June 5, 2007

Banff Green Paper 2007

The Future of Television in Canada

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Nordicity Group Ltd. (www.nordicity.com) is the pre-eminent, independent, Canadian consulting firm specializing in policy regulatory and economic analysis; and business strategy, feasibility analysis, financial forecasting, and market assessment for clients in the communications and cultural sectors.

We are leaders in assessment, analysis, and evaluation of policy, programs, and regulation for government agencies. We also provide our deep understanding of policy and regulatory analysis to our private sector communications and media clients, and associations.

Nordicity helps organizations transform their business through sound strategic decisions, shrewd investments and resource commitments, and effective changes in processes. We integrate knowledge of market trends, emerging technologies, regulatory and policy support structures and competitive conditions to help develop new business and new technology applications. Nordicity also works with the public sector to assess the economic and business impacts of business conditions and policy or regulatory developments.

Since 1979, Nordicity has provided business and policy solutions for media and communications in Canada and around the world. Nordicity has offices in Ottawa and Toronto, with associates in other Canadian cities. We also offer global delivery of our expertise through affiliations with international professional services firms.

1 Preface

This Green Paper 2007 is a companion document for the Town Hall discussion of the future of Canadian television and Canadian television programming. It was financially sponsored by the Canadian Television Fund and the Banff World Television Festival in the Department of Canadian Heritage. However, the responsibility over the content of this paper rests entirely with Nordicity Group Ltd.[1]

1.1 The Potentially Disrupting Trends Since Banff 2006

This past year has been an eventful one for Canadian television, and many new developments occurred in the business and technical applications of digital technology and the Internet. Some of these developments could have major repercussions for the Canadian television system, for example:

- US studios alarmed Canadian broadcasters by licensing some prime time programming to Canadian cable operators for VOD; as well, in some cases US studios have not licensed Canadian broadcasters the rights to on-line versions of the episodes that they acquire for broadcast in Canada. *If the on-line world can be "geo-blocked" and managed by Hollywood majors, will key rights to top rated US programming become unavailable to Canadian broadcasters?*
- On-line access to video and television programming moved closer to reality; Google acquired YouTube for $1.65 billion[2], thus demonstrating the power of user-generated content; Apple launched its new iPhone for mobile video display and Apple TV which connects the broadband Internet to the TV set; and peer-to-peer (P2P) initiatives emerged that will test the capability of the Internet for video access (e.g. Joost's "beta" launch of its Internet TV service, Babelgum, and other P2P plays). *Does this mean that broadband Internet will take meaningful chunks of television distribution away from traditional cable and satellite distributors?*
- Internet advertising gobbled up more market share of ad dollars, earning a significant 14% share in the UK, and 6% in both the US and Canada, enough to break the $1 billion barrier in 2006 in Canada[3]. In 2007 it is closing in on surpassing the advertising spend for radio in Canada. *Does this level of growth*

[1] The principal authors at Nordicity are Peter Lyman and Terri Wills. Contributions were made by Dustin Chodorowicz, Stuart Jack, Chiara Cosenza, and Brook Simpson. We interviewed about a dozen key stakeholders in the broadcasting, production, and policy sectors, and thank them for their insights, observations, and counsel.
[2] Google Press Release, Google To Acquire YouTube for $1.65 Billion in Stock, MOUNTAIN VIEW, Calif., October 9, 2006 - Google Inc.
[3] IAB/PWC data for U.S. and Canada 2007, U.K. estimates from media agencies cited in New York Times article "The Future of Web Ads Is in Britain", December 2006

represent an important diversion of advertising spent outside the broadcasting system, and thus threaten the economic base of Canadian broadcasters?

- At the industry level, two large broadcasting groups in Canada made major moves to consolidate the television sector (CTV's and CanWest Global's proposed acquisitions of CHUM and Alliance-Atlantis respectively). These are excellent broadcasting properties. However, given that broadband Internet may convulse the industry it is interesting that CTV and CWG are paying top dollar for traditional broadcasting assets. Yet growing competition from unregulated sources is a real concern to broadcasters.

1.2 A Buoyant Market for Regulatory and Policy Reviews

- In 2006, the CRTC launched proceedings into (i) a review of technology and its potential impact on broadcasting, and (ii) a review of policy governing conventional TV broadcasters, In both cases, the CRTC concluded that the Canadian television sector was not about to collapse, so that major changes to regulation were not required, at least not at this time.
- Two important policy proceedings on the regulation of licensed broadcasting distribution undertakings ("BDUs")[4] and pay and specialty services are to take place in 2007. As well, there is an internal enquiry at the Commission into the question of whether/how new media contributes to and affects the broadcasting system. Once again, similar issues will be raised about the impact of new technology, new platforms, and new media on the broadcasting system, in particular the pay and specialty services and the BDUs.
- On the TV program financing front, the Canadian Television Fund (CTF) suffered the shock wave from the threat of a pull-out by key financial contributors in the cable sector. As a result, the CRTC is reviewing the Fund as well as the place of new media in broadcasting regulation. The actions by certain major cable operators reflect in part the growing role of BDUs in content acquisition and programming for VOD and pay-per-view (PPV) services.
- Another major financial support measure is the federal tax credit for film and video production. This measure that is designed to assist the independent production sector is under current review. At issue is how to motivate production companies to grow stronger so that they can take advantage of the new frontier of multi-platform distribution. *Should financial incentives like the tax credit embrace new*

[4] Broadcasting Distribution Undertakings is the formal term in Canada for subscription-based, or pay-TV services, and includes cable, direct-to-home satellite, IPTV, and fixed wireless transmission.

media, new on-demand distribution (like VOD), or should they be retained for the traditional program production sector?

1.3 Framing the Debate

Last year's green paper argued that Canada's future in television would be determined by its ability to seize opportunities and address challenges presented by technological developments and access to foreign markets. Various regulatory and program policies were discussed. Green paper 2007 re-assesses the challenges facing broadcasting and program production, and re-frames the debate in the context of today's challenges.

- **A basic question: is it worth the candle?** Given the seemingly inexorable move toward a sector that cannot be regulated as in the past, one could pose a very basic question: *Should Canada still try to protect the "unprotectable"? Should we just have an industrial rather than cultural policy in broadcasting and TV production?*
- Obviously, these questions are quite fundamental, and lead to an even more basic debate on what is culture anyway. For example, if we placed a broad definition on culture, we might conclude that Canada should place more emphasis on creating an accessible infrastructure and access for Canadians to socially engage as opposed to creating appealing Canadian programming that they can consume. Some might argue that it would be more culturally relevant than trying to artificially boost Canadian content. Some would argue that it no longer matters in the Internet age, and so what if the Canadian content production community shrinks dramatically in a deregulated system.
- For the purposes of this Green Paper, however, we assume that there is consensus around the main objectives of the Broadcasting Act, i.e. to support Canadian content and Canadian expression as currently embodied in TV programming. While we acknowledge that there could be a fundamental debate, we begin with the assumption that support for Canadian content remains a central goal. Indeed, it is in line with several decades of broadcasting and cultural policy, and has crossed all political party lines.
- **Is the Canadian broadcasting system about to collapse*:*** In framing the debate, it is useful to worth reflecting more on the Internet and technology developments and their broad impact on the television industry. While we cannot predict its full impact, the debate is more informed if we closely monitor industry trends, such as evolving viewer habits and consumer behaviour, the Internet as a video distribution system, and emerging business models.

- While there are a few cracks in the system, there remains conflicting evidence as to its short and medium term import. We know that the Internet and related technologies are disruptive, but we do not know the extent of the disruption, nor the timeframe for a "collapse". Drawing on a variety of experiences and evidence, then, the first debate is on the following questions: *Is the broadcasting system collapsing - in part or as a whole? Is it happening slowly or quickly? What are the markers to watch?*
- **Winners, losers, and new entrants:** The growth of the multi-platform world has a domino effect on the roles of – and relationships among – BDUs, broadcasters, producers, and creators. While there is some excitement about the possibilities of the new multiplatform world, each component of the industry value chain perceives real threats to its business model and economic foundations.
- Having debated whether the broadcasting system is collapsing, we can move to the next critical issue. We can identify potential new players and business models, and discuss how the broadcasting system is adjusting to the new world. We can then address the following question: *Do we assume a zero sum game, where the winners will be new entrants outside the regulated system? What are the specific impacts on the Canadian broadcasting system – TV broadcasters, BDUs, and program producers/creators?*
- **End of regulation as we know it:** The general assumption these days is that broadcasting regulation as it currently stands will atrophy because of a more on-demand world and the emergence of distribution through unregulated systems. There is debate around how quickly this will occur, but few would disagree that diminished regulatory leverage over broadcasting is inevitable. While protecting Canadian content ('CanCon") in this new environment will become ever more challenging, there should remain opportunities to exploit our talent/content at home and internationally. Thus, the broad debate can be framed as follows: *Should we start moving toward a system whereby we strengthen Cancon through promotion and incentives, and stop relying on protection measures?*

This Green Paper sets up the debate about what changes are occurring, and what impact they are having on the broadcasting system in Canada. The debate may provide guidance to traditional broadcasters and program producers in making the transition to an on-demand and interactive world.

