Canadian content : the bottom line
or
Better (culturally) dead than (financially) red

by Lawson Hunter

Lawson Hunter, director of the combines investigation and research branch of the bureau of competition policy, department of Consumer and Corporate Affairs, has recommended major reductions in pay-TV Canadian content requirements as being preferable to "the drastic step" of permitting a monopoly in Canadian pay-TV.

Hunter's startling presentation was made on the first day of the Canadian Radio-television and Telecommunications Commission (CRTC) hearing July 24 on the amalgamation of the Ontario and Alberta Superchannels by Allarcom Pay Television Ltd. (APT) and the splitting of Canada's national, English-language, general — interest pay-TV networks into Eastern (First Choice) and Western (APT) regional monopolies.

Herewith, major exerpts of Hunter's presentation before the CRTC:

Argument for a Competitive Pay-TV Structure

Issues

1. First Choice and Allarcom propose a monopoly structure which would divide the Canadian pay television market between them and in their view solve the problems currently besetting the pay-TV industry. The Director (i.e., Lawson Hunter) resists in principle the creation of a monopoly structure to resolve industry performance and policy problems. It is quite clear that in any competitive industry, duplication of costs among competitors occurs. However, the elimination of such cost duplication through the formation of industry-wide monopolies has never been accepted in law or by the public as beneficial to the general interest of the nation. Economists are of one voice in declaring that, with rare exception, monopoly industrial structures produce inefficiencies and a resistance to innovation. In the present case, the Director proposes that the CRTC examine alternative approaches which will preserve the advantages of competition while reducing the difficulties now faced by licensees. The present proceeding presents an opportunity to undertake a fundamental review of the Canadian content provisions constituting the primary cause of the performance problems of the pay-TV industry.

The current Canadian content provisions have not achieved the Commission's Canadian programming objectives. As well, they have jeopardized the financial viability of the two licensees in question. Subscriber penetration projections have not been achieved and the Canadian content provisions in the Broadcasting Act may not be sustainable for pay-TV. First Choice and Allarcom have argued that sufficient savings would result from the elimination of expenditures incurred in a competitive environment to place the two licensees on a firm financial footing and hence meet their Canadian content commitments.

However, in the Director's view, the Canadian content and programming expenditure stipulations in the conditions of licence constitute the major single financial burden on the two pay licensees, specifically because :

(i) There is insufficient Canadian drama product (feature film for theatrical release, made-for-pay-TV movies, and TV dramas) to meet the minimum requirements imposed on them by the 30% Canadian content rule and the market needs of a pay-TV channel. In this regard, it is clear that Canadian content cannot consist predominantly of non-drama product ; drama must be available in adequate quantity.

(ii) It appears that the limited inventory of extant Canadian shelf product, coupled with the 30% content rule, has permitted distributors to charge licensing fees well in excess of the fees for comparable or superior non-Canadian product. Examination of the pro forma statements submitted by the applicants to the Commission indicates that the Canadian product to be acquired by First Choice in 1984-85 is expected to cost 272% of the cost per unit of the foreign product acquired by the company.

(iii) The pay-TV licensees are forced into repeating the exhibition of the limited Canadian product at a rate that is considered a substantial contributor to churn. Moreover, evidence of comparatively low audience viewership of Canadian product suggests lower subscriber satisfaction in relation to foreign product and presumably a negative impact on subscriber penetration levels.

(iv) The programming expenditures requirements (45% of total revenues and 60% of total programming expenses) constitute a further financial burden on pay-TV licensees.

(v) Lower programming expenditures could be translated into lower retail prices. A major consumer barrier to subscription and an additional reason for churn is the perceived low value of the $15.95/mo. subscription price.

Furthermore, the Director submits that the Canadian content and expenditure stipulations do not now, nor will they in future, provide sufficient incentives to increase the number of available Canadian productions to a level which will permit licensees to meet the 30% schedule requirements, let alone the 50% content rule to come into effect in 1986. This is so for the following reasons :

(i) The combination of license fees and investment that can be expected to flow to producers from pay-TV licensees does not add up to more than a small percentage of the total production cost of pay-TV drama products.

