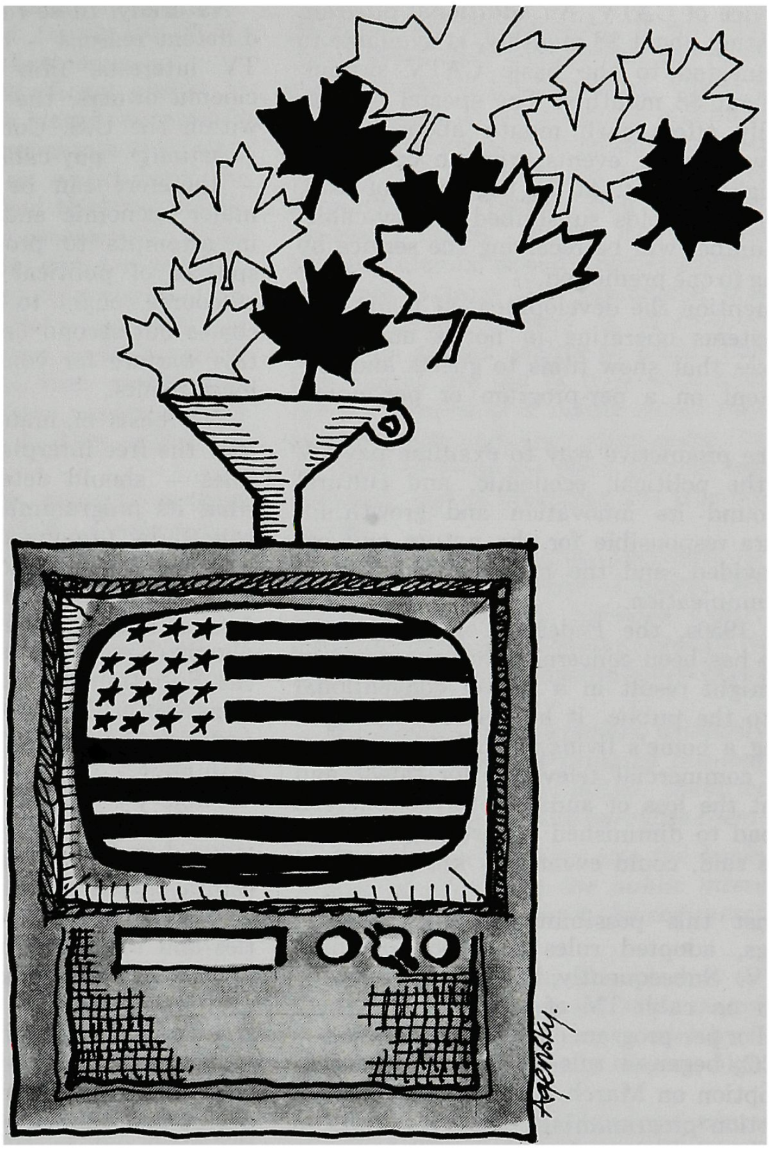

Pay TV in the United States Contradictions in Search of a Policy

by Thomas H. Guback

The status of pay-TV in the United States can be examined from two perspectives.

First, one could discuss its history and trace its development chronologically. Since the early 1950s, there have been numerous subscription television experiments in which a station broadcasts a scrambled signal that must be decoded in the home by a special apparatus attached to the subscriber's television set. The mechanism is activated by the insertion of coins or a special card that allows the viewer to be billed later.

For various reasons, these systems barely have moved beyond the experimental stage into large-scale use. Yet this method of transmitting programs for a fee to households clearly is not dead. Earlier this year, the American Subscription TV Company announced plans to launch such a service in Los Angeles; programming hopefully would begin early in 1977. Although the station's signals will cover an area with about 10 million people, the pay-TV service initially is aiming for 20,000 homes – the number necessary to break even financially. The anticipated monthly fee for use of the descrambling device probably will be around $5, and there will be a per-program charge for feature films comparable to the cost of a single cinema admission – that is, between $3 and $4.

The most widespread form of pay-TV now operates as a new auxiliary service of CATV. An additional program channel, usually costing about $8 monthly, is available to homes already connected to the basic CATV system, which also costs about $8 monthly. The special pay-cable service generally offers each month about twenty feature films, a few sporting events, and an occasional popular music or nightclub act. At the beginning of 1976, over half a million households subscribed to pay-cable. Three times that number will be receiving the service by year's end, according to one prediction.