Traditional policy tool kit measures of regulation are challenged by this new environment, so we examine the possible policy and regulatory measures that can be considered in light of the realities of an interactive and on-demand world. In green paper tradition, there are no recommendations, but we suggest how policy-makers and industry stakeholders might address the near term regulatory and policy review processes.

2 Is the System Collapsing?

We know from the numerous reviews over the last year – the CRTC over-the-air (OTA) review, the CRTC technology review – that the viewing landscape is changing. We see signs of massive change afoot. New technologies are offering yet more enticements for spending time online, including viewing video over the Internet. Yet viewing data demonstrate that Canadian households are still spending the same number of hours watching TV; Canadian hits are breaking through; and BDUs are faring well. So will the system collapse? If so, how far into the future will it be?

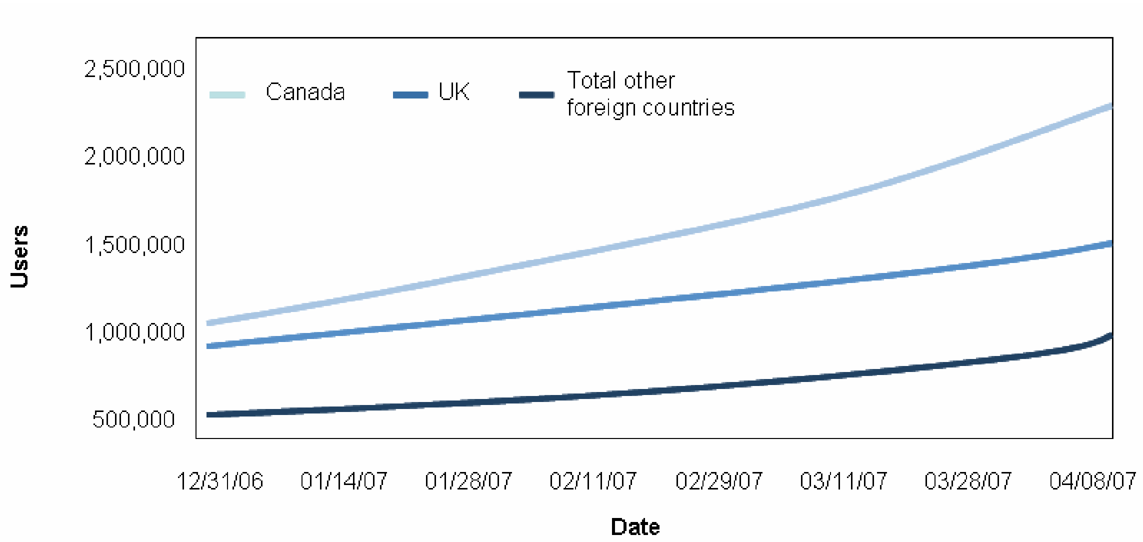
2.1 Signs of Big Change are Afoot

In the last year, we have seen a number of developments in consumer behaviour, technologies, and the revenue mix of the broadcasting system. Young people are increasingly viewing TV online; peer-to-peer networking technologies are quickly evolving to gain more bandwidth efficiencies; and advertising revenues are being diverted to the Internet. While we have not yet reached a point of collapse, the changes may signal the potential for the metamorphosis of the broadcasting system as we have known it for some time.

- **The phenomenal rise of social networking demonstrates how audiences are glued to the internet:** We know that youth are spending inordinate amounts of time communicating with fellow teens online. Social networking site Facebook in Toronto for a while was one of the largest community groups worldwide. As shown in Figure 1, Canada witnessed one of the fastest uptakes of Facebook worldwide. While social networking is not TV, the predilection for time spent online can have an impact on what else these people are doing while they are online. Evidence demonstrates that video viewing on the Internet is highest among younger audiences –- for example, research from SRG indicates that 16% of Canadians aged 15 to 29 downloaded a TV show, as compared to 6% in the 30 to 40 year old category [5][6]. For this group, quality of picture has been less of an issue, and escaping annoying parents in the main living room or diverting money to beer rather than cable in university may be driving these habits.

[5] Note that figures for downloading TV shows is not necessarily indicative of total TV viewing online, as some TV viewing is streamed – such as via websites like CTV and CBC.
[6] "Fast Forward Trend Analysis" , by Solutions Research Group, prepared for the CRTC August 2006

Figure 1: Canada's Phenomenal Uptake of Social Networking Demonstrated by Facebook[7]



- So, while Internet viewing of video is not yet in the mainstream, today's youth will grow up and likely they will have formed habits that carry into the future – used to getting the content that they want, when they want it, they will grow impatient with linear schedules. This behaviour potentially threatens broadcasting and its distribution as we know it today.
- **The launch of P2P aggregators, like Joost, will begin to offer viewers the quality and speeds they've been waiting for:** To date, quality of picture and speed have been issues that may not have bothered teens in their bedrooms, but have discouraged audiences more sophisticated in their quality tastes from migrating to web-TV. Delivering high quality TV online has been a struggle in the past due to bandwidth constraints and costs, and hence economics favour BDUs over broadband Internet for TV programming. Watching television costs the average Canadian household about 20 cents/hour via a licensed BDU, but much more for the equivalent programming via broadband, according to Convergence Consulting in a recent report[8].
- Yet the Internet may be a classic disruptive technology, where a new technology that is initially inferior begins to chip away at the market and eventually catches up

[7] Official Facebook Engineer Blog; http://blog.facebook.com/blog.php?post=2398302130
[8] "Broadband Access Not Necessarily a Vote for Web TV", by GrantRobertson, Globe and Mail, April 2, 2007

to the quality of the mature technology.[9] Case in point: the application of peer-to-peer (P2P) networks to TV distribution online. With P2P networks, the greater the number the users, the greater the power of the network and hence the lower the costs of bandwidth to the content distributor for distributing high quality video content online[10].

- The wunderkinds who created kazaa and Skype have applied P2P network technologies to the delivery of TV via recently launched Joost, a content aggregator that replicates a traditional TV experience. Because of P2P technologies, their business model becomes viable as they will not be crippled by bandwidth costs. Canada's own Michael Cowpland has launched an Internet TV network through his company (ZIM). It partners with one of the world's largest peer-to-peer network and will distribute linear programming over the web for $2000/month at 400kbits.[11] While this data rate is not nearly the quality of standard definition TV, it is quite acceptable in small formats.

- The debate over network neutrality may increase pricing as ISPs will want to charge *someone* for extra bandwidth use. However, technology will evolve so that more efficient means of delivering content will become possible.[12] Issues of quality, speed, and economics have prevented massive disruption in the system to date; however, evolving technologies may hasten the change.

- **Advertisers are investing more in the Internet:** As consumer behaviour and technologies are moving audiences to the Internet, ad dollars are following them. Traditional media like television are naturally concerned about potential erosion. Forecasters project a continued rapid growth of Internet advertising, and a flattening of the TV ad market. For example, PwC predicts a compound growth

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[9] See Clayton Christianson, "The Opportunity and Threat of Disruptive Technologies," Boston: Harvard Business School Publishing, 2003

[10] The following offers a brief explanation of how P2P networks function: "In P2P networks, by contrast, there are no central servers: each user's PC exchanges data with many others in an ever-shifting mesh. This means that servers and their overtaxed network connections bear less of a burden; data is instead provided by peers, saving bandwidth in the Internet's core. If one user leaves the mesh, others can easily fill the gap. And adding users actually *increases* a P2P network's power." *TR10 – Peering into Video's Future,* March 12, 2007, Technology Review published by MIT

[11] As well, within 3-5 years and the introduction of 4th generation mobile standards, the quality of the mobile signal will also deliver acceptable SDTV quality for smaller screens.

[12] For example, Cornell University is testing a P2P system called Chunkyspread that reduces the amount of metadata sent between nodes in a network to reduce bandwidth. See *TR10 – Peering into Video's Future,* March 12, 2007, Technology Review published by MIT

rate of 18.8% over the next 5 years, compared to only 3.8% for TV[13]. While not exactly a collapse of the ad market for television, it seems to be reaching the status of one of the mature media. In this environment specific advertiser decisions to shift out of TV to the Internet are scary for conventional broadcasters. For example, Kraft (New York headquarters) recently announced that it was shifting 30% of its advertising dollars from TV to online and mobile.[14]

- **Loss of TV advertising means loss of dollars from Canadian properties:** The ad dollars are not only being siphoned away from traditional media such as television but are leaking outside of Canada. As Figure 2 demonstrates, Canadian Web properties rank far behind major American sites such as the major search engines (led by Google), portals (like Yahoo), and user-generated content sites (like YouTube) and social networking sites (like Facebook). Even UK BBC news website is neck and neck with CBC in terms of Canadian traffic. While not all the high traffic sites have fully evolved as ad supported media, as this happens, it will be mainly the U.S. properties which are able to profit from selling Canadian users to advertisers.

