosing the broadcast space, for both movies and series, the oligopoly core cripples independent producers and forces them into the cable arena, insofar as the independents desire to distribute over the television platform. The cable space, though, is a hostile environment as well, wherein the very same entities own the most attractive distribution channels in the space. Independents are forced into the least attractive cable channels on the least favorable terms.

Exhibit IV-10 presents order of magnitude estimates of the revenues, expenditures and audiences of the TV movie sectors and Home Video. The revenue from the TV sector dwarfs the movie sector revenue, even when video sales/rentals are included. Total revenues are about three times are large. Domestic revenue is six times as large. Programming expenditures are on the order of five to six times as large.

Exhibit IV-10: The Importance of Television in the Video Entertainment Product Space (circa 2003-2004)

	Majors	**Independents**		**Broadcast**	**Cable/ Satellite**
Revenues (Billions)					
Box Office			Ad Revenue/ Subscription	$35	$50
Domestic	$8.0	$1.0			
Foreign	8.0	1.0			
Video Sales/					
Domestic	11.0	1.3			
Foreign	8.0	.8			
TV series					
Domestic	.7	.1			
Foreign	2.1	.4			
TV Movies					
Domestic	3.5	0.5			
Foreign	1.7	.4			
Total	35.0	5.5			
	40.5			85	
Programming	7.0	.4		$40	

Budgets (Billions)		**Audience (Hours Per Year)**		
Theatrical	13	Broadcast	780	
Home Video	80	Basic		830
Total	93	Premium		180

Sources: U.S. Box Office and Programming budgets are based on MPAA, *Theatrical Market Statistical Report, 2005.* Programming budgets do not include marketing and assume 120 releases from the majors. Foreign Box Office, home video and TV revenues are from David Waterman, *Hollywood's Road to Riches* (Cambridge: Harvard University Press, 2005), Table C.1. Independent programming budgets from American Film Marketing Association, *The Economic Impact of Independent File Production,* April 2003Cable Revenue is from Federal Communications Commission, *Twelfth Annual Report in the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming,* MB Docket No. 05-255, March 3, 2006, p. 19.

The extreme importance of TV in terms of audience is also clear. Broadcast and cable pull almost twenty times the audience of movies even combining theatrical and home video viewing. Premium cable (arguably similar to movies since it is a pay service) alone has a larger audience.

Although basic cable and broadcast are about equal in audience, prime time broadcast still is the dominant exhibition space on TV. For example, the advance sales of advertising slots on the four national networks – called the up front sales – equals the total annual Box Office of theatrical releases in the U.S. Advertisers pay a rich premium for this space because the networks still aggregate many more viewers than cable shows. As Mara Einstein, the author of the most comprehensive analysis of the repeal of the Fin-Syn rules noted, the gatekeeper role of the networks is essential since,

> while the networks must decide between best show versus best buy, they remain acutely aware of their ability to provide something that no other media vehicle can, and that is the ability to create a valuable asset because no medium can provide the kind of exposure and promotion that network television does.[39]

The networks are well aware of their advantage. As Less Moonves recently put it, "If you want 30 million people," you can't get that anywhere else."[40] The next chapter examines how that gatekeeper role impacted access to distribution under the new policy adopted in the 1990s.

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[39] Einstein, Mara, *Media Diversity: Economics, Ownership and the FCC* (Mahwah: Lawrence Erlbaum, 2004), p. 192.
[40] Fabricant, Geraldine and Bill Carter, "A Tortoise Savors the Lead," *New York Times*, September 12, 2006, p. CC11.

V. THE IMPACT OF MARKET STRUCTURE ON INDEPENDENT PRODUCTION

THE CRITICAL ROLE OF GATE KEEPING IN THE VIDEO PRODUCT SPACE

At the center of the picture I have painted of vertical integration following the policy decisions of the 1990s stand the broadcasters as gatekeepers of access to audiences. A key role in the process was played by the absorption of the major studios. Interestingly, David Waterman's recent economic history of the major studios is based on the premise that

> the most important feature of the studios is their role as *distributors*, and we often refer to them by that term. By controlling distribution, the studios act as gatekeepers: they decide which movies get produced and how they are made, and they also largely determine when and at what price viewers get to see them on which media.[41]

The historic role of vertical integration in the movie industry and the effects of policy underscore the enduring importance of these aspects of video industry structure. The key gate keeping role of distribution in the movie industry depended upon integrated and consolidated entities in the first half century of the existence of the movie industry. While there is a debate about the factors that shaped the role of the major studios, Waterman pinpoints two critical issues that parallel the core of my analysis of the video product space in the 1990s. One was a policy decision that forced deintegration.

> Fox, MGM, Warner, Paramount, and RKO, known at the time as the five majors, were vertically integrated into production and theater exhibition and had consistently dominated the industry since the mid-1930s. The three others – Universal, Columbia and United Artists, known as "the minors" at the time – owned no theaters… All eight of these studios were brought to trial by the U.S. Justice Department in the 1940s, and an eventual Supreme Court decision in 1948, *United States v. Paramount Pictures, Inc. et al.*, ruled that the eight distributors had violated the Sherman Act and other antitrust laws… The Court ordered the five major distributors to divest their extensive theater holdings… established a number of regulations on contractual relationships between distributors and theaters that were incented to level the playing field for independent companies.[42]

The second factor that shaped the market for theatrical movies was the growth of television.

> After the *Paramount* decision, the prewar stability of industry structure among the eight Paramount defendants began to crumble. Industry positions of the majors and the minors converged, and the extent of independent entry increased. We argue in the following chapter that the almost coincident diffusion of television has more profound long-range effects on the movie industry than did *Paramount*, but it is likely that

[41] Waterman, David, Hollywood's Road to Riches (Cambridge: Harvard University Press, 2005), p. 16.
[42] Waterman, p. 30.

ascendance of all three of the minor studios into the majors ranks, and perhaps the rise of independents in the 1960s, were related to the Court's intervention.[43]

Thus, the policy of forcing deintegration of production and distribution of theatrically released movies opened the door to entry, while the advent of television created a whole new channel for the distribution of video product. Waterman reckons that the technological factor played a large part in shaping the video entertainment space, although not so much in determining concentration as in altering the types of products the sector produced and the marketing patterns of those products. However, from the point of view of the analysis in this paper the critical point is that the convergence of the same two factors – integration policy and multiple distribution platforms – that worked to weaken the gatekeeper role of the studios in the 1950s, worked in the opposite direction for the broadcasters in the 1990s. Removing the policy restriction on vertical integration opened the door to reintegration of the production and distribution of video product and the merger of production (studios) and distribution (broadcasting and cable). The lesson is clear: if given the chance, entities will merge and integrate vertically in order to dominate the sector by controlling distribution.

Mara Einstein, notes that before and after the policy limiting vertical integration the broadcasters used their control over access to audiences to monopolize ownership of network programming. Before the Fin-Syn rules were in place, networks asserted ownership over prime-time programming.