One also must mention the development of many "in-house" pay-TV systems operating in hotels and large apartment complexes that show films to guests and residents, with payment on a per-program or per-month basis.

Another and more productive way to examine pay-TV is in relation to the political, economic, and cultural policies that surround its innovation and growth, for these ultimately are responsible for the nature and extent of service provided, and the medium's impact on other means of communication.

Since the early 1950s, the Federal Communications Commission (FCC) has been concerned that the development of pay-TV might result in a loss of conventional television service to the public. It has been feared that pay-TV, by turning a home's living room into a box office, could outbid commercial television for talent and programs, and that the loss of audience for commercial television would lead to diminished advertising revenue. These factors, it is said, could eventually kill individual TV stations.

To guard against this possibility, the FCC, after lengthy proceedings, adopted rules in 1968 governing over-the-air pay-TV. Subsequently, these were applied to the distribution on cable-TV of material for which specific per-channel or per-program charges are made.

In 1972, the FCC began a rule-making process that resulted in the adoption on March 20, 1975, of new rules regulating subscription programming. These continue to reflect the Commission's policy that the public's access to programs currently offered by commercial TV at no direct cost to viewers should not be threatened by pay-TV. Due to this position, the FCC is charged with being "pro-broadcasting industry" because its rules are said to protect commercial TV while hindering the growth of pay-TV.

The FCC's rules are complex, but provide that commercial advertising is not permitted in conjunction with pay-TV programs and that series programs previously broadcast on commercial TV are not to be offered on pay-TV. Moreover, not more than 90 percent (!) of the total programming on a pay-TV system may be sports and feature films. In practice, however, current programming on pay-TV consists almost entirely of motion pictures. FCC rules stipulate that pay-TV may show a film

(a) within three years after its theatrical release;

(b) more than three years after its theatrical release only if the film is licensed to be shown on commercial TV in the same market served by the pay-TV system;

(c) that has been in theatrical release for at least ten years;

(d) if it is in a foreign language and not dubbed.

Naturally, these rules are opposed – but often for very different reasons – by the pay-TV industry, commercial TV interests, film production-distribution companies, cinema owners, the Department of Justice, and groups within the U.S. Congress. The development of pay-TV – actually "pay-cable", because it is the dominant form – therefore can be seen as a power struggle, pitting major economic and political forces against each other in attempts to protect private interests and to exert spheres of political influence. The determining factor, of course, ought to be the public interest, but it often comes out second best as groups entrench themselves in this warfare for commercial spoils and to protect their investments.

The basis of many of the arguments is a belief that only the free interplay of competition – rather than FCC rules – should determine how pay-cable develops and what its programming ought to be. This position is advanced by (among others) the pay-TV industry, CATV interests, the Motion Picture Association of America (which argues that any restriction is a violation of freedom of speech), the Department of Justice, and is apparent as well in the January 1976 report by the staff of the Subcommittee on Communications of the House of Representatives. These groups call for "de-regulation" and the abolition of FCC rules concerning pay-TV programming.

Cable-TV interests, in addition, have asserted that revenues from their normal CATV operations have not been sufficiently high to attract new investors in this capital-intensive industry. They argue that more investment is needed to extend CATV to additional communities and to maintain the level of service of existing systems. CATV representatives claim that commercially attractive programs on a pay-channel, which does not greatly increase capital investment in equipment, can be a significant source of new profit that will attract more investors. It is asserted, therefore, that rules about the nature and quantity of pay-cable programming – such as those governing use of feature films – restrict the operations and profitability of pay-TV and CATV companies and therefore inherently retard national expansion of the system.

Commercial broadcasters, on the other hand, argue that pay-TV's unhindered use of feature films, sporting events, and entertainment programs will "siphon" such material from "free TV," and that the public will be obliged in the future to pay for what it now receives without direct cost. Commercial broadcasters, claiming that only strict FCC rules can preserve conventional TV from being crippled by pay-TV, have applied continuous pressure on the FCC and the Congress to achieve their objectives, just as CATV interests have lobbied against such rules.