[13] PriceWaterhouseCoopers Media and Entertainment Outlook, 2006
[14] Comment by panelist Kevin Shea, May 1, 2007, at the Insight conference on telecom and broadcasting in Ottawa

Figure 2: Top Ranked Sites in Canada by Hits, May 2007

Rank	Site	Type
1	Google.ca	Internet portal
2	Msn.com	Internet portal and ISP (in the USA)
3	Yahoo	Internet portal
4	Facebook	Social networking site
5	Google.com	Search engine
6	YouTube	Platform to share user and broadcasters' videos
7	Windows Live	Internet portal
8	My Space	Social networking site
9	Wikipedia.org	Online collaborative encyclopedia
10	Msn.ca	Internet portal
-		
22	CNN	US news broadcaster
25	BBC	UK public broadcaster
31	**CBC**	**Canadian public broadcaster**
47	**The Globe and Mail**	**Canadian newspaper**
55	**The Toronto Star**	**Canadian newspaper**
84	**Radio Canada.ca**	**Canadian French language public broadcaster**

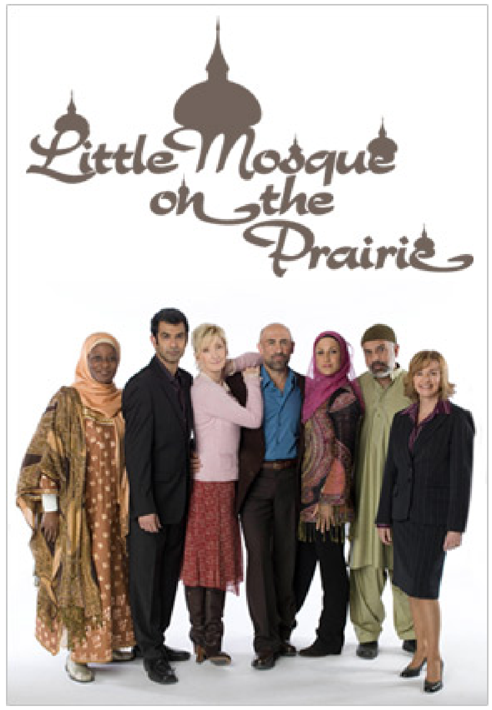
Source: Alexa Web, May 2007

2.2 Despite These Changes, the Old TV System Still Seems to Be in Fairly Rude Health

Despite these changes, we see evidence that the old adage rings true – plus ça change… plus c'est la même chose. As concluded in Spain's 50th Celebration of TV in the country, while TV is undergoing an "intense mutation" across various screens, "television will keep its position as the main screen for some time".[15] And we're seeing the same thing in Canada.

[15] FORO 50: Conclusions on Future Trends in Television Contents and Programs, by RTVE, December 15, 2006.

- **"A great day for Canadian television" can only happen if people are watching TV**: Unheard of in the annals of intense competition of TV serials, this year the writers of *Corner Gas* sent a bouquet of flowers to their compatriots at *Little Mosque on the Prairie* to congratulate them on a job well done – or more specifically, according to the attached card, "A Great Day for Canadian Television". The program had reached over 2 million households in the first episode[16]. If TV is hemorrhaging viewers, then where did this 2 million come from? According to Statistics Canada, heavy Internet users do not actually watch less TV than moderate or non-users[17], so it is unlikely that the Internet will have a profound impact on viewing TV anytime soon.



- **As Canadians fall in love with HD, people are upgrading – rather than ditching – their TV sets:** In addition to the fact that people are still watching TV, they're still planning on watching it for some time as they are investing in HDTV sets. While 28% of the U.S. population has an HDTV set[18], only approximately 13% of Canadian households do[19]. However, according to some research, our imports of high-definition television have doubled every year for the past five years[20]– and as demonstrated in Figure 3, estimates for HDTV set uptake are set to soar in the future. In Canada if the appetite continues, the drive to HD digital will be accelerated because of the recent CRTC decision to establish an analogue switch-off date – for 2011, two years after the US[21].

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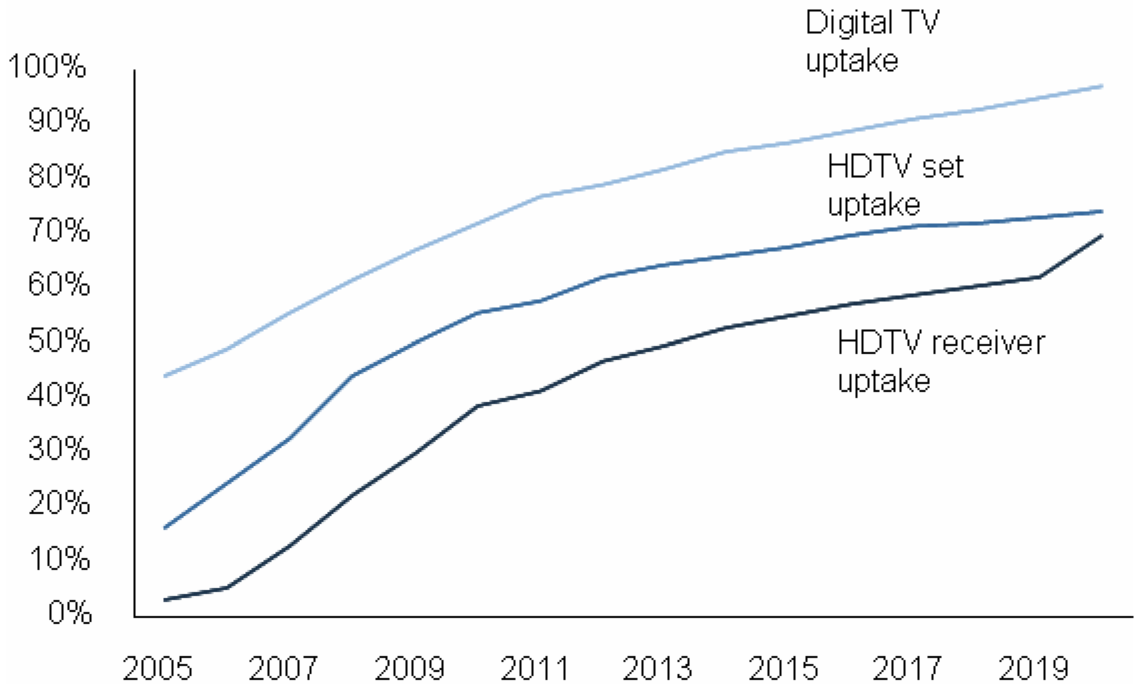
[16] Playback Magazine, "Let's Give CBC a Break", by Tamsen Tilsen, April 30, 2007
[17] "The Internet: Is It Changing the Way Canadians Spend Their Time?" by Ben Veenhof, Statistics Canada, August 2006.
[18] EngadgetHD, *28-percent of Americans now own an HDTV*, April 13th 2007 (http://www.engadgethd.com/2007/04/13/28-percent-of-americans-now-own-an-hdtv/)
[19] Informa 2005 data, 2010 projection, Informa Telecoms & Media.
[20] "We love our HDTV –- and Mexico loves us",;The Globe and Mail, Saturday May 12, 2007
[21] CRTC Broadcasting Public Notice CRTC 2007-53, Ottawa, 17 May 2007

Figure 3: Nordicity Estimates for HDTV Set Uptake in Canada



Source: Nordicity estimates, Ciel Satellite Co. Market Assessment for Satellite Services in Canada, 2006.
NB: HDTV receivers refer to set-top-boxes and/or terrestrial receivers

- **Canada remains a leader in subscription TV providers*:*** Maintaining Canada's TV system and regulation which supports the system depends on Canadians consuming their TV via broadcast distribution undertakings – BDUs contribute to Canadian content production through the CTF, as well as distribute signals for conventional and specialty broadcasters. An immediate collapse of a system would happen if overnight everyone ditched their cable and satellite for video online. Yet Canada, similar to the U.S., is a country full of folk willing to pay $50+ for their cable or satellite bills on a monthly basis to obtain a comparatively rich array of TV channels. Complete reliance on off-air signals in Canada is very much in the minority, restricted to very light viewers or in pockets of cities and in remote regions without cable or satellite service.
- Subscription revenues make up a high percentage of the revenues for pay and specialty services, in fact higher than equivalent services in the US which has much greater TV advertising intensity. The fact that we have such a high penetration of BDU TV viewing in the country attests that TV in the traditional sense is still very much enjoyed and viewed (see BDU subscriptions worldwide, Figure 4), and will continue to provide BDUs and specialty broadcasters with a steady supply of revenues. While BDUs are likely to continue to put pressure on

pay and specialty wholesale rates, the strong subscription culture in Canada will do its bit toward preventing an imminent collapse of the system.