> In the 1970s, what led the FCC to institute the financial interest and syndication rules was a concern that the networks were becoming both too powerful and too demanding when it came to the [program] selection process. Too powerful in that they were the gatekeepers of news, information, and entertainment for the American public. This was so because of the limits of radio spectrum… Too demanding, because networks were requiring an equity stake in a program before it would be accepted as part of the prime-time schedule…. [T]he networks had ownership of more than 70% of their prime-time schedule by the mid-1960s, up from only 45% the previous decade. The strong arming of producers was a fundamental reason for the creation of fin-syn.[44]

The timing is informative. TV arrives on the scene in the 1950s and becomes the dominant medium by the early 1960s. In the early days, it lacked both production capacity and market power to self-supply content. Once it achieves ascendance, it uses it resources and leverage to assert ownership over price time programming.

The broadcast networks also had a history of antitrust problems in their role as gatekeepers of access to the television audience. In 1978 they lost an antitrust case that paralleled the *Paramount* case.

> In the *Unites States v. National Broadcasting Co.,* The government specifically accused the National Broadcasting Company (NBC) of restraint of trade as it related to purchasing programs from independent producers and of using its network power to

[43] Waterman, p. 23.
[44] Einstein, Mara, *Media Diversity: Economics, Ownership and the FCC* (Mahwah: Lawrence Earlbaum, 2004), p. 179

> monopolize prime-time programming production of shows broadcast on the network. The Department also claimed that NBC, with CBS and ABC, was trying to develop a monopoly over the television programming market.[45]

After a twenty-year period in which the networks were restrained by the Fin-Syn rules, the broadcasters moved to reassert ownership in prime-time programming once the rules were repealed.

> Since the rules were repealed in 1995, the economic structure of the industry changed drastically. The television networks have become vertically integrated institutions with the ability to produce programming through internal business units. Corporate parents put pressure on the networks to purchase programming internally to achieve synergies and, of course, increase profits. Being part of large media conglomerates, there is added pressure on the networks to be profitable so that Wall Street may find the parent company appealing.[46]

> The networks each have at least a 50% stake in the programming on their air and some have as high as 70 and even 90%.[47] The networks could never achieve those kinds of ownership numbers without requesting a stake in the programming that appears on their air. It is no secret to anyone that the networks do this.[48]

In the previous section I have noted the evolving pattern of behavior by the broadcasters in asserting ownership of prime time programming. Bielby and Bielby have argued that the network behavior was political, as well as economic, and noted the evolving nature of their rhetoric. At first the broadcasters argued that the independents would not be squeezed out. Later they argued that independents were irrelevant.

> The network executives' initial position was that independent producers would thrive in a deregulated industry and that network ownership was not a threat to creativity and program quality. Increasingly, in recent years, network executives and deregulation advocates have taken the position that their opponents' positions are irrelevant, because they are out of touch with the realities of the marketplace. In effect, they are saying, vertical and horizontal integration were necessary for the industry to survive in the face of rising costs and increased competition from new technologies.[49]

As this process unfolded, the impact was felt in more than just access to audiences. The leverage that the vertically integrated core of the industry acquired also dramatically changed the terms of trade between the independents and vertically integrated conglomerates. With a small number of vertically integrated buyers and a large number of much smaller product sellers, the core oligopoly gains monopsony power. They can impose onerous terms on the supplier, appropriating maximum surplus. With all of the major distribution channels

[45] Einstein, p. 60.
[46] Einstein, pp. 179-180.
[47] Einstein, p. 217, citing Mermigas, 2002,
[48] Einstein, p. 217.
[49] Bielby William T. and Denise D. Bielby, "Controlling Prime Time: Organizational Concentration and Network Television Programming Strategies," *Journal of Broadcasting & Electronic Media,* 47: 4 (2003), p. 585.

under their control, the vertically integrated oligopoly can slash the amount they are willing to pay for independent product.

The experience in the video product space over the two decades in which the vertical integrated oligopoly emerged suggests that vertical integration increased barriers to entry into the television sector.

> [B]ecause the vertically integrated structure creates such a barrier to entry… it is not necessary for these executives to collude…. The complexity has made it almost impossible for new players to enter the market, because they have to do so on so many levels – production, distribution, cable outlet, and so forth.[50]

> Compared to recorded music, production costs in television are astronomical, creating substantial barriers to entry to new program suppliers and creating incentives to the networks to demand greater control over costs…. In the increasingly deregulated business environment, the enhanced market power of the corporations that control access to channels of distribution has made it more difficult for independent suppliers of new television series to survive in the industry. Moreover, the high cost of producing episodic television makes it extremely difficult to operate through channels of distribution outside of network television, such as first run syndication or cable (especially when those off-network venues are increasingly controlled by the same corporations).[51]

FAVORING AFFILIATES

The gatekeeper role translates into leverage because "with increased vertical integration, independent producers have less access to audiences, or they must align themselves with studios or networks to get their shows on the air."[52] Einstein concludes that integration favors internally produced product.

> Given vertical integration and the combined network/programming departments, all things being equal, an internally produced show is going to get an airing over one in which the network does not have an interest. It is also more likely to get a better time slot and be kept on the air longer. While it is possible that some shows of lesser quality are given preference over those produced by outsiders, this is a situation that is not likely to be sustained.[53]

> Producers claim that with the demise of the Fin-Syn Rules, networks have used their enhanced market position in several ways to gain unfair advantage over outside program suppliers. First, they claim that when selecting series for the prime-time schedule and deciding between a series from an outside producer versus one of comparable or even less quality produced in-house by the network or by a network joint venture, the network will favor the series in which it has a financial interest.

[50] Einstein, p. 217.
[51] Bielby and Bielby, p. 341.
[52] Einstein, pp. 180-181.
[53] Einstein, p. 194-195.

> Moreover, many producers perceive that this kind of favoritism has intensified in recent years.[54]

Einstein and others identify a number of ways in which vertical integration affects the flow of programming. Clearly inferior shows are aired primarily because the vertically integrated media conglomerate owns them, although there is a difference of opinion on how prevalent this outcome is.

> There are already many examples of network-produced programs that have failed miserably. Shows that were put on the schedule for no other reason than the network studio produced them.[55]

> There is definitely favoritism for internally produced shows over those produced out of house… There are limits to this…. To the extent that they won't put on a bad show that's produced internally over a good show that's not, but certainly if two shows are of equal value the internally produced show will get the nod.[56]

> Indeed, according to one producer, a network financial stake in a proposed series "practically guarantees" a slot in the prime-time schedule… "Without question, if I know that I am gonna lose, I just want to know that at the end of the day the shows that beat me out did so because they are better shows and not just because they're co-owned by the network.[57]

More generally, owned-programming gets an inside track and is chosen when there are close calls.

> [I]t appears the incentives introduced into the program selection process by the repeal of the Fin-Syn rules have clearly affected the program selection process within broadcast networks. Specifically, the networks have an incentive to select programs produced in-house because of both financial and political reasons.[58]

> [I] is important to note here that internally produced programming has the so-called home court advantage when it comes to being selected for the prime-time schedule…. 'If you put the network person in charge of both sides of the fence… It's impossible to ask the network person to have that much objectivity.[59]

Owned programming is given better time slots.

