



September 27th, 2006

Ms. Diane Rhéaume
Secretary General
CRTC
Ottawa, ON
K1A 0N2

Dear Ms. Rhéaume:

Re: *Broadcasting Notice of Public Hearing CRTC 2006-5:
Regulatory Framework for Over-The-Air (OTA) Television*

1. *Summary:* Broadcast regulation is a system of rules that facilitates markets, and ensures that licensees contribute towards the goals of the *Broadcasting Act*. As the profitability of specialty services has surpassed that of over the air broadcasters, the Commission needs to address the financial viability of OTA broadcasting going forward. In this submission, Friends addresses advertising regulations, OTA subscriber fees, a new funding mechanism for public broadcasting which could strengthen private OTA broadcasting, out-of-market tuning, time shifting, the exhibition of Canadian programming, local programming, the benefits policy and HD issues.
2. Friends of Canadian Broadcasting wishes to appear at the public hearing in order to present a viewers' and listeners' perspective on the future regulatory framework for OTA television. Friends is a watchdog group for Canadian content in English-language radio and television, and is supported by 100,000 Canadians.
3. One of the five principles cited by the Commission in the notice is to "require regulation only where the goals of the *Broadcasting Act*

cannot be met by other means". Regulation is by no means a 'necessary evil'. Rather it is system of rules that facilitates markets. In the Canadian broadcasting system, regulation provides a set of rules by which each of the licensed participants understands what is expected of them. It also ensures that each makes a contribution towards the Act's goals according to their respective means.

4. Needless to say, OTA broadcasters must be financially healthy in order to make these contributions, and to respond to viewers' expectations, as recommended in this submission. Friends' advice begins with comments regarding the options before the Commission which relate to ensuring the future financial viability of the OTA system.
5. As noted in Friends' response to PN CRTC 2006-72: *Future Environment Facing the Canadian Broadcasting System*, audience fragmentation is an ongoing challenge to the system because it reduces audiences, and therefore revenues generated from advertising sales. This applies in spades to the OTA system. Fragmentation takes a variety of forms; not just the addition of new services, but also time-shifted viewing: audiences which cannot be monetized by OTA broadcasters. Increasingly, unregulated sources of content such as the Internet, and various wireless devices including phones and personal digital assistants (PDAs) are competing directly with OTA television for viewer attention.
6. While television constitutes the largest component of media advertising, the consolidated data obscure the challenges OTA broadcasters face including a continuing and substantial shift in ad spending towards non-traditional media, principally the Internet. The profitability of specialty channels has overtaken OTA profits, and this trend is likely to continue. Another financial challenge facing OTA television is the continuing decrease in the value of programming rights, as many programs are now available on multiple platforms which hitherto did not exist.
7. The Commission has asked for input on a number of possible mechanisms which might impact the long term viability of OTA television. Friends' comments follow.
8. *Advertising regulations*: Irrespective of regulation, advertising limits have a built-in maximum based upon audience response.

For example, most US network programming does not exceed 16 minutes per hour of advertising content. Friends also notes the traditional antipathy of advertisers to overexposure, which dilutes the quality of the advertising experience. The 33% gap between the effective US maximum and Canadian regulations plays an important role in Canadian interstitial programming, public service announcements and promotional materials that serve to distinguish and enhance the Canadian viewing experience.

9. Further, while viewers might tolerate additional advertising, Friends considers that relaxing the current limit would have the unintended result of favouring the larger television groups over their smaller competitors. As some broadcasters have noted, television is a demand medium. Demand is highest for the most popular shows. Accordingly, broadcasters with fewer top-ranked programs will likely be disadvantaged in a more-ads environment. Any increase in advertising inventory would accrue disproportionately to the larger groups while reducing the ad revenue available to the smaller groups.
10. Nor would increasing allowable advertising time guarantee that more ad revenues would flow to OTA television. Instead, existing revenues would likely be redistributed away from the smaller groups. For these reasons, Friends opposes any relaxation of the current ad limits.
11. As the Commission has stated in the Notice, there are many other forms of advertising which are much more difficult to regulate, including product placement, virtual advertising and background advertising such as rink boards. Friends notes an enormous inequity in the fact that US prime time shows with significant product placement air in Canada without consequence while smaller specialty Canadian programs (e.g., fishing and boating shows), which are expected to exist on the revenues of a weekend afternoon placement, are subject to frame-by-frame scrutiny by the Commission.
12. Friends recommends that the Commission deregulate advertising content that is not in the form of 15, 30 or 60 second spots. This would enhance creativity without a significant impact on the existing balance between broadcast groups. As well, Friends considers that monitoring this kind of 'grey' commercial activity is a less than optimal use of valuable CRTC staff time.