Figure 4: Subscription TV Uptake in a Number of Countries, Worldwide

2005 (% of TV Households)	Direct-to-home Satellite	Cable	Digital Terrestrial Television	IPTV	Total Subscription TV Uptake
Sweden	25%	49%	17%	0.5%	91%
Canada	22%	68%	–	0.1%	90%
U.S	24%	63%	–	2%	89%
Germany	2%	54%	5%	0.1%	56%
India	0.2%	50%	–	–	50%
UK	32%	12%	30%	0.1%	44%
Singapore	0.0%	40%	–	1%	41%
Spain	18%	10%	–	0.7%	28%
Mexico	7%	12%	–	–	19%
Italy	16%	0%	–	1.4%	18%
Brazil	3%	10%	–	–	13%

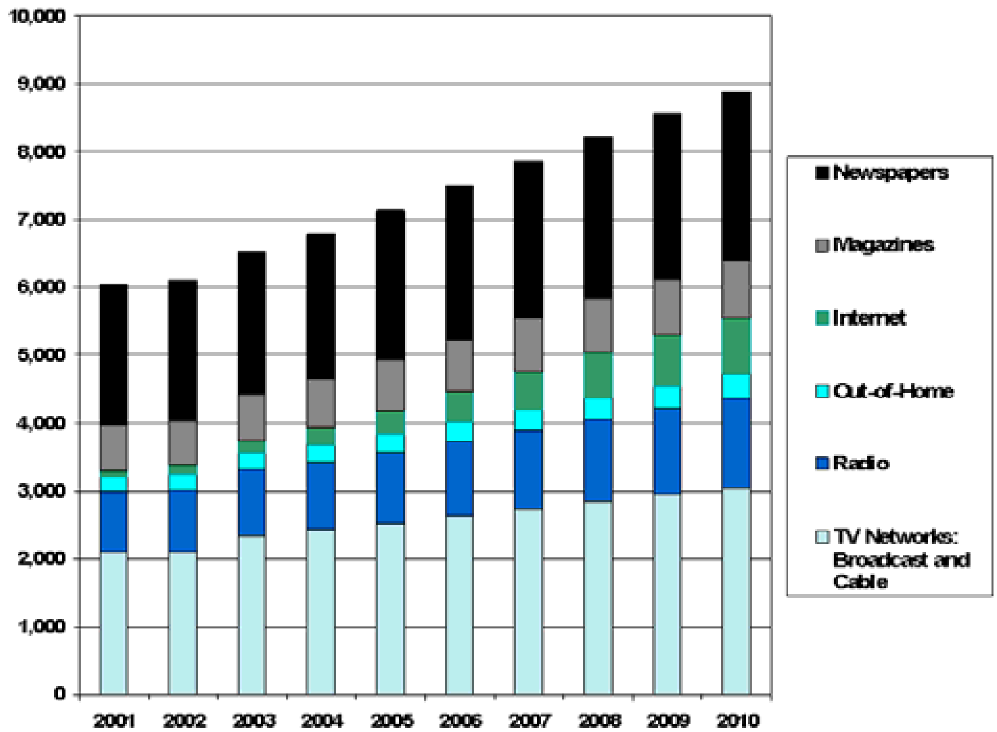
Source: PricewaterhouseCoopers 2007 Media and Entertainment Outlook

- **While some TV advertising is leaking, the total pie is still growing:** While subscription television revenues remain stable, the concern for broadcasters may be around loss of advertising dollars. While some advertisers are pulling money out of TV, according to a PwC forecast, total advertising expenditure, TV advertising expenditure, as well as TV advertising as a proportion of total advertising are all growing (see Figure 5).
- In TV, this growth appears to be driven particularly by a number of strong specialty-TV favourites. Specialty-TV advertising is driving the majority of overall television growth with expected cumulative average growth rate (CAGR) of 8.9%[22] over the next 5 years, likely driven from a number of the top-tier specialties which enjoy high viewing and highly desirable demographics for advertisers. We know that pay and specialties viewing share increased from 33.6% in 2002-3 up to 38.3% in

[22] *PwC Globe Entertainment and Media Outlook 2005-2009*

2004-5, whereas Canadian conventional broadcasters have marginally decreased from 39.4% share of viewing down to 39% in 2004-5[23].

Figure 5: Current and Forecasted Ad Revenue in Canada ($U.S.), 2001



Source: PricewaterhouseCoopers Media and Entertainment Outlook Note that the exchange rate used in PwC Media and Entertainment Outlook was the average for 2005 (meaning 1.2 Canadian per USD)

- **Broadcasters and content companies may be able to recoup some leakage going to the Web**: While Canadian web-sites may not be necessarily be the first choice for Canadian consumers, domestic companies will be able to compensate by earning back *some* of the revenues by making its content available on these sites. If Canadian broadcasting companies can establish new revenue streams, their collapse as media companies is much less likely.

- The CBC, recognizing the potential, has started streaming free, ad-supported news and entertainment content on seven websites run by HandHeld Entertainment based in San Francisco[24]. The CBC will provide segments from shows including *The Hour with George Stroumboulopoulos* and

[23] CRTC Broadcasting Policy Monitoring Report, 2006, Table 3.3, p. 43
[24] "CBC joins HandHeld Network"; 250507; http://www.playbackmag.com/articles/daily/20070525/CBC.html

The National and *Fashion File*. While ad revenues might be limited at first, the CBC is at least attempting to recoup some of the revenues lost by traffic migrating to U.S. based sites. If CBC is successful, such moves can help the stem the ad losses to U.S. based sites.

2.3 We See Co-existence Rather than Cannibalization – But the Current Model Will Change

History shows that new media (e.g. television at its introduction) appears disruptive at the outset, threatening to destruct traditional media. Yet what we have seen happen is that they eventually settle into a co-existence with one another as they each evolve to fulfill different roles in our everyday lives. TV did not destroy radio, as radio did not destroy newspapers – although each did replace some of the role of the medium it followed. In the same regard, the Internet will challenge the role of traditional TV distribution, and interactive content will compete to a certain extent with TV content – but there will likely be some form of co-existence.

- **Certain content will suit certain distribution forms and technologies*:*** As radio plays died a quick death following the introduction of television, certain content currently viewed on linear television may be driven to the Web for viewing, while other content may no longer be delivered in linear schedules via a broadcaster, but direct from a BDU via on-demand or pay-per-view. While it is unclear what those genres will be, research from AOL in Figure 6 demonstrates the different preferences American viewers have for viewing different genres online. In the future, linear TV may still be best for live programming, such as sports for example, while on-demand will best deliver a range of hit and niche programming in addition to movies as it does now. The Internet may be best currently to deliver news clips, but your satellite or cable package best to deliver *Corner Gas* in HD.

Figure 6: Preferred Audiovisual Content of Americans Over the Internet

Content Type	% of People Who Preferred this Content
News	72%
Television and movie excerpts	59%
Music videos	48%
Sports highlights	44%
Amateur videos	43%
Full television programs and films	22%

Source: AP-AOL Study, September 2006[25]

- **The Internet will continue to compete with TV – but people will become better and better at multi-tasking:** We may be witnessing evolutionary development comparable to the opposable thumb in that audiences are managing to ever-more multi-task and fit more into the day. While such is beyond the scope of this paper, we experience it in our everyday lives and the figures we have demonstrated back this up – email is done during TV commercials, blogs are written with a hockey game in the background. Also, while youth will grow up and evolve their habits in step with their life-stage, certain habits will be formed – for example, the ease with which the likes of YouTube and Google can search oodles of content on the web will drive expectations about navigation tools for TV which are more user-friendly than the clunky BDU electronic programming guides (EPGs) we see today. The system may not collapse – but all stakeholders in the Canadian television system will have to address the attention scarcity challenge.
- Revenues will come from a variety of sources, and the television broadcasting industry expects to have fingers in all pots. The media buying world is not going to shift overnight to the Internet, as TV spots still deliver mass audiences and engender greater involvement (for good ads) compared to viewing a web site banner ad. But the measurability of Internet advertising, combined with the ability to precisely target niche audiences, will drive many advertisers to rethink their media mix. For this reason, as we discuss further, broadcasters will continue to need to shift their content strategies to keep pace with shifts in the ad markets.
- **Geo-blocking will maintain closed markets – like what we are used to today:** The worry with TV over the Internet has been that it would create a system so open that Canadians will have access to content disseminated from anywhere, and

[25] Cited in "Trends in Multiplatform and Multimedia", Research conducted for the Canadian Television Fund, prepared by RADAR Services Médias. Jan 12 2007

eyeballs and hence revenues would escape to the south. But geo-blocking or geo-fencing – that is, the ability to restrict access to content depending on geographical locations – and subsequent restrictions for rights maintain a closed system that in some ways mimic closed systems of country-specific BDU platforms. While our inability to access tv shows on iTunes or NBC.com might be frustrating for users, geo-fencing enables producers and broadcasters to divvy up rights for territories like in the old world.