Strange as it may seem, motion picture theatres generally have been overlooked in the debate about pay-TV and its competitive nature. Cinemas are threatened because the new medium will take away not only their films but also their audiences, and will exacerbate the kind of blow TV itself has dealt to theatres during the past three decades. Official statements from the Department of Justice, the staff of the House Communications Subcommittee, and others, simply ignore that theatres are a legitimate contestant in the debate about pay-TV. This is all the more surprising because the programming of pay-TV consists chiefly of feature films, the sole products offered by theatres. A curious fact is that although

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the FCC rules, as noted above, establish time frames for films available for showing on pay-cable – and thus **de facto** manipulate the pool of pictures also available for theatrical exhibition – the FCC has turned a deaf ear to testimony by the National Association of Theatre Owners. The FCC claims that it has jurisdiction only over broadcasting, not over cinemas, and refuses to recognize any negative effects of pay-TV on theatres.

Although this appears to be an insignificant matter, it is worthwhile to analyze it in more detail because it highlights a number of aspects of arguments over pay-cable, and exposes some fallacies on which they are based. A consequence of having ignored theatres is that much of the debate about pay-TV has proceeded from an inadequate conception of competition and the marketplace. Here, of course, it is necessary to accept as unalterable certain assumptions that have provided the basis for American media: that they are to be privately owned and operated for profit; and that competitive forces, without government intervention, automatically will regulate the behavior of media so that selfish interest is turned into public good.

The Department of Justice position exemplifies these beliefs, but unfortunately does not include a comprehensive view of communications media. In the absence of vigorous judicial efforts to eliminate concentration and cross-media ownership (conditions created, in part, by the FCC's pro-broadcasting bias), the Department of Justice seeks to foster pay-TV in order to create competition within geographic markets already characterized by centralized media ownership. The Department – implicitly attacking the FCC's protection of commercial broadcasting – believes that cable-TV should be released from confining regulations and should be allowed to compete freely for programming material and audiences against entrenched broadcasting interests.

In this respect, the Department of Justice, seeing the battle only as commercial TV versus pay-TV, misconstrues the dimensions of the real marketplace because it ignores cinemas, even though pay-TV's programing is almost entirely films. Obviously, pay-cable will have an impact on cinemas and the supply of pictures, but the Department has not bothered to inquire what it will be. As a result, the Department's policy of trying to stimulate competition through the expansion of pay-cable has the long-range effect of actually reducing competition because theatres will close due to pay-cable's use of films.

Seeking to unleash pay-cable in order to neutralize the oligopoly of the three TV networks, the Department implicitly admits its failure to pursue a strong program of antitrust and deconcentration as it pertains to broadcasting in particular, and to media in general. In effect, the Department of Justice acknowledges that not only has competition led directly to its opposite, but also that it is incapable of counteracting this inexorable trend through forceful legal programs, and that it must rely upon **anticipated effects** of new technology to accomplish what it has not been able to achieve.

Part of the fallacy in the Department's position – and in the report from the staff of the House Communications Subcommittee – stems from a failure to recognize that the new technology, like previous ones, is privately owned and operated for profit, and that this, rather than any magical essence in the technology itself, introduces the terms on which the technology is put to use.

The Department's argument, incidentally, parallels one advanced by Home Box Office and other pay-cable interests that "pay-cable is free of the restraints of commercial broadcasting." This, of course, is pure nonsense. Both the form of ownership and motive for ownership are identical. What matters ultimately is the accounting book. Programming inevitably will tend toward what is commercially profitable.

This is an important consideration, especially because pay-cable proponents argue that it can provide a great diversity of programming. From an engineering standpoint, it can. In actuality, it will not, and for precisely the reasons that commercial television does not offer a great variety of programming. Under principles of sound management, in which profit maximization is the standard of achievement, programming naturally will be consistent with the revenues that are generated. Economic considerations, rather than attention to aesthetics or "minority tastes," dictate what is offered – and pay-cable in America already demonstrates this tendency. Its mandate is from the commercial marketplace. As long as the cable industry is profit-motivated, arguments about its alleged ability to bring "culture" to the populace simply are out of tune with reality. The history of private ownership of media shows these claims to be unfounded, although they often serve the purpose of arousing support from the more gullible segments of the intelligentsia, and of obscuring the true economic motives involved.