13. *Subscriber Fees for OTA signals:* The original business model for specialty services in Canada was based largely on subscription revenues. Conventional wisdom at that time concluded that specialties would attract only small niche audiences, and that those who were interested in a given service would be prepared to pay for it. Today, while subscription fees still constitute 64% of pay and specialty revenues, traditional advertising, at 35%, accounts for almost all the balance. This ad growth demonstrates the value to advertisers of narrowly focused specialty audiences. Specialty channel ad growth has also increased because the fee subsidy has allowed specialty channels to sell advertising inventory that is often significantly discounted in comparison with OTA rates.
14. According to CRTC financial data, private OTA broadcasters had a profit before income tax (PBIT) margin of 11% and a pre-tax margin of almost 4% in 2005, while the pay and specialty sector produced a PBIT margin of 25% and a pre-tax margin of 24% during the same year. Pay and specialty services have greatly expanded the diversity of offerings in the Canadian broadcasting system. Their expenditures on the production and presentation of Canadian programming have averaged 36% of total revenues over the past five years. Clearly, subscription fees enabled this commendable record.
15. The financial model for OTA television, on the other hand, has relied on basic carriage drawing substantial audiences, and advertising revenues. Over time, this model is losing its viability—to the point where OTA television profitability will no longer be sustainable at levels of financial return acceptable to shareholders. And this trend puts at risk the future contribution of OTA stations to local and regional news, as well as other valuable Canadian programming. Therefore, in principle, OTA television should be permitted equitable access to subscriber fees.
16. If this Commission agrees with this conclusion, legitimate concerns arise about the impact of any such decision on the pocketbooks of television subscribers. Friends can recall no specialty applicant arriving before the Commission without copious research proving viewers' willingness to pay for its proposed service. The Commission has correctly considered such findings with appropriate skepticism. The Commission should not consider the existing and historical subscriber fee structure for analog specialty channels to be sacrosanct. The public interest would be

well served by a mechanism to ensure value for money in the system through a re-apportionment to other priority needs based on financial performance data.

17. *Subscriber Fees for Improved Services:* The greatest amount of incremental fragmentation results from the introduction of digital television separate and distinct from High Definition (HD) television. Therefore, it would be appropriate for OTA broadcasters to obtain subscription revenues based on the total number of digital subscribers. Canadian Digital Television estimates that two million HD capable television sets have been sold in Canada, whereas only 400,000 HD set-top boxes have thus far been deployed. This appears to be too small an audience base to create a viable subscription revenue model.
18. One priority for subscription fees might be enhanced local services by OTA broadcasters. Friends recommends that any subscription fees for local stations should be levied only upon digital customers. Analog customers, especially lower income customers purchasing basic services, should not be required to bear any additional fee increases.
19. Last month, the Commission published a study by Canadian Media Research Inc. entitled "How Many Canadians Subscribe to Cable TV or Satellite TV?" Using its findings in conjunction with data from the Commission's Broadcast Distribution Undertaking (BDU) financial database for 2005, it is estimated that the total number of basic subscribers is in the range of ten million households. The following chart details basic cable and DTH subscribers as well as revenues generated from basic and non-basic carriage, net of Internet, installation fees, digital box rentals or sales:

Basic Cable and DTH Subscribers and Revenue		
Cable Subscribers		%
Cable Direct Subscribers	6,242,244	
Cable Indirect Subscribers	375,134	
Total Cable Subscribers	6,617,378	72.7%
DTH Subscribers		
Direct Subscribers	2,464,783	
Indirect Subscribers	21,589	
Total DTH Subscribers	2,486,372	27.3%
Total Cable and DTH Subscribers	9,103,750	100.0%
Revenue		
Cable Basic Direct Subscription	1,706,548,888	
Cable Basic Indirect subscription	105,204,396	
Cable Non Basic	1,393,379,398	
Total Cable Revenue	\$3,205,132,682	69.1%
Revenue		
DTH Basic Direct Subscription	494,114,667	
DTH Basic Indirect subscription	10,715,291	
DTH Non Basic Revenue	931,379,584	
Total DTH Revenue	\$1,436,209,542	30.9%
Total Cable and DTH Revenue	\$4,641,342,224	
Average annual cable revenue per subscriber	\$484.35	
Average monthly cable revenue per subscriber	\$40.36	
Average annual DTH revenue per subscriber	\$577.63	
Average monthly DTH revenue per subscriber	\$48.14	

Source: CRTC Class 1 BDU Financial Database 2005

20. While the average cable bill for all customers is \$40, the average DTH invoice is \$48, possibly because the cable average includes both basic and digital customers whereas all DTH customers are digital. This provides a means of estimating the cost of additional fees. Friends suggests that an increase of 10% phased in over two years might be an acceptable threshold. This would raise approximately an additional \$278 million to finance local programming or other system priorities. This calculation is derived from the following chart:

Summary Of Key Company Digital Subscribers				
Company	Period Ending	Total Subs	Digital Subs	Dig. %
Cable				
Rogers	30-Jun-06	2,253,800	1,002,200	44%
Shaw	31-May-06	2,181,476	660,107	30%
Videotron	30-Jun-06	1,521,000	545,400	36%
Cogeco Ontario	31-May-06	588,397	209,871	36%
Cogeco Quebec	31-May-06	244,095	106,930	44%
Sub-total cable		6,788,768	2,524,508	37%
DTH				
Bell ExpressVu	30-Jun-06	1,758,000	1,758,000	
Star Choice	31-May-06	865,987	865,987	100%
Sub-total DTH		2,623,987	2,623,987	100%
Total Subscribers		9,412,755	5,148,495	55%

21. In order to scope what a 10% increase would yield at the end of the second year, Friends has used an estimated average monthly digital subscriber fee of \$45. A 10% increase in monthly fee would equal \$4.50 for a total of \$49.50 based on total digital subscribers of 5,148,495 (as detailed above). Annual subscription revenues would generate something in the range of \$278 million per annum. As more digital subscribers came on board, this amount would continue to increase. As overall digital cable penetration is only 37%, there is the potential for substantial growth.
22. *Other Criteria for a Subscription Fee:* Friends believes that a subscription fee should be considered only for services that are eligible under BDU regulations for local carriage and are providing local and/or regional programming. The number of subscribers, again as noted above, should be based on digital subscribers.
23. An alternative scenario would be to allocate a subscriber fee to the Canadian Broadcasting Corporation (CBC) in return for the CBC reducing or eliminating its draw on ad revenues, thereby benefiting the private sector OTA broadcasters. In principle, Friends would support this initiative. Although CBC is substantially subsidized by general revenues, it currently relies on ad revenue to the tune of approximately \$300 million annually.
24. This reliance has the undesirable effect of pushing CBC in the direction of programs with commercial appeal which stray from its public service mandate under the Act. At the very least, CBC's schedule is skewed towards professional sports as a result of this dependency. Another example might be the recent disastrous decision to air *The One*, an American reality show, bumping its flagship *The National* in Ontario and Quebec during this summer's

Middle East crisis, until that show was pulled by ABC because of its tanking ratings in the US market.