3 The Impact on the Broadcasting System: Zero-Sum Game or a Rising Tide that Lifts All Boats?

As we witness the changes to the broadcast identified earlier, the pundits speculate who the winners and losers will be in the broadcast system. Will broadcasters win if they can retain the rights to programs and bypass cable and satellite BDUs by going online? Or will producers win if they can retain the rights and they can go directly to content aggregators like *Joost* without needing a broadcaster's green light? Yet the impact of new technologies and consumer behaviour on the broadcasting system might not lead to such a clear-cut zero-sum game for all the players. Certain moves by broadcasters might hurt producers and BDUs, yes, but other moves by broadcasters can work to strengthen a system whose success would create a rising tide that would lift all boats in the broadcasting system. Here, we examine the impact of the changes to be experienced by the major broadcasting system stakeholders, and discuss if in Canada such changes will drive the system to become a zero-sum game or whether they will give us the chance to develop a rising tide.

3.1 Emerging New Players in the System

The typical value chain in the broadcasting system to date has consisted of BDUs, broadcasters, producers, and creators. But as TV viewing takes off online or via mobile wireless, a number of new players are emerging which will become integral parts of the system. While not all of these new players are Canadian based, they will all form a key part of the value chain in the future. While there are numerous models, we have attempted to categorize the roles we see these new players taking on in the new system. Some new players will take on more than one role, and some old players will move into these new roles.

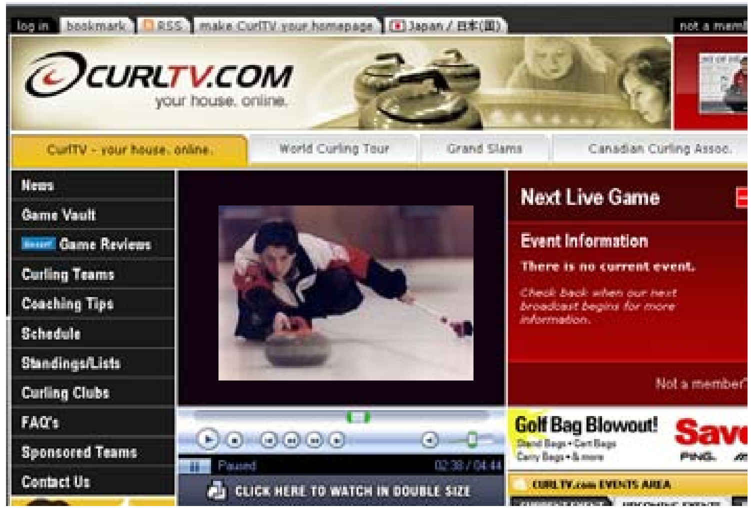
- **Aggregators who master navigation technologies such as search and recommendation engines will be the ones who monetize the long-tail***:* As we mentioned earlier, the youth whose TV viewing habits may change over time will not be easily weaned off the ease and efficiency of super search engines returning a googol of results in perfect order of desirability and relevance. For this reason, companies that pull together vast amounts of content and provide top search and navigation functions will reap the rewards. For example, while YouTube started as a user-generated site, now its function extends to searching and finding the gem clip such as "Hedley and Wyche British Toothpaste Ad' from Saturday Night Live from the 1990s in 2 seconds flat.

- While this kind of search engine will work for content already known and in the water cooler vernacular, recommendation engines such as the type adopted by Amazon and even more sophisticated ones like *Pandora's Music Genome Project* coding will draw in consumers and enable them to sift through millions of videos. P2P aggregators such as *Joost* and *Babelgum* will offer sophisticated technology (as well as easy navigation interfaces) that helps viewers find what they are looking for, but also that helps advertisers target directly those consumers they are looking for. Delivering for consumers as well as advertisers will propel aggregators to the top of the food chain in the online TV world.

- **New curators and taste-makers will draw in viewers who don't know what they are looking for:** Noted broadcaster and producer Michael MacMillan calls the function of selecting, compiling, and organizing content 'curating' in the new TV and content world. As in the art world, a curator selects, organizes, and markets content as a human function and this is what draws in audiences. While aggregators will provide technical navigation and search functionality, curators will be the taste-makers – selecting content which exists, or commissioning new content, organizing it with other content in a way which appeals to viewers. To a certain extent, broadcasters currently do that in scheduling programming for linear channels, and VOD operators do the same in acquiring the rights to programs which they offer consumers with a fairly crude form of navigational assistance for the viewer.

- But new players, Canadian companies among them, are integrating the selection of top content, separating the wheat from the long-tail chaff, and also managing the rights negotiations, marketing, and platforms to become the new curator class – at least until they are bought out by media companies with the larger brands and promotional platform. Many new companies starting to make enter this arena are still half aggregator, half curator – such as *iThentic* and *Heavy.com* – but over time, companies will emerge to own this space and deliver serendipity content to consumers.

- **Niche channels will succeed by being destinations as well as brokers of niche content:** Companies who master specific genres, demographics, or specific brands of content will not only be able to draw in traffic to destination sites but they may also be able to exploit rights to content they've acquired or packaged. One successful



example is a Canadian company called Statusfirm that has launched a number of niche channels online – including *Curl-TV* and *RawVegas.com.* Rather than aim for large audiences, it selects smaller groups of viewers where it knows it can drive advertising or subscriptions. It has broken even in a number of its properties even with less than 10,000 viewers for example on Curl TV[26]. Some niche channels will exist solely on the internet – like CurlTV does – but others will succeed across platforms. For example, CHUM's established niches in Fashion and Music will continue to succeed at both packaging content for other content providers as well as attracting audiences across platforms to destination channels and sites like fashiontelevision.com.

- While most niche channels will be buyers of content, there will be a lucky few producers who will break through with their own channels. The phenomenon of Quebecois Têtes-à-Claques demonstrates that successful producers can create own their niche channel and reap the benefits of owning the consumer and the rights. Salambo productions created these animated

shorts and distributed them on a website which quickly became one of the top-visited sites in French Canada. Têtes-à-Claques has also partnered with Bell to make the clips available Mobility, ExpressVu and Sympatico/MSN services[27]. While not many will make it as a niche channel, there will be a lucky few who break

[26] **"An idea of small Web TV sites goes big-time", by Grant Robertson, Globe and Mail, April 21, 2007**
[27] **Bell Press Release, Feb 1, 2007 "**Bell Canada first to give Canadians a laugh with the Têtes à Claques phenomenon"

through and succeed without needing to go through other channels or broadcasters necessarily.

Of course, the categories we have identified are not discrete. Many good niche channels will act as curators; aggregators might employee curatorial techniques; and niche channels might aggregate content within their certain niche. For example, Canadian specialty channel Bite-TV is a niche channel providing short-clips for 18 to 34 year old men, but they also aggregate user-generated content, curate selected content, and co-produce content. So, while many new and old players will be a hybrid of all three categories, the understanding of emerging business models can help to identify how the future will impact the various stakeholders of the broadcasting system in the future.