(ii) The CBC and commercial TV market, boosted by Telefilm investments from the Broadcast Program Fund, are not sufficient complementary markets to trigger the number of new Canadian titles required by the pay-TV licensees under the 30% Canadian content stipulation.

(iii) To meet the 30% Canadian content criterion, pay-TV licensees will have to continue to resort to licensing substantial off-the-shelf product and spread their investment in new productions over many titles.

In view of the preceeding facts, the Director believes that the Commission's Canadian content requirements fail to take account of the production industry's capacity to satisfy pay television's programming requirements. This structural element of the pay-TV industry has a negative impact on the licensees' business, and does not provide the benefits the Commission intended should accrue to the program production industry.

Alternatives

In lieu of resolving the structural problems of the pay television industry in the manner proposed by First Choice and Allarcom, the Director recommends that the Commission consider revising the Canadian content formula for pay-TV in Canada and retain the current competitive structure of the industry. There are three basic approaches which merit consideration in revising the present content formula. These are :

(i) Substantially lower the 30% Canadian content time quota stipulation, perhaps to 15%, while retaining the Canadian programming expenditure commitments.

(ii) Reducing both the content time quota as in (i) above *and* the dollar commitments, for example, to 30% of total revenues and 40% of total expenditures.

(iii) Reducing the content time quota as in (i) above and *removing* the dollar commitments altogether, while imposing a tax on pay-TV operators which would be directed towards increasing the revenue of the Broadcast Production Fund.

Conclusions

1. Eliminating competition between the pay television licensees will not resolve the industry's poor financial position because the creation of a monopoly structure does not address the primary problem. After restructuring, the companies will have no alternative but to approach the Commission to vary the conditions for the reasons enumerated earlier. At that time, the Commission will be dealing with two regional monopolies rather than two competing entities. Consequently, the Commission's leverage to require adherence to its conditions will be substantially reduced. It is the Director's proposal that the system of content obligations must be revised now. The problems arising out of the Canadian content obligations can be addressed and resolved while maintaining the competitive market structure.

2. The reliance on shelf rather than new product, aggravated by a high time-quota rule, appears possibly to have yielded windfall income to those holding the rights to Canadian programming because licensees find themselves in an untenable bargaining position in dealing with those groups. As a result, considerable amounts of money which would have been directed into production in a more efficient manner has been undersirably dissipated.

3. If the Canadian content criteria are revised as proposed, while maintaining the competitive structure of the industry, all of the Director's proposals would have the following advantages :

(i) the *viewer* retains a service alternative which will ensure the availability of quality foreign programs, and quite possibly a more highly differentiated choice once pay-TV licensees are able to spend more for individual Canadian productions ;

(ii) the Canadian *producer/distributor* is able to sell projects to two major buyers, either exclusively or not, as well as being to obtain greater financial participation from each pay-TV licensee. As well, the total number of pay-TV subscribers will be larger as a result of competition, thus contributing more overall to the Canadian producer/distributor.

(iii) reducing the Canadian content requirements will permit the reduction of wholesale and retail price levels, should the licensees wish to do so. This, in turn, would reduce the churn generated by the currently high price charged for pay television services. This would contribute to the profitability of the pay television companies.

4. The major differences in the advantages of the above proposals are :

(i) *Approach No. 1 :* a greater concentration of programming funds in fewer productions and a more realistic target for the number of Canadian titles. This may lead to the production of higher quality programs with higher viewer satisfaction levels and a greater potential to earn revenues in other markets.

(ii) *Approach No. 2 :* a somewhat greater concentration of programming resources in fewer productions, with the concommitant benefits indicated in (i) above, coupled with a lessening of the financial burden on pay-TV licensees which would positively encourage their survival.

(iii) *Approach No. 3 :* a transfer of some or all of the stipulated Canadian programming expenditures to Telefilm would provide greater public scrutiny and targetting of the subsidy to Canadian programming.

Recommendation

The Director realizes that such fundamental changes to Canadian content rules require further study as to their impact on licensees and the program production industry. The Director recommends that, before deciding on the joint application, the Commission should explore the various alternatives which allow the retention of competition. ●