25. *Calculation of a Subscription Fee:* As noted above, the fee would be collected from digital subscribers, maintaining an analog status quo. This is consonant with the impact of digital conversion on the OTA television business model. The Commission should make sure that such a fee is not subject to any further pass-through charges from BDUs, which would incur no incremental costs, and which have free access to these OTA signals.
26. *The Apparent Failure to Monetize Out-of-Market Tuning:* Lacking first-hand experience in selling television time, Friends has been persuaded by a variety of credible sources that out-of-market tuning is indeed a serious issue for OTA broadcasters because it expands viewing options for the same program, either through carriage on more than one station within the same time zone, or by availabilities from other zones. The primary reason for the inability to monetize out-of-market tuning is that BBM and Nielsen Media Research do not count out-of-market tuning as part of total tuning, except in the case of some network programming. Accordingly, time-shifted viewing is essentially lost to the system.
27. Time shifting also brings out-of-market US signals into play. As most program rights are controlled nationally, much of the fragmentation resulting from time-shifted signals is from the broadcasters' own out-of-market stations. US time-shifted signals also introduce yet another viewing option, and for the most part out-of-market stations can only be covered off in the same time zone when the program airing time and episode are identical.
28. While a Canadian OTA broadcaster can request simultaneous substitution on the local US signal, audiences watching that signal in a different time zone are lost entirely to the Canadian system. While simultaneous substitution has in the past served the useful purpose of protecting broadcasting rights, the advent of out-of-market signals through cable and DTH makes a new approach necessary. At a minimum, Friends considers that the Commission should allow for the concurrent substitution of a local market signal in the same time zone. As well, we believe that the time has come to revisit the notion of non-simultaneous substitution in order to protect program rights effectively.

29. Friends' advice comes from the perspective that broadcasters cannot make the meaningful contributions, which we insist they should make, unless they enjoy a sound financial footing. Clearly, out-of-market and time-shifted signals are a threat to OTA broadcasters' financial capacity.
30. *Exhibition of Canadian Programming*: Friends is greatly concerned that the Commission has, as yet, not published individual station group data regarding spending on Canadian programming, as it did in the lead-up to the 1998 television policy process. This publication is essential so that the contributions made by each of the station groups can be separately considered.
31. Similarly, the aggregation of English- and French-language Canadian program spending data obscure the situation of each language group's behaviour, although the Commission has addressed this by disaggregating those data in the Notice.
32. Withholding the data which the Commission possesses on individual station group spending makes it impossible for outside observers to determine the real impact of the Commission's 1999 Television Policy, especially on individual programming categories. There is no justifiable public policy reason for withholding these data.
33. Friends' principal concern in this policy review is to ensure that the production of high quality Canadian programming, especially drama, as well as regional and local programming, is not compromised going forward.
34. Since the introduction of the 1999 Television Policy, notable successes in programming have included *Corner Gas* and *Canadian Idol*. However, Friends considers that most of the public policy credit for these successes derives from the public benefits policy, rather than the Television Policy.
35. For example, in 2000, benefits spending on all categories was \$744,000 (0.15% of total Canadian program spending). In 2005, benefits spending increased to \$15,520,266 (2.6% of total Canadian program spending). In the case of drama, 2000 benefits spending was \$91,218, and increased to \$2,629,864 by 2005. News benefits spending increased from zero in 2000 to \$7,079,021 in 2005.

36. Maintaining the current levels of Canadian program spending after the end of the current round of benefits is a pressing concern.
37. Friends believes that the implementation of both time and advertising credits related to the production of Canada drama have been useful initiatives and should be continued.
38. Owing to the correlation between spending and quality, Friends recommends that public policy be designed to ensure that all parties contribute in a fair and equitable manner to the system. The Commission should reinstate its previous policy of requiring a percentage of revenue to be spent on the production of Canadian programming, with a specific percentage of revenue dedicated to Category 7 programming.
39. Friends recommends that overall spending on Canadian programming be required at a minimum level of 30% of revenue and that the specific expenditure on Category 7 programming should, at a minimum, exceed 5%.
40. Friends also proposes that the Priority Programming regime be amended to require that four of the eight weekly hours must be broadcast in the 15 hours of peak prime time, from 8:00 to 11:00 pm, Monday to Friday.
41. *Local and Regional Programming:* Local reflection is a key, and threatened, value in the Canadian broadcasting system. Accordingly, for OTA broadcasters, the production of local programming has always been necessary in order to access local advertising. As Friends has documented in previous submissions, the production of local programming has lost ground in recent years, and in most centres is now confined largely to news programs. Friends also detects a tendency on the part of OTA broadcasters (certainly including CBC English Television) to move away from local news programming towards more regional news programming.
42. Friends therefore recommends that the Commission reintroduce the specific requirement that OTA broadcasters provide local news and also that cable companies providing local and community news coverage be eligible to access local advertising adjacent to their new programming on condition that 80% of the new-found revenues be invested incrementally in local news programs.