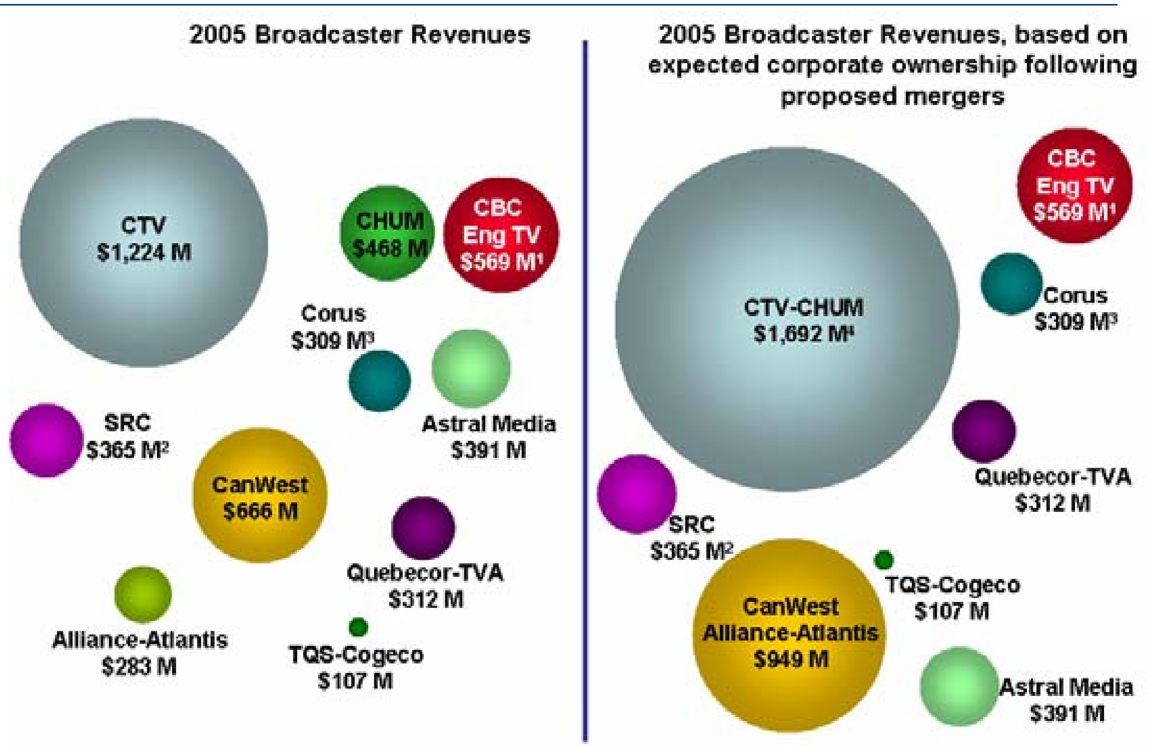
3.2 Broadcasters as Aggregators, Curators, or Niche Channel Operators

This year we have seen the move toward consolidation in the broadcasting sector. A number of factors have driven this consolidation – including an opportunity to gain a little leverage in the competition for advertising, programming, and access to BDUs. This consolidation does create several media behemoths which may lead to a certain imbalance in the market – particularly in terms of the buying of Canadian programming. However, with wise decisions, the new strength could also drive success of the Canadian system by becoming or even acquiring curators to discover and finance new Canadian content, driving new business models for niche channels, through successful rights exploitation and acquisitions of innovative companies.

- **The move toward consolidation is a rational strategy to buy time and resources to make the Internet play.** Why did broadcasting groups pay full price for assets that have likely reached their peak? In part it was to gird themselves for the future development of broadcasting. As broadcasters witness the massive changes in the market – changing viewing habits and technologies, the emergence of aggregators brokering advertising deals in their place – they realize that something should be done. Without established business models, it just is not clear what yet. Consolidation enables broadcasters to gain the strength that might be needed in a new world where Hollywood rights become harder and more expensive to acquire; strength to invest in rights exploitation and revenue generating online where one can expect a lot of trial and error, and where offering “360” multi-platform content becomes a must. However, with power comes responsibility to benefit the Canadian broadcasting system.
- **The emergence of a King-Kong creates an imbalanced market:** While consolidation may be a rational play, Canada will see an imbalance in the structure of the broadcasting market. In the U.K., former BBC Chief Greg Dyke referred to

the broadcasting market as having three 800-pound gorillas and emphasized the importance of having three broadcasters of equal weight to balance each other – with ITV and Sky each over £2 bn pounds, the BBC of equal weight provides counterbalance. Figure 7 below demonstrates a before and after snapshots of the Canadian market – and what we see is no gorillas, but the emergence of a King Kong that towers over the rest. Consolidation then does in essence create an oligopsony – an awkward term identifying conditions of imperfect competition where there are many sellers but few buyers. Producers worry that there could be a negative as they have no choice but to take the terms imposed on them by powerful buyers in the market.

Figure 7: 2005 Broadcaster Revenues Before and After Consolidation



1. Includes estimates for 2005 advertising revenues lost due to NHL lockout; includes pro-rated estimate of CBC English TV's share of annual parliamentary appropriations; includes CBC Newsworld and CBC Country Canada
2. Includes pro-rated estimate of SRCs share of annual parliamentary appropriations; includes RDI
3. Excludes revenues of Corus' three conventional TV stations
4. Includes 100% of CHUM revenues; does account for the transfer of certain CHUM assets to Roger Communications Inc.

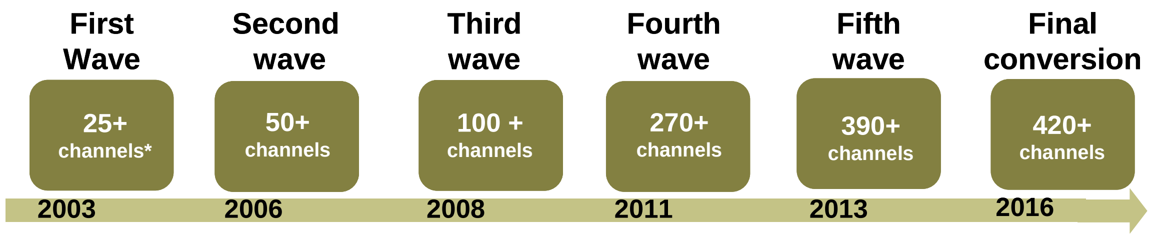
Source: Annual Reports; CRTC, Broadcasting Policy Monitoring Report 2005; and CRTC financial statistics for individual pay and specialty television services.

- **Broadcasters need continued access to U.S. programming to cross-subsidize Canadian content:** While an oligopsony could hurt Canadian producers, a more consolidated broadcasting system might be needed to keep intact the Canadian TV market for purchasing rights for top rated American programming – on terms that can continue the cross-subsidy for Canadian content. While providing TV programming content online is still expensive, the US rights holders will be exploring business models to extract ever more revenue from their properties, which will include selling online rights to other jurisdictions for a cost much too high considering the limited pay-off from online rights at this stage.

- If rights for TV and online distribution continue to become so exorbitant relative to their value in ad dollars, some Canadian broadcasters may soon find that their annual trek to Hollywood screenings change dramatically – that top TV series will be beyond their means. That would be dramatic for Canadian commercial broadcasters and take away their prime breadwinners – and the profits from which they can cross-subsidize Canadian programming. While it is impossible to predict if this outcome will occur, the US rights holders would have to consider how they would replace the revenue from the sale for the Canadian television market. Since Canadian broadcasters are paying an ever higher price for these US shows, it is ironic in that it may serve to protect the market longer from any alternative way that the US rights holders could monetize their program assets. At the same time, the more Canadian broadcasters pay for these rights, the less of an ROI they will make – which means less for Canadian programming.
- **Capacity constraints from HD may drive niche broadcasters to look for new distribution and revenue models:** As we demonstrated previously, there is evidence of increasing demand for HD services – but Standard Definition (SD) will need to co-exist for some time with HD until all Canadians convert. The capacity needed for both to co-exist will place strains on BDUs and satellite operators. Besides having to produce in HD, and acquire HD programming, broadcasters face steep costs to transmit HD programming.
- In Figure 8, we show that TV channels are expected to convert to HD over time in waves. First, there are conventional TV networks and larger specialties launching HD services, leaving behinds smaller specialty channels to the final waves. This delay could place these lagging specialties at a competitive disadvantage for viewers who set their EPG favourites to HD-only channels. These smaller specialties or niche channels, will struggle to find the business case to convert to HD – leaving them to pursue alternate distribution options[28].
- While it may first appear that these niche specialties will 'lose' due to the high HD conversion costs, they may be pushed to find innovative distribution and revenue models before the large conventional networks with conservative and risk-averse shareholders, and these niche specialties have the opportunity to emerge as winners. If Curl-TV can make ends meet via online distribution only, why not some existing niche channels?

[28] "Market Assessment of Broadcast Market for Satellite Services in Canada" for Ciel Satellite Group, by Nordicity Group (2006)., p.35

Figure 8: Many Niche Specialties May Not Convert to HD until beyond 2010[29]



3.3 BDUs as the New Programming Aggregators

Despite concerns cable and satellite BDUs are not going to experience significant losses from Internet distribution any time soon. To prepare for the future, however, they would be wise to seriously explore the future role of aggregators and curators and determine where they might make a play.