> What is less known is that the networks are selling time periods, giving the best time slots on the schedule to those who make the best deal with the network.[60]

Owned programming is kept on the air longer.

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[54] Bielby and Bielby, p. 581.
[55] Einstein, p. 194-195.
[56] Einstein, p. 217.
[57] Bielby and Bielby, p. 581.
[58] Einstein, pp. 180-181.
[59] Einstein, p. 187.
[60] Einstein, p. 217.

> Shows are also being maintained on the schedule for longer than they might be if the network did not have an ownership interest in the show. [61]
>
> Owned programming clogs syndication.
>
> A new issue has arisen in the syndication market that is adversely affecting producers to the benefit of the networks and their parent companies. Due to increased vertical integration, more and more companies are selling programs within their own company rather than going out into the marketplace to sell a show. For instance, a network that has its own production company will sell a hit show to its cable network at a below-market rate without opening the show to bidding by other outlets, cable or broadcast. Though this is very lucrative for the company, it is detrimental to the profit participants in the show—the producers, the actors and so forth. If the vertically integrated company sells the show internally, it is at a heavily discounted price, which means that the profit participants are cheated out of their rightfully earned money. By selling internally, the companies have almost created a new form of warehousing. Rather than keeping a show off the market, they are keeping the show off the market to competitors.[62]

The pattern of acquisition of shows and movies discussed in the previous chapter also suggests that when the oligopolists are not self-supplying, they engage in reciprocal dealing, buying shows from one another. The interviews with the independent producers indicate that with the vertical integration of studios into the core of the oligopoly, the problem afflicted the movie segment as well. The playing field is simply not level.

Interviews with independent movie producers suggest that the problems that afflict independents in syndication are somewhat different for producers of series and movies. The literature on independent producers of series shows that when independents were squeezed out of the prime time series market, they simply did not have product to sell into syndication, since they were literally put out of business. To some extent, producers of movies were similarly affected, since they did not have larger budget movies to sell into syndication, but they are still in the movie business. Their theatrical releases were also squeezed in the syndication space as the vertically integrated entities came to dominate syndication. The squeeze was two-pronged. They found it more difficult to get placement and the license fees and other terms deteriorated.

MONOPSONY POWER

The final area of concern identified in the analytic framework is the exercise of monopsony power. The gatekeeper problem is at the core of monopsony power problems in the video content industry.[63] The harm in the exercise of monopsony power is the reduction

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[61] Einstein, p. 192.
[62] Einstein, pp. 198-199.
[63] Curtin, John J., Daniel L. Goldberg and Daniel S. Savrin, "The EC's Rejection of the Kesko/Tuko Merger: Leading the Way to the Application of a 'Gatekeeper' Analysis of Retailer Market Power Under U.S. Antitrust Law," 40 *B.C. L. Rev.* 537 (1999).

of prices paid to suppliers and therefore a reduction of the quantity or quality of the product supplied.

This problem is evident in the TV video space as well. Broadcasters have the leverage to extract equity shares for shows not developed internally.

> [I] in recent years, the networks seem to have refined their strategy even further – recognizing that when series with high potential do appear from outside producers, they can use their market power to extract an ownership stake after the pilot has been produced.
>
> Secondarily, if the show is not internally produced, then the ability to have equity ownership in an externally produced show is expected for inclusion on the prime-time schedule.[64]
>
> Even shows in which the networks did not originally have an interest have had their financing restructured to allow the network to become a financial partner for a show to stay on air, particularly in the ever-important fifth year…. "'Shakedown is probably too strong a word, but they should not have the right to insist on ownership just to provide real estate on the airwaves.'"
>
> Giving a piece of the show to the network has become a normal way of doing business since the repeal of the Fin-Syn rules, because access to the airwaves depends on giving the networks a financial interest in the program. Sometimes these requirements are subtle, like requesting that a producer create their show with their studio's production facilities, and sometimes they are quite blatant – your money or your show.[65]
>
> Of even greater concern to these producers than the perceived favoritism towards in-house production and joint ventures is an increasingly common practice by the networks of commissioning pilots from independent producers then demanding a financial stake as a condition of picking up a series for the prime time schedule.[66]

Networks gain market power to meddle with the content offered by independents.

> The argument being advanced here is that the increase in in-house production following the demise of the Fin-Syn Rules created a conflict of interest as business executives from the networks are placed in a position to meddle in the creative process. Under the Fin-Syn Rules, it is argued independent producers and those affiliated with the major studios were insulated from this kind of interference.[67]

Interviews with the independent film producers underscore the problem of monopsony power. The pervasive control over distribution channels on TV allows the integrated firms to dictate terms and conditions that squeeze the independents. The include license fees that do not cover the costs, given the quality that is demanded, extremely long license periods, and

[64] Einstein, pp. 180-181.
[65] Einstein, p. 192.
[66] Bielby and Bielby, p. 581.
[67] Beilby and Bielby, p. 580.

claims to back end-rights – home video, foreign sales and digital distribution -- that limit the ability of independents to make up for the inadequate license fees. The exercise of this monopsony power has gone so far as to allow the buyers to repurpose of content to "higher" value" distribution channels without compensation for the independent producer. By taking a product that was purchased at terms and conditions for a lower value outlet and the re-using it on one its much higher value outlet, the vertically integrated company extracts much greater value, without compensating the producer.

This is exercise of monopsony power is akin to a practice that the vertically integrated companies had applied in the series space. In that space, the vertically integrated firms take a high value product and sell it at very low prices to a lower value outlet, in essence under stating the value of the product, to which independent participants might have a claim.

> A new issue has arisen in the syndication market that is adversely affecting producers to the benefit of the networks and their parent companies. Due to increased vertical integration, more and more companies selling programs within their own company rather than going out into the marketplace to sell a show. For instance, a network that has its own production company will sell a hit show to its cable network at a below market rate without opening the shoe to bidding by other outlets, cable or broadcast. Though this is very lucrative for the company, it is detrimental to the profit participants in a show – the producers, the actors and so forth.[68]

It should be evident from these examples, that cable outlets do not alter the landscape because the networks have captured a substantial hold over the most important cable networks.

> One way that networks are ensuring a faster return on investment is by having a secondary distribution channel usually in the form of a general entertainment cable channel. These channels are used as a secondary outlet through which they can distribute their programs…. Each of these networks present programming on the broadcast network that is then re-presented (or repurposed) on the secondary outlet. This will lead to more redundant programming and less new content through more outlets. Networks are also making their prime time programming available through video-on-demand and DVD collections.[69]

> Another increasingly popular business strategy implemented by the big four and emerging networks also offsets the impact of expanding channels of distribution. "Repurposing" involves exhibiting each episode of a series on an affiliated broadcast or cable network immediately after the initial network broadcast.[70]

[68] Epstein, pp. 198-199.
[69] Einstein, pp. 218-219, on the latter point Einstein cited Adalian, 2002.
[70] Beilby and Bielby, p. 592.