It is indeed refreshing, therefore, to discover a candid statement about these matters. Miles Rubin, board chairman of Optical Systems Corp., supplier of programs to pay-cable systems through its Channel 100 subsidiary, asserted to a Senate committee last year:

> *We entered this business primarily, if not solely, for the purpose of bringing full-length motion pictures, after their initial theatrical release... to viewers who sought to purchase them...*
>
> *We were not entering into the business for the purpose of advancing the public interest. We entered into the business purely for commercial purposes.*

The position of the Department of Justice is curious. It tries to attack concentration in network TV and centralized ownership of local media by fostering CATV and pay-cable, which already display high concentration and cross-media ownership.

On the community level, of course, each cable system is a private monopoly. Obviously if subscribers do not like what the pay-cable company offers, they have no place else to turn. Nationally, there is considerable centralization of control. The top five CATV system operators (TelePrompter Corp., Tele-Communications Inc., Warner Cable Corp., American TV and Communication Corp., and Cox Cable Communications Inc.) account for 28 percent of the 10.8 million households using CATV. Together with the next five operators (Viacom International, Sammons Communications Inc., Communications Properties Inc., United Cable TV Corp., and Cablecom-General Inc.), they have 39 percent of all subscribers. The 41 next-largest operators together have only 27 percent of all CATV subscribers, and the remainder is shared by many hundreds of other firms.

If one considers only CATV systems offering a pay-TV channel, then the same pattern emerges. According to a TelePrompter press release of March 11, 1976, the company had 96,500 pay-cable subscribers, out of approximately 404,000 pay subscribers nationwide, estimated at the end of 1975. Thus, it already controls close to a quarter of the market, and is growing rapidly.

Suppliers of programs to pay-cable systems exhibit even more centralization. **The Pay-TV Newsletter** of February 3, 1976, reported that at the beginning of that year, Home Box Office was distributing program material (predominantly feature films) to almost 281,000 pay-cable subscribers – about 60 percent of the national total. The second and third-place firms, Telemation Program Service and Optical Systems' Channel 100, together had about 31 percent of the market.

Home Box Office, a division of the Time, Inc. empire (1975 assets of $760 million), declared that on April 2 of this year its pay-TV programming reached 386,000 subscribers, of which 75,000 received service through 28 earth stations from an RCA satellite, and another 306,000 through microwave links. The HBO network, which has the capability of simultaneous transmission of eight different programs, now has affiliated cable systems in 26 states, with orders placed for 47 additional ground stations.

The connection between the largest program supplier (Home Box Office) and the largest cable system operator (TelePrompter) merits special attention. Russell Karp, president of TelePrompter, recently pointed out:

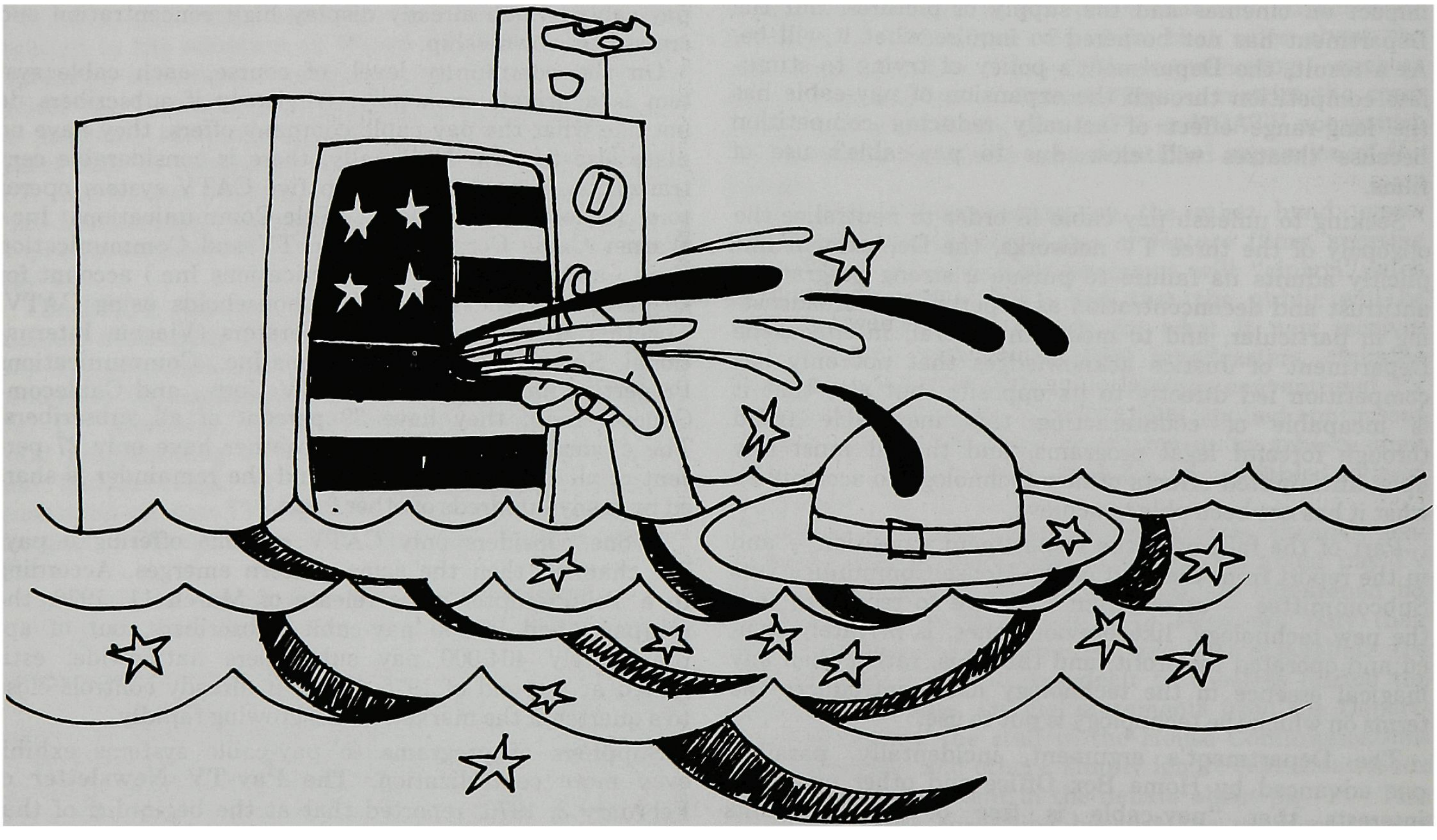
> *The past year (1975) was characterized by an all-out commitment to pay-cable. We signed an agreement with Home Box Office, Inc.,... enabling us to offer Home Box Office programming to our subscribers, most of whom pay an additional monthly charge of about $10 for this service. By mid-1976, we expect to offer Home Box Office and other pay cable services in 66 of our systems serving a total of 920,000 subscribers.*

Moreover, the major cable system operators are engaged in other activities such as common carrier microwave operations, feature film and television program production and distribution, cinema operation, background music, phonograph, and radio and television station operation.

Although the Department of Justice continually calls for competition, the terms of competition between pay-cable and cinemas simply are not equal. More than twenty-five years ago, the Department of Justice ruled that cinemas must bid for motion pictures on a theatre-by-theatre, film-by-film basis. Concerted action to acquire films by exhibitors, even by a theatre chain, was prohibited, as was the renting of packages of films. On the other hand, pay-cable systems, through their program suppliers (such as Home Box Office), are allowed to engage in concerted action to acquire films. One industry is forbidden to do what another is permitted. This amounts to a government grant of privilege to pay-cable that distorts the competition between it and cinemas.

Film producers and distributors have been active in renting their pictures to pay-cable, seeing it as another source of revenue with considerable potential. In July 1976, Twentieth Century-Fox and United Artists announced the formation of Hollywood Home Theater, a joint venture to lease daily programs of films and other entertainment to pay-cable systems. Apparently formed as a way to by-pass program brokers such as Channel 100 and HBO, Hollywood Home Theater will offer its facilities to all film producers and distributors. The company believes that feature films are "the cornerstone of pay cable television."

Another problem involves the sequential release pattern for motion pictures and where pay-cable fits in this scheme. Jack Valenti, president of the Motion Picture Association of America – a trade group representing a handful of the largest production-distribution companies – stated last year that films first would be released to theatres, then to pay-TV, then to network TV, and finally to individual stations. This gives the mistaken impression that each of the four tiers is autonomous, and that pay-TV will not compete directly with theatres for feature films.



In reality, however, there is no frontier between showing films on pay-cable and exhibition in cinemas. The FCC's rules, in fact, encourage pay-TV systems to show films as soon as possible after release. At the present, pay-TV overlaps with the second theatrical run of films, and in many cases is showing features six months or less after their first theatrical release. As pay-TV becomes more widespread and economically important, it is entirely possible that film distributors will by-pass most theatres and use it as the principal manner of getting films to the public.