43. *Transfer of Ownership Benefits*: Public benefits spending has materially improved the quantity and quality of Canadian program production. In recent years, the success of such shows as *Corner Gas*, *Canadian Idol*, *Degrassi*, *Global National* and the new (and improved) *Juno Awards* has resulted from the Commission's benefits policy. As the Notice states, benefits spending is not ongoing. This means that much of these gains could subsequently fall by the wayside.
44. In the BCE/CTV decision, the Commission permitted CTV to control the vast majority of its proposed \$293 million benefits package, as opposed to requiring that the money be placed in a fund accessible to all parties. For the most part, this experiment has been a great success, enabling the applicant to develop, green light and promote numerous projects.
45. However, it is clear to Friends that granting CTV the capacity to control spending on such a scale conferred on one player an unfair advantage over its principal competitors. For context, the amount of money in question is on the scale of three years of federal government contributions to the Canadian Television Fund. On balance, Friends suggests that the public interest, and a level playing field among business competitors would be better served by funnelling benefits monies into a fund accessible to all licensees.
46. In the Notice, the Commission quoted from one of the key principles the 1999 Television Policy as follows: "the expectation that applicants in transfers of ownership or control will propose tangible benefits of at least 10% of the value of the transaction" (emphasis added). Notwithstanding this statement, Friends notes that in the case of the recent sale of BCE's controlling interest in Bell Globemedia, the Commission accepted BGM's submission that benefits should not be payable because no change of control took place. In Friends' view, that decision contradicted the principle quoted above.
47. Friends therefore recommends that the Commission provide clear direction on whether benefits are payable on any transfer, or only on transfers of control. Friends recommends the former. Exceptions should be made for inter-corporate reorganizations which do not result in an effective change of ownership.

48. *High Definition Programming:* In the study by Canadian Media Research commissioned by the Commission and referenced above, the percentage of Canadians receiving television signals over the air has continued to shrink and now approximates 10% on a Canada-wide basis.
49. Evidently, the remaining OTA viewers are not early adopters and will not be leading a charge on the conversion to HD television. The cost of replicating the entire analog OTA system in HD is estimated in the hundreds of millions of dollars, notwithstanding the continuing decline in the cost of HD transmission and production equipment.
50. Friends understands why licensees might be reluctant to invest on this order of magnitude when such a small percentage of the audience continues to rely upon OTA reception, and likely represents a still smaller percentage of aggregate personal income. Yet the Commission has confirmed that 26 OTA digital television licences have been issued in Montreal, Toronto and Vancouver.
51. If having an originating digital transmitter in a market remains the sole criterion for receiving priority carriage and qualifying for simultaneous substitution, then we may expect that digital applications will continue to be submitted, but only in the largest markets where investments in new transmission equipment and towers can be amortized against a large audience base.
52. When technology changes to the extent that it has, it seems appropriate to examine existing rules. Spending hundreds of millions of dollars for the single purpose of meeting existing distribution regulations for local carriage may be considered a poor use of limited resources. Friends wishes to support the notion that monies that would otherwise be available for HD programming should be diverted away from HD transmission equipment and into HD production equipment. Friends supports reform of the Distribution Regulations which would result in locally-licensed stations receiving mandatory carriage without an originating HD transmitter.
53. In the meantime, while we await more Canadian stations developing a HD service, US HD channels are widely available on most Class 1 systems across the country. Friends shares the

concern outlined in the Notice regarding HD viewers moving to foreign signals. As the Commission notes, "it may be difficult to repatriate them, even when Canadian programming is (subsequently) available on HD". To compound this problem, Friends notes that simultaneous substitution is not being performed by BDUs where the Canadian station is airing a HD program of equal technical quality.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Ian Morrison". The signature is written in a cursive, slightly slanted style.

Ian Morrison
Spokesperson

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For information: Jim Thompson 613-567-9592