VI. THE DEBATE OVER QUALITY

OBSERVATIONS ON THE CREATIVE PROCESS

Should policy makers care that video production is in the hands of a small number of firms. We have already suggested that they should because it plays an important role in democratic discourse and cultural production. But does market structure matter?

The theoretical reason why source diversity is so crucial to the overall goal of diversity is that the larger the number of sources, competing to develop programming, particularly if they are independent, the more vibrant the ideas that are tried will be. There are repeated examples of independents being rejected by one network, but succeeding wildly on another; of one network wanting to alter the essential nature of a show, while another did not. Here I stress that it is the infrastructure of creativity that is important and the willingness to take risk and shop options around to distributors that is undermined by vertical integration. The trend toward consolidation and vertical integration between the production and distribution of content has resulted in a decline in the quality of product and the elimination of independent sources of output.

The exercise of monopsony power is clearly affecting the structure of the industry. Two effects have been noted.

First, the number of entities engaged in the process has been reduced sharply because the distribution of risk and rewards has been shifted in favor of the networks.

> [T]he statistical patterns summarized above include instances in which the networks have used their enhanced market power to negotiate ownership shares in series pilots brought to them by outside suppliers. In these situations, the program supplier, not the network, absorbs development costs, while the network acquires a share of the back end profits if the series eventually becomes a hit and goes into syndication. From the program suppliers' perspective, the costs of development for new series remain the same, but to reach the prime-time schedule, the supplier has to agree to forgo a share of the future revenues. According to some in the industry, this revenue squeeze on independent program suppliers is the primary reason that a number of them have exited the business of prime-time series development.[71]
>
> So far, the most visible impact of deregulation has been a reduction in the number of organizational settings in which those who create television series are employed, and an increase in corporate control over the circumstances under which they practice their craft.[72]

The second effect is to eliminate the creative tension that once existed between the producer and the distributor of product.

[71] Beilby and Bielby, p. 590.
[72] Beilby and Bielby, p. 593.

> Vertical integration is seen as eliminating a valuable step in the development process. First, developing programming is a creative process. When one entity created the programming and another would select it, the two companies could argue and disagree and out of those discussions, the show would often be improved... [T]he process did favor internal shows and eliminated much of the development process altogether. Producers also stated that this process was detrimental to the overall quality of network programming. [73]

One aspect of the debate over quality that is intriguing but little studied is the potential relationship between integration, declining quality and declining ratings. As Bielby and Bielby note:

> In 1999, *Advertising Age* editorialized that ABC was "auctioning" its most desirable prime-time time slot to the program supplier willing to give the network a financial stake, part of a trend that is making it "increasingly clear the broadcast networks are more interested in financial deals than putting the best shows they can find on the air." The trade publication warned that the ratings decline experienced by the networks would accelerate if "financial packages rather than program quality determine what gets on the schedule."[74]

The ratings decline certainly did continue, as integrated ownership of programming increased. As is frequently the case in this sector, many other things were changing that could account for the decline in ratings, but the correlation is notable.

Waterman sees some evidence of the latter effect on the studio side of the business.

> [E]xcessive movie budgets and an overreliance on sequels or derivative movies have also been associated unfavorably with conglomerate organization and the mentality of the top executive in charge.[75]

Waterman also notes that the claimed efficiency benefits of conglomeration have come into question.

> When merger plans are announced, industry analysts often cite efficiencies, such as workforce combinations, or marketing advantages, such as the ability to cross-promote movies using television, magazines or other media assets also owned by the conglomerate. Also commonly mentioned are the advantages of vertical integration, such as the ownership of television or cable networks that can serve as guaranteed outlets for movies produced by the conglomerate's studio branch. A related benefit is the ability to consolidate exploitation of a single story idea or character through books, magazines, television shoes, music publishing, Internet web sites, or other media within a single corporation. The economic advantages of such operating efficiencies (often called economies of scope) are plausible. However, real multimedia exploitation within the same conglomerate is apparently infrequent and

[73] Einstein, p. 194-195.
[74] Bielby and Bielby, p. 581.
[75] Waterman, p. 30.

> other efficiency claims have come into recent disrepute – notably in the cases of AOL-Time Warner and the ABC-Disney mergers.[76]

What we may be left with are the market power advantages of a tight oligopoly in the video entertainment space, which do not yield efficiency gains while imposing a heavy price in terms of diversity and quality.

TELEVISION

Diversity of Content

Discussions of quality frequently start and end with the most famous examples of "groundbreaking" shows mentioned above. *All in the Family* and the *Cosby Show* have become famous as independent shows that fought their way into prime time and changed the face of television. Independently, conceived and produced, it was only by having alternative outlets available that these shows were able to preserve their distinct content. It turns out that this is the tip of the iceberg during the Fin-Syn era (see Exhibit V-1).

There can be no doubt that the independents who rose during the period of Fin-Syn shattered the "Ozzie and Harriet" image of America, the image of a lily white, suburban America, where father's worked and knew best and mothers prepared meals. There is a stunning list of independently produced TV shows that reminded the public in prime time and before huge audiences that America was black, white and brown; male and female; married, divorced, widowed, or abandoned; more urban than rural, more working class than not; where single moms of both races worked in interesting and sometimes dangerous occupations while raising families on their own, and older Americans were more than just grandparents fawning over grand kids, but lived real lives with human appetites and frailties. While the most frequently cited examples, *All in the Family* and *The Cosby Show* appear on the list and they are the most spectacular in their success and their spin-offs, it is the breadth of independently produced shows that should get attention too. Over two dozen shows from almost a dozen different producers broadened and enriched television with different images and issues during the period of Fin-Syn. These shows won over half the Emmys for Best Comedy or Best Drama series in the twenty year period that Fin-Syn was firmly in place.

Thus, while it may be a bit of an exaggeration to say that most of the groundbreaking, socially relevant diversity in the history of television was brought to the TV screen by independents who owed their opportunity to the implementation of Fin Syn, the list of shows in Exhibit VI-1 demonstrates that it is not much of an exaggeration. And, this is not a comprehensive list of successful independent shows, just a list of those that seem to have made a unique contribution to diversity. Indeed, the exhibit emphasizes the possibility of

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[76] Waterman, p. 30; Peltier, Stephanie, "Mergers and Acquisitions in the Media Industries: Were Failures Predictable," *Journal of Media Economics,* 17(4), 2004.