Pay-TV's present use of films threatens cinemas because there has been a long-term decline in the number of releases by national distributors. Companies know, of course, that merely producing more pictures does not correspondingly increase their revenues, and that their position is favored when supply diminishes and a seller's market is created – especially when each separate theatre must bid against pay-TV systems for a film. By playing films simultaneously with cinemas, pay-TV begins to drain the already small pool of pictures suitable for theatrical exhibition, thereby exacerbating the product shortage.

Furthermore, data I have gathered demonstrate pay-cable's obvious negative impact on cinema box offices. In the New York City suburbs, theatres exhibiting a certain popular film after its showing on pay-cable in the same towns had significantly lower box office receipts than theatres in non-pay-TV communities close by that showed the same picture. This confirms what common-sense suggests. Cinema owners obviously are aware of pay-cable's competition and therefore avoid booking films that have been shown in their cities on pay-cable, or are advertised as going to be shown on pay-TV in the near future.

Basically the positions on pay-TV in America can be summarized in these ways: cinemas would like to be assured that they will have first chance to exhibit feature films, and that government regulation (if necessary) should insure that pay-TV has access to films only after at least a year has passed since their initial theatrical release; commercial broadcasters, especially the three networks, wish to be protected against pay-TV's potential ability to outbid them for feature films, entertainment programs, and sporting events; film producers and distributors naturally want no restrictions at all on pay-TV programming and want to be able to rent their pictures when and to whom they please; pay-TV companies want no restrictions on their own operations and believe – as Adam Smith did – that the marketplace should be the only guide.

These positions are indicative, of course, of the crisis in contemporary communications in which new technical forms are put to work under an ideological and economic umbrella that was functioning two centuries ago, even before the industrial revolution. As long as present forms of ownership are perpetuated, there can be no resolution of the contradictions and conflicts that stem from commercial motives and the warfare among private commercial interests.

What has not been considered in the United States is the question of public control of the means of production and distribution, and the creation of a communication system that serves society's needs, rather than one that generates new alienating wants. Private ownership simply is taken for granted.

It would seem that Canada, with different history, traditions, and precedents, needs to debate this fundamental issue, as well as an equally important one: whether pay-TV will turn into a conduit for the showing of more American films. □

The June 1975 Public Hearing (CRTC)

Groups which submitted briefs on Pay-TV to the CRTC for the June 1975 public hearing

Rogers Cable TV Limited
* Motion Picture Theatre Association of Canada
Keg Productions Limited
Advertel Productions Limited
* Bell Canada
ACTRA (Ass. of Canadian Television and Radio Artists)
Telecommunications Research Group – Simon Fraser University, B.C.
* Council of Canadian Filmmakers
* Consumers' Association of Canada
ACTV Limited - Edmonton
* Canadian Cable Television Association
* CTV Television Network Limited
National Cablevision Limitée
Canadian Film and Television Association
* C.P.R.
  - Canadian Cablesystems Limited
  - Premier Cablevision Limited
  - Rogers Cable TV Limited
The Rogers Group of Companies
  - Rogers Cable TV Limited
  - Coaxial Colourview Limited
  - Bramalea Telecable Limited
  - Essex Cable TV Limited
* Canadian Association of Motion Picture Producers
Broadband Communications Networks Limited
* CITY-TV
* Association for Public Broadcasting in British Columbia
Western Coded Television Limited
* The Canadian Broadcasting League
* Canadian Association of Broadcasters
Joint Broadcast Committee
  - Association of Canadian Advertisers Inc.
  - Institute of Canadian Advertising
Northern Access Network
Greater Toronto Cable TV Association
Maclean - Hunter Cable TV Limited
* Agra Industries
Wendy O'Flaherty - 3165 12th Avenue, Vancouver, B.C.
Western Cablevision Limited
CBC
* British Columbia Telephone Company
Video Program Services
* Telesat Canada
W. Clifford Wingrove - London, Ontario
Agravoice Productions Limited
Bay Ridges Cable TV Limited
Cable TV Montreal
Western Cablevision Limited
* Canadian Film Development Corporation

(*) Appearing before CRTC on June 10, 1975