- **While Canadians love their many channel services, some are opting for TV online:** As we saw earlier, Canada enjoys one of the highest multi-channel subscription penetration in the world. Because of this distribution infrastructure, Canada also is able to support one of the highest number of subscription TV platforms compared to any other countries. While many countries may have seen the emergence of several providers of subscription TV at one point, many of these providers have gone bankrupt or consolidated, typically leaving 2, at most 3, different providers[30]. Unlike Europeans, Canadians have come to culturally accept the TV bill as an essential. And the subscription price continues to increase as BDUs provide more channels, more services, and more HDTV programming. We are also seeing subscription TV household take-up increase rather than decline.
- Maybe the new generation who buys broadband Internet (say, at college) before BDU service – and thereby watch TV online - will change the consumer patterns. However, many other Canadians will continue to pay their satellite or cable bill for some time in order to get HD and premium content to their widescreen TV. For that reason, Canadian BDUs are far from facing imminent crisis.
- **The new platforms will mean that new BDUs – and subsequently revenues – will arise:** Contrary to what some think, the Internet is not free. The more traffic, the more bandwidth is required despite improvements in throughput or such technological approaches like peer to peer. Broadband ISPs like cable and

[29] Ibid
[30] In a report for South African satellite TV licence applicant, Midi-Sat, Nordicity identified a number of countries where only 2 or 3 subscription TV platforms existed after mergers or bankruptcies of others – including Spain, Brazil, and Italy. Reference: *The Case against Over-licensing and Recommended Regulatory Measures to Promote a Competitive Pay TV Environment in South Africa, (*2006), by Nordicity Group.

terrestrial phone companies will expect more return on their capital investment in capacity than simply renting their pipes to others – they would like to share in the new revenues. But this expectation runs counter to the previously accepted telecommunications principle of non-discriminatory access. The debate of "net neutrality"[31] has begun in earnest in the US. Google, e-Bay, Amazon and other Internet giants are in a legal and regulatory battle over whether broadband ISPs can charge different rates for different customers – thus carving more of a share of the revenue pie. Imagine the cable industry, which faces competition from the new IPTV telcos, forecast to grow from 100,000 in 2005 to 800,000 by 2010[32]. BDUs are also seeing potential market share drain on the broadband ISP side of the house. While not on the policy agenda for 2007, the issue of net neutrality will shape who remains the gatekeeper of the future.

- **BDUs entrance into aggregation and the curatorial scare broadcasters, but may not be that harmful:** Many BDUs are ramping up their content plays to feed their VOD or PPV offerings. An early leader in Canada is SaskTel, which has regularly launched content for the last four years. Rogers now purchases *Survivor* directly, which pits it into direct competition with broadcasters. Bell Express-Vu operates many HD PPV services to compete against cable's VOD. Telus is on the hunt for essentially a Chief Creative Officer who will seek out the best content to put across its IPTV and wireless platforms.
- The content acquired by BDUs is sourced from both broadcasters and producers directly – while some productions stand alone with their production brand name (such as *Survivor* or *This is Daniel Cook*) other content will come from known broadcasting brands (such as Fashion Television). If BDUs are able to drive innovation in this area – putting out desirable content on a range of platforms – they are competing against broadcasters. However, they do not appear to be trying to duplicate the work of broadcasters in linear programming, and may often be partners with or customers of broadcasters and producers.

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[31] **Network neutrality** is a term used to denote regulation whereby ISP networks cannot favour some destinations over others, or classes of application over (e.g. the world wide web) over others (e.g. VOIP);

- An argument for network neutrality would be to prevent ISPs becoming Internet gatekeepers, deciding which web sites go fast or slow and which would not load at all, which would enable the ISPs to discriminate in favour of their own search engines, Internet phone services, and streaming video.
- An argument against network neutrality would be that sweeping and rigid net neutrality legislation could erode the quality and responsiveness of the Internet, limit consumers' competitive choices, and discourage investment in broadband deployment

[32] RBC Capital Markets, North American Telecom Services, July 2006

3.4 Producers Riddle – How to Overcome Unfavourable Economics to Take Advantage of the New Markets

Unfortunately, producers can look toward a smaller domestic market in the near term for a number of reasons: conventional broadcaster advertising revenue growth is forecast to be flat over the next 5 years, and they may have to pay ever higher prices (and thus earn less margin) on acquiring the rights to foreign (US) prime time programming; and a variety of forces will squeeze the pay and specialty-TV's financial ability to acquire Canadian programming (e.g. loss of subscribers in analog's migration to digital; parallel operation of HD and SD channels; pressure on wholesale fees from BDUs).

The significant benefits packages from the two major broadcasting group consolidations may offset these market pressures for several years. However, the regulatory support system will become less helpful with the increase in on-demand programming and on-line access.

By and large producers already live precariously with very thin profit margins, and need to do a continuous stream of productions to stay in business. While many fear the collapse of a system protecting Canadian content, others see the multi-platform developments as presenting a possible golden age for Canadian producers. Yet the route to that golden age is far from clear.

- **The 'dirty truth' of the long-tail means that going it alone on the Web is not necessarily a solution:** While certain niche sites and channels will work, much of the long-tail – that is the thousands of niche TV programs each viewed by small audiences – will benefit the successful aggregators rather than the content suppliers. Aggregators will be able to monetize the content through thousands of transactions, but. content suppliers could see their product languish on the "shelf" with absolutely no sales, or tiny sales. Owning the rights to a program and taking the program directly to a Joost or a Babelgum is not likely going to substitute for a broadcaster license fee.
- Some ancillary content rights are more valuable than others. Kids' genre, like the *Degrassi* franchise has more ancillary rights potential, as does a content concept that lends itself to an interactive game application. Serialized drama programs (like *24* or *Lost)* have a greater DVD or online potential than series with self-contained episodes (e.g. *CSI* or *Law and Order).* While it may take a complex matrix algorithm to figure out what will work where, such considerations should factor into rights negotiations. Producers and broadcasters have to learn more about the relative value of various rights, and perhaps be more flexible in their rights negotiations in certain cases.

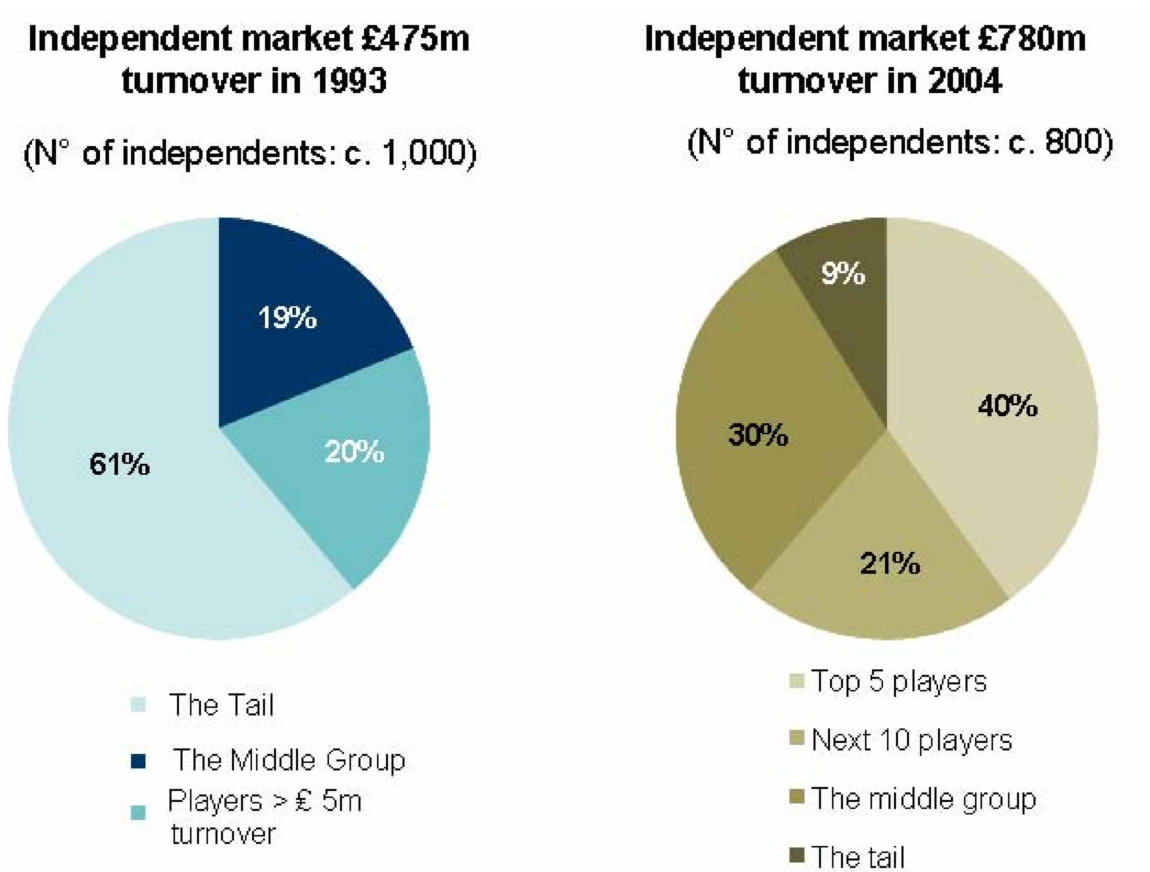
- **Innovative and savvy program producers are learning how to become true rights managers and build equity**: Subscription or ad revenues via the long-tail may come after exploitation has been maximized through licence agreements with broadcasters. Thus, they have learned to negotiate for reverting rights back after a short period, or sooner if the broadcaster has not acted on those rights.
- In some instances, innovative models like sponsorship. Savvy producers are also working with advertisers to develop sponsorship models which can offer the initial funding needed for development and funding, leaving the producer less reliant on the broadcaster for the capital outlay which often comes at a cost of giving up rights. For example, Marblemedia's upcoming *Taste buds,* a cooking show for kids, presents numerous possibilities for in-offensive but potentially lucrative sponsorship deals.