Exhibit VI-1:
Leading Independent TV Series Contributing to Content Diversity during the Full Implementation of the Financial and Syndication Rules

Series	Start	1st Year in Top 30	Last Year	Number of Years In 1st Run	Number of Years In Top 30
Mary Tyler Moore	1970	1970	1977	8	6
All in the Family	1971	1971	1983	12	11
Sanford and Sons	1972	1972	1977	6	6
The Waltons	1972	1972	1981	10	6
Maude	1972	1972	1978	7	4
Good Times	1973	1973	1979	7	4
Streets of San Fran.	1972	1973	1977	6	3
Chico & the Man	1974	1974	1978	5	2
Rhoda	1974	1974	1978	5	3
Jeffersons	1975	1975	1985	11	8
One Day at a Time	1975	1975	1982	10	8
Welcome Back Kotter	1975	1975	1979	5	3
Barney Mill	1975	1978	1982	8	4
Tony Randall Show	1976	1976	1978	3	1
Lou Grant	1977	1978	1982	6	2
Benson	1979	1979	1986	7	1
Hill Street Blues	1981	1981	1987	8	3
Kate & Allie	1984	1984	1989	6	4
Cagney and Lacy	1982	1983	1988	6	2
Cosby show	1984	1984	1993	10	10
Golden Girls	1985	2985	1992	8	7
Moonlighting	1985	1985	1989	5	3
A Different World	1987	1987	1993	7	5
Roseanne	1988	1988	1997	10	7
Seinfeld	1990	1992	1998	9	7

Source: shows from William M. Kunz, *Culture Conglomerates* (New York, Rowman and Littlefield, 2007), chapter 5. Prime Time rankings from Tim Brooks and Earle Marcsh, *The Complete Directory to Prime Time Network and Cable TV Shows: 1946-Present* (New York: Ballantine Books, 2003), Appendices 2 and 3.

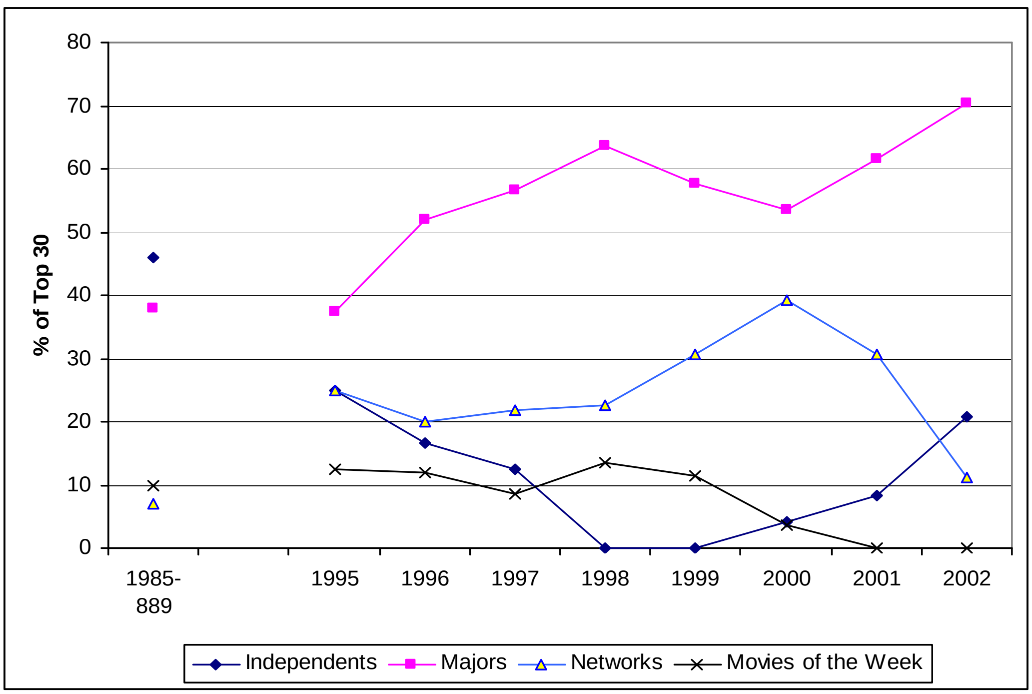
succeeding commercially while contributing to diversity. The exhibit demonstrates that these shows that dealt with important social issues were not only critically acclaimed, but also successful. Many had long runs with long periods in the top thirty rated shows.

Quality

The quantitative analysis of the quality of television is quite complex. Independents were virtually eliminated from prime time and have little opportunity to bring new product to that space, so before and after comparisons tell us little, other than the fact that they were excluded. Moreover, there is no box office to count. The essential point here is that given the opportunity to appear in the exhibition space, independents held their own.

Exhibit VI-2 compares the source origin of the top thirty shows for two periods: 1985-1989, which is the base period I have been using for the Fin-Syn era, and 1995 to 2002 for the post Fin-Syn period. Ratings are the closest equivalent to theatrical Box Office. I have included all, non-news shows that appeared in the top 30. I have used the same coding approach as in the earlier analysis of all shows on TV. That is, where a major studio is listed

Exhibit VI-2:
Producers of Top 30-Rated TV Shows.



Source: Tim Brooks and Earle Marsh, *The Complete Directory to Prime Time Network and Cable TV Shows: 1946 – Present,* (New York: Ballantine, 2003), Appendix 3; Beta Study System database.

in a co-production, it is considered the producer. Where the producer uses both the name of a network and a major studio, it is counted as the major. The details of the counts might change somewhat with a different approach, but the basic patterns would be clear.

Prior to the repeal of Fin-Sin, independents and major studios dominated the top show. The networks did not even pull their weight. They were somewhat underrepresented in these ratings. After the repeal of Fin-Sin, the vertically integrated oligopoly completely dominates the space. There are very few independents and no non-integrated majors in the top 30 shows. When the independents do return to the top 30 in the early 2000s, it is with reality shows, not scripted entertainments.

I have included the category of Movies of the Week, although I do not have the producers for the actual movies for two reasons. First, as we have seen, in the broader market share analysis, these were almost always independents and majors prior to the repeal of Fin-Sin; afterwards, they almost entirely had vertically integrated majors as producers. Second, the nature of prime time movies changed. Movies of the Week were big events with large budgets and appeared in the top 30 shows consistently, accounting for about 10 percent of the total, until the end of the 1990s. They then drop quickly out of sight. This was the period of the expansion of Basic cable movies.

The pattern of popularity helps to provide background for the analysis of awards – the Emmys. There are a very large number of categories across many different types of shows. The categories also change over time. A separate category for Made for TV Movies was not added until the 1990s, so there is no baseline. For the purposes of this analysis, I focus on the Emmys for Best Comedy and Drama. These are series of scripted shows that most parallel movies and were available to independents for which awards were consistently given.

Over the course of the 1980s there were 20 such awards given for each genre (see Exhibit VI-3). The distribution of the awards reflects the market share of the different types of producers closely. The point here is that if these awards represent an independent measure of quality, the independents held their own. The vertical restriction did not cause “inferior” products to be aired. With the repeal of Fin-Syn, independents were banished from these two categories of television entertainment and they disappear from the awards. As I have noted, their presence in prime time is largely restricted to reality shows. The pattern of awards is similar to the other data we have seen in that as Fin-Syn was under attack in the early 1990s the independents decline, then they are eliminated after repeal.

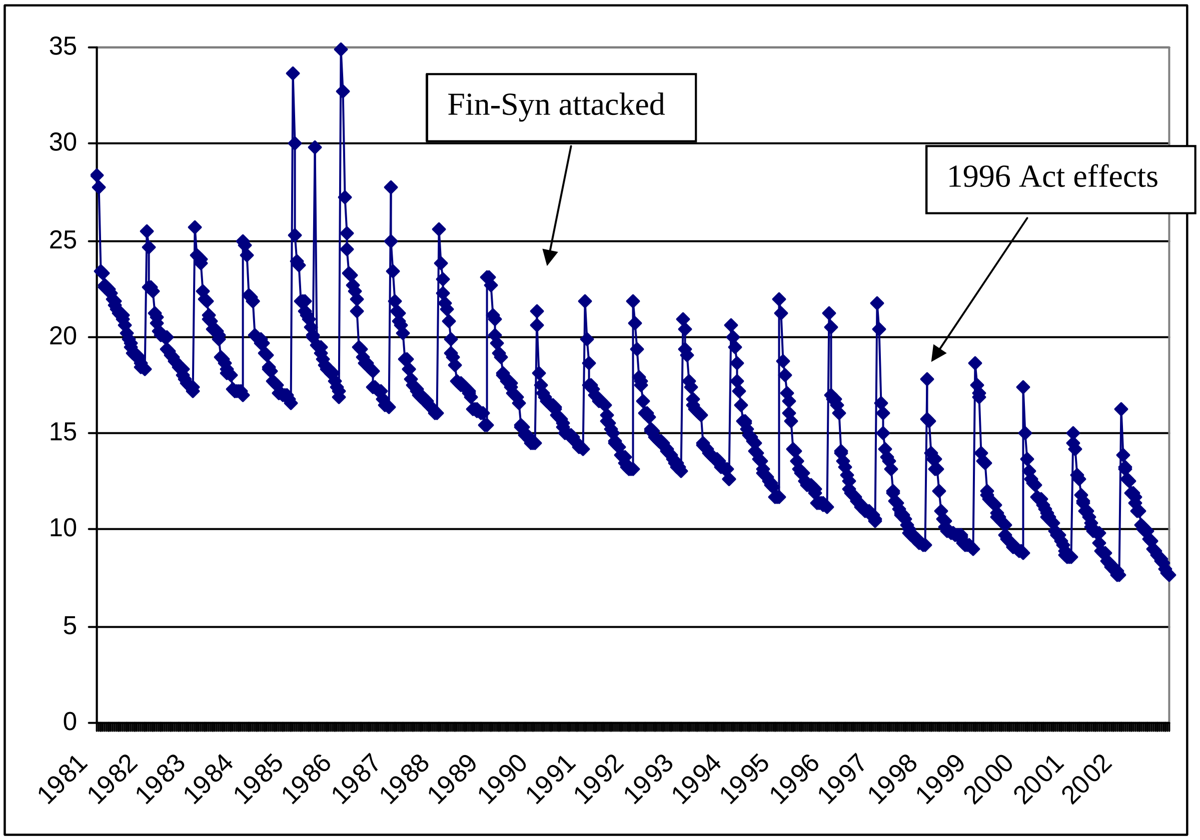
The debate over the impact of vertical integration on quality is difficult to resolve, as many factors were affecting the industry. Still, the pattern of declining ratings observed over a twenty year period is consistent with the claim that self-dealing had an impact (see Exhibit VI-4). The Exhibit shows the average rating of the top 30 shows for each year. There are two

Exhibit VI-3:
Emmys for Best Comedy and Drama

Producer	**80-84**	**85-89**	**90-94**	**95-99**	**00-04**
Independents	70	40	20	0	0
Networks	20	40	50	100	60
Majors	10	20	30	0	40

Source: Tim Brooks and Earle Marsh, *The Complete Directory to Prime Time Network and Cable TV Shows: 1946 – Present,* (New York: Ballantine, 2003), Appendix 3; Beta Study System database.

Exhibit VI-4: Declining Ratings of the Top 30 TV Shows



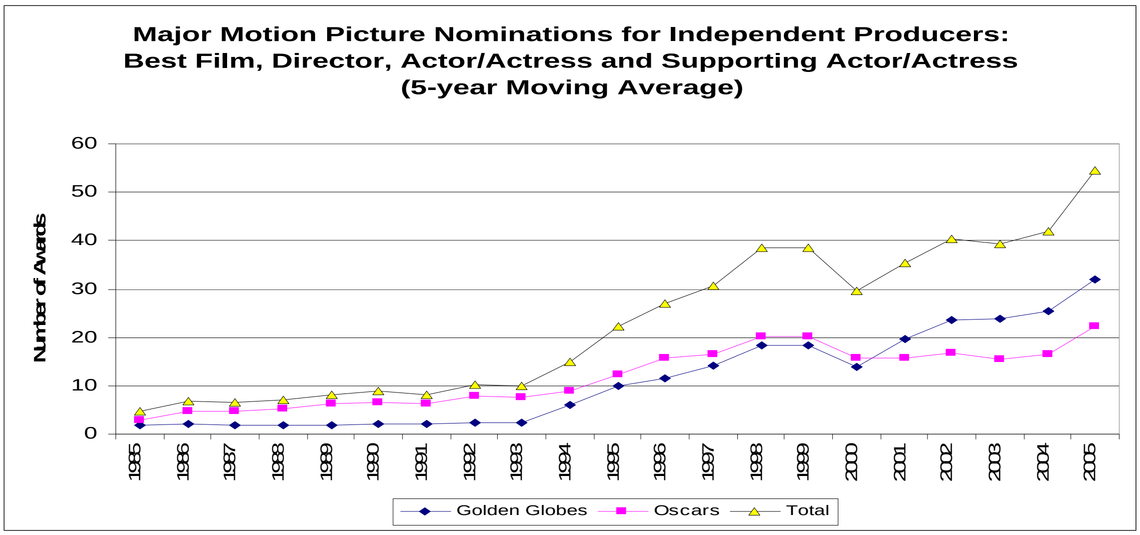
Source: Tim Brooks and Earle Marsh, *The Complete Directory to Prime Time Network and Cable TV Shows: 1946 – Present,* (New York: Ballantine, 2003), Appendix 3; Beta Study System database.