- Producers understand that they may need broadcaster collaboration to exploit new platform rights in many instances – whether it is through sequencing of exploitation in certain territories with broadcasters and other content companies, packaging and selling components of 360 productions, and considering subscription or ad revenue via long-tail distribution as the last phase in an exploitation strategy. However, there will be serious negotiations over, say, whether the online properties will be exploited through the producer or broadcaster websites.
- **For others, consolidation or collaboration with other producers may be necessary to exploit rights successfully.** While there are producers who with knowledge, experience and clout will be in a position to negotiate retention of rights and then be able to exploit them, some smaller producers may struggle retain rights in negotiations with powerful broadcasters. And if they succeed, they might find that the exploitation of such rights reaps little rewards for them. Marketing costs for each hour of content are likely to take a higher proportion of program budgets than they currently do.[33]
- As 360 elements of projects become critical, not all producers can do their own marketing and create interactive elements. Merging – or collaborating – with companies that have strong distribution and sales arms to apply economies of scale to marketing could help producers exploit rights, as well as partnerships or acquisitions with interactive agencies can help producers deliver on this increasingly important element of productions.

[33] Future of Broadcasting Regulation, p.18

- Such developments appear to have occurred in the UK – as new terms of trade for producers piqued the interest and investment of the financial sector, the sector in turn has encouraged consolidation deals in order to achieve economies of scale[34]. The result is a more consolidated sector, but also one that exploits its domestic content well. Currently, for every $10 million of production in the U.K. there are 1.7 production companies, comparative to 2.5 in Canada[35]. And 19.8% of all TV revenue now comes from the international market, a fact partly attributed to having sizable distribution arms as well as new rights ownership framework. Unfortunately in Canada, virtually all of the producers who have raised money in the public markets have failed, or as in the case of Alliance-Atlantis morphed into broadcasting companies. It is not clear whether the "street" will ever be a friend of the production sector in Canada.

Figure 9: Consolidation in the U.K.'s Production Sector



[34] See "The Creation of Regulated Terms of Trade Between Producers and Broadcasters in the U.K" written by Nordicity Group for the CFTPA, 2006, Annex to the CFTPA's 2006 submission to the CRTC TV Policy Review .

[35] Canadian figures include feature film where the U.K. does not. As features have much larger budgets, the picture would be more drastic if comparable TV only production data were available

[36] Among the study's recommendations were the following: early stage loan guarantees for financing production, interim and gap financing subsidies, tax credit holdback loan guarantees, and earlier payment of tax credits – all designed to strengthen the production company's balance sheet.

and diminished regulation, the global market has to figure more prominently in the future of program production.

4 Regulatory and Policy Implications

As a leading proponent of the UNESCO Declaration on Diversity[37], Canada has an evolved "took kit" of measures to ensure a diversity of Canadian voices are expressed and distributed in the broadcasting system.[38] While one could debate whether the whole system should be abandoned, we are assuming that the challenge is to adjust the tool kit to the realities of TV as it is evolving.

That we are living in the two worlds of traditional and emerging media is evident from the current trends in the business, as outlined in sections 2 and 3. Accordingly, continued fine tuning of the existing mechanisms would appear to be relevant to world number one. At the same time there is need for reflection on what changes in regulation, policy, and tax measures should be considered for world number two, i.e. the world consisting of new distribution platforms and content formats.

Public intervention in Canada is both regulatory and program policy, including tax measures within a broad definition of government programs. The first issue is to determine whether it is time to act, i.e. when has the ground shifted enough so that new approaches to regulation and programs are warranted. The second is how the tool kit should be adjusted to take account of both worlds. How the plethora of developments in new media might create a new alignment of regulation and program policy is addressed below.

4.1 Regulation can be a drag on change or a force that shapes broadcasting

The original basis for issuing broadcasting licences on a selective basis was for reasons of spectrum scarcity. Most countries continue to allocate broadcasting and distribution licences, even if spectrum scarcity is only indirectly or not at all at issue. In Canada, we use broadcasting regulation to meet the objectives of the Broadcasting Act – including the requirement for appropriate contributions to the broadcasting system to promote Canadian content.[39] However, new technology applications and consumer responses

[37] "UNESCO Declaration on Diversity," 2002. This is a declaration on the preservation of cultural diversity. http://unesdoc.unesco.org/images/0012/001271/127160m.pdf
[38] See an excellent description of a tool kit in Peter Grant, *Blockbusters and Trade Wars:Popular Culture in a Globalized World* (Vancouver: Douglas and McIntyre Ltd. 2004).
[39] S. 3(1)(e): "…each element of the Canadian Broadcasting system contribute in an appropriate manner to the creation and presentation of Canadian programming;"

to new products and new offerings could seriously erode the regulator's leverage over the broadcasting system. In essence, the regulatory implication is twofold:

- **On-demand access eliminates prime time Cancon quotas:** The more that TV programming is being viewed on an on-demand basis, the less regulatory sway the CRTC has because it cannot impose content requirements on prime time viewing; for example, the CRTC can specify that Canadian content can be offered on VOD, but obviously cannot impose obligations on VOD operators to display Canadian content when it is not requested by the subscriber.
- **Unlicensed online competition weakens the case for strict regulation of BDUs:** The more content is being consumed via distribution systems that cannot easily be regulated, the more pressure is put on the regulator to relax the rules for the activities still under regulation; for example, the New Media Exemption Order and a confirmation of its appropriateness for mobile content services have shown that the CRTC has chosen not to try to regulate these new platforms (at this time).[40] Given this hands-off approach, it is only natural that licensees operating within the regulated part of the system should ask for diminished regulation to be competitive with non-regulated services – such as online distribution of TV programming.

Canadian regulation is a complex web of support system for broadcasters and Canadian content. It is based on the regulated allocation of licences, protecting the terms of access to BDUs, and minimum content and Canadian programming expenditure commitments. These measures are best suited for the linear television model. So, should the Commission start regulating for the on-demand and online environment?

- **New TV policy cautious on changing the system:** Triggered by announcements at last year's Banff Conference, the CRTC examined conducted a fact finding enquiry into the impact of technology on the broadcasting system,[41] and reviewed TV policy for over-the-air television services.[42] With respect to the latter, the CRTC concluded that broadcasting system, although operating within an environment of rapid development in Internet-based applications, had not convulsed enough to warrant major changes in regulation. The CRTC concluded that there was no necessity to grant conventional broadcasters access to more revenues through the

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[40] See New Media Exemption Order at http://www.crtc.gc.ca/archive/ENG/Notices/1999/PB99-197.HTM and Mobile content services at http://www.crtc.gc.ca/archive/ENG/Notices/2006/pb2006-47.htm.

[3]9 The Government of Canada asks the CRTC to report on the impact of new technologies and the broadcasting industry Press Release, June 11, 2006, http://www.pch.gc.ca/newsroom/index_e.cfm?fuseaction=displayDocument&DocIDCd=CBO0603

[42] \ Broadcasting Notice of Public Hearing CRTC 2006-5, 12 June 2006.

imposition of fees for carriage. However, the CRTC did announce the removal of the 12 minute limit on advertising in order to stimulate more revenues for private broadcasters.[43] It would seem that while the CRTC has decided not to re-regulate that which is exempted, it is not yet backing off from current regulations for conventional TV services.

- **Big regulatory agenda on distribution and specialty-TV:** This year's CRTC agenda will consider the regulation of pay/specialty-TV services and BDU regulations[44]. To foster new service innovation and provide customers with choice, BDUs will be seeking maximum flexibility to set rates for programming entities, select which of them they want to carry, and package however they want – although generally they seem to be prepared to commit to maintain the preponderance rule, whereby they would always offer a preponderance of Canadian TV services. The new telecom BDUs, i.e. Canadian telephone companies entering the BDU business via IPTV, have ported telecom regulation thinking into the process, for example arguing for ex post facto regulation vs. ex ante.[45]
- Already facing a tough period of transition from analog to digital,[46] Canadian pay/specialty services view this flexibility as being counter to their interests. Logically, they will warn the CRTC that they might need to consolidate, fold