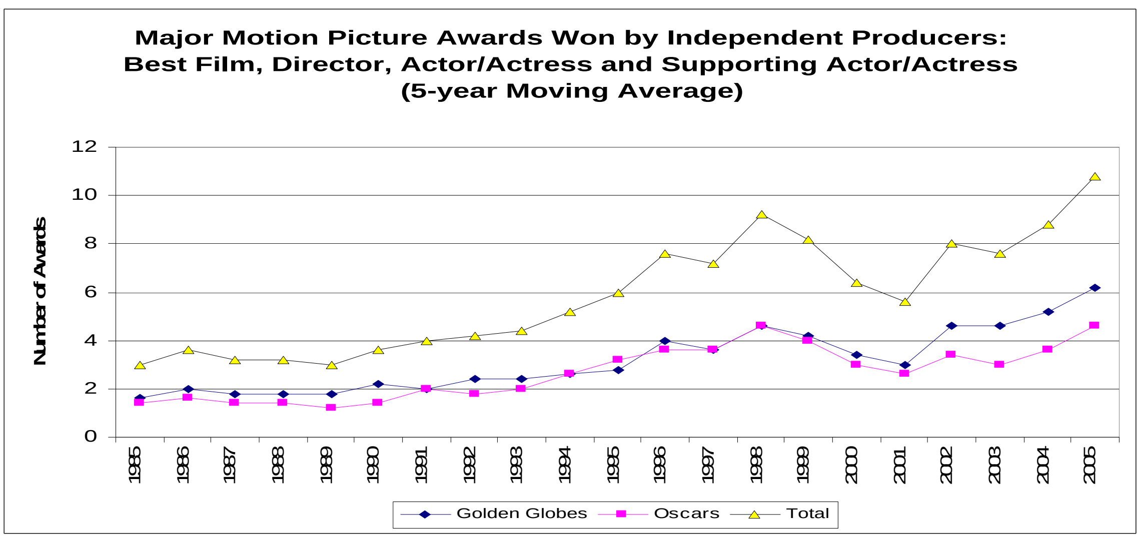
shifts downward – one in the early 1990s, as the Fin-Syn rules came under attack; one in the late 1990s, early 2000s, as the integration of major studios took place. The correlation with the changing pattern of program acquisition discussed earlier is clear. While the quantitative and qualitative evidence on quality cannot prove that vertical integration was the culprit in the decline of quality, it makes a strong case that the elimination of independents cannot be blamed on their inability to produce high quality and popular content.

Movies

Objective measures of quality in product in the entertainment space are notoriously difficult to come by. In the movie space, analysts frequently turn to the annual awards ceremonies. The elimination of independent movie producers from TV space also defies the "quality" claims for vertical integration, however. The Oscars and Golden Globe Awards contradict the claim that independents suffered some sort of collapse in the 1990s. In fact, their share of awards has been constant, if not rising (see Exhibits VI-5 and VI-6).

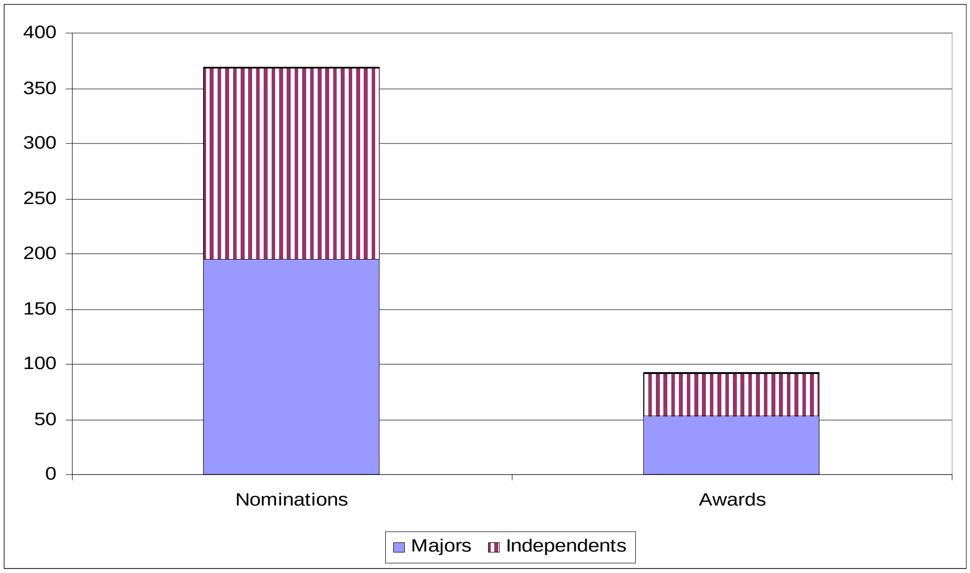
Exhibit VI-5:
Major Categories, Golden Globes and Oscars: Majors v. Independents





Source: Box Office Mojo.com

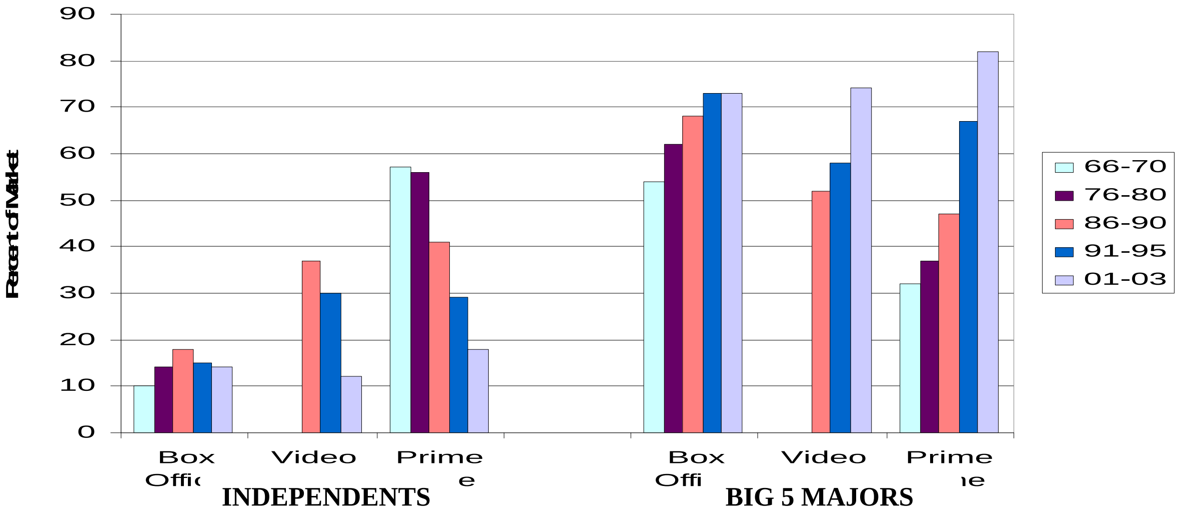
Exhibit VI-6:
Oscar Nominations and Awards 2001-2005:
Majors v. Independents



Source: Box Officemojo.com

Arguably, a second measure of quality is success. For movies, box office is the predominant measure, although success at the box office reflects many things beyond simple quality, such as the advertising budget. For comparative purposes across time and distribution channels, the market shares in Exhibits VI-7 make a simple point. Independents held their market share in the Box Office much better than they did in the other distribution channels, where vertical leverage was most directly exercised.

Exhibit VI-7:
The Shares of Independent Producers in Box Office, Video Revenue and Prime Time Hours Late 1960s to Early 2000s



Sources: Box Office and Video Revenue are five year averages from David Waterman, *Hollywood's Road to Riches* (Cambridge: Harvard University Press, 2005), pp. 21, 25, 86-90 and 01-03. Big Five Majors are the studios that have been acquired by major TV programmers – Disney/ABC; Fox/20th Century Fox; NBC/Universal; Warner Bros.; CBS/paramount. Other majors (not shown) are MGM/UA and Columbia. Independents are what Waterman calls "the residual." Prime Time is percent of hours in 1989, and 2002 from Mara Einstein, *Program diversity and the Program Selection Process on Broadcast Network Television* (Washington D.C.: Federal Communications Commission, September 2003), pp. 26. First-run syndication is from C. Puresell and C. Ross, "Vertical Integration and Syndication," *Electronic Media,* 22(1): 2003, for 1993 and 2002. It includes only vertical integration and not internal dealing among the big 5.

VII. CONCLUSION:

This paper has shown that the policies adopted by the FCC and Congress in the 1990s lead to a dramatic decline in source diversity on broadcast television. In the early and mid 1990s, the Broadcast networks were given three huge advantages in the television video product space. First, the Financial Interest and Syndication Rules were attacked and repealed (1990-1995). Second, they were given carriage rights on cable networks (1992). Finally, they were allowed to own multiple stations in a single market (1996). They used this leverage to extend their control over the video content product space vertically – by merging with studios – and horizontally – by self-supplying content in broadcast prime time and expanding distribution on cable.

A tight, vertically integrated oligopoly now dominates the broadcast, cable and theatrical space in America. Promises that the prime time would not become dominated by the networks and theories that claimed competition would not let it happen have proven wrong. Hopes that expanding competition from cable with its expanding capacity have been dashed as the incumbent broadcaster networks extended their reach over cable's viewers by demanding carriage and extending their brands and control into the new space.

While the purpose of this paper is to document what happened and why, it is clear that if policymakers still believe in source diversity, then a change in policy to promote it would be in order. Previous technological changes have not been able to deconcentrate the product space. It has taken policy changes to break the stranglehold on distribution. Whether it was theaters in the 1940s or broadcasters in the 1970s, gate keeping is a powerful force in the industry that appears to be unstoppable, except by clear public policies.

While the history of the video entertainment product space is clear, as is the basis for adopting policies that promote source diversity, there is no doubt that policymakers who contemplate adopting such policies will be bombarded with claims that, even though the policies that affect the traditional video distribution channels have been disastrous, we need not be concerned because 'the Internet changes everything.'

This claim should be viewed with a great deal of skepticism. In fact, the more likely question that policy makers in this area should ask is "Does the Internet change anything?"

Because of the high cost of producing movies and other video content, the aggregation of audiences remains a critical function. With such a powerful hold on all forms of video distribution, it will be extremely difficult to dislodge the dominant players. They are the brands and continue to create the brands in the premium, large audience outlets.

The best assessment at present is "only a few small experiments in altering the movie-release paradigm have been conducted to date."[77] While the role of the Internet is currently unclear, one thing is certain. It is another distribution platform that the vertically integrated conglomerates are moving to dominate. Whether it will be able to de-concentrate the video

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[77] Thompson, Anne, "Independent Producers and Distributors," *Hollywood Reporter*, August 1, 2006, p. 1.

exhibition space described in this paper remains a subject to debate. However, without sufficient regulation that provides equal access to all, the internet will fall subject to the same fate as, first broadcast television, then premium cable television, and finally basic cable television: domination by the vertically integrated oligopoly created by the regulatory changes of the last decade.

As we have seen, in a world with limited shelf space, placement is everything. If you cannot get on the shelf, the audience cannot find you. In a world of infinite shelf space, placement is *still* everything. When there is such a cacophony of outlets, the audience cannot find you unless you have prominent placement. Whether it is simultaneous release on multiple platforms or digital distribution, the key challenge remains "finding a way to brand a movie. In the end, says producer Jim Stark, "Nothing beats five weeks in a theater."[78]

One need only review the critique of the launches of new Internet-based distribution platforms to see the problem in clear relief. The central questions are: what do their libraries look like? What are the majors doing with respect to the platform? If the major are not there, the platform is deemed to have dim prospects. When the majors and networks are there, they tend to get the best placement and the best deals. Little has changed. The reporting on the announcement of Apple's "video streaming gadget code-named ITV."[79]

> Apple's competition included the movie studios themselves plus many other ambitious firms such as Amazon, which recently unveiled its Unbox download service.
>
> TV shows are also starting to turn up the online service for Microsoft's Xbox…
>
> Apple pre-announced its ITV box in a bid to convince potential partners that its ambitions are serious… it hoped to build "momentum" and get movie makers and broadcasters talking about putting content on the Apple service. For example, Amazon's Unbox offers movie downloads from 20th Century Fox, Paramount, Sony, Universal and Warner Bros. So far, only Disney movies are available from Apple.[80]

The quote from Les Moonves of CBS above, which touted the advantages that broadcasters have, was actually given in response to claims that the Internet was displacing the networks. Responding to the claim that broadcast share would shrink, "Mr. Moonves doesn't see it that way. "If you want 30 million people, you can't get that anywhere else." Mr. Moonves said. "Television will hold and the Internet will augment what we do."[81]

Dana Walden of 20th Century Fox TV echoes this view. "In the digital space, the extensions seem to come after the fact. We're trying to create brands on the (broadcast) networks that are enhanced by digital opportunities."[82]

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[78] Thompson, p. 1.
[79] Ward, Mark, "Apple Video Divides Industry," *BBC News, September 13, 2006,* p. 1.
[80] Ward, p. 2.
[81] Fabrikant and Carter, p. C11.
[82] "A TV Navigation Guide," *Hollywood Reporter,* September 13, 2006, p. 2.

While the potential and prospects are unclear, the reaction to a new technology is predictable and the studios/networks will seek to extend their gatekeeper function. Already, as one recent article observed, "studio business affairs executives now were insisting that this exclusivity include the Internet as well."[83]

Thus, the Internet has not done much to break the grip of the vertically integrated oligopoly on the video revenue streams in the video entertainment product space. As the independent producers emphasized in the interviews, these firms control the TV outlets and syndication, have the output deals for domestic and foreign theatrical releases, and have a huge advantage in foreign TV deals. They control the branding process with their access to audiences that is being leveraged into dominance of commercial distribution on the Internet.

Claims and hopes that a new distribution platform – broadband Internet – have eliminated the concerns about media concentration are just that, claims and hopes, not reality. Similar claims were made for cable, but in the end a handful of companies dominated the new broadcast-cable space, accounting for approximately four fifths of the views, and revenues of the sector. Television usage still dominates the commercial mass media – taking far more of the public's time and attention than alternatives. The dominant firms in the vertically integrated video oligopoly are transitioning their product to the new distribution platform. Business models that will support a vibrant, independent video production sector on the Internet – one that can match the remarkable success and creativity of the sector that existed under the policies that promoted source diversity in the 1970s and 1980s – are nowhere to be found.

If policymakers value source diversity, which they should, structural restraints on the market power of the vertically integrated companies will have to be imposed. These structural restraints will have to apply to both the broadcast and cable distribution channels because public policy created the leverage that broadcasters have used to dominate the cable distribution platform. The restraints should also apply to the Internet and all other developing distribution technologies.

[83] Hlestand, Jesse, "Profit Anticipation," *Hollywood Reporter*, June 6, 2006, p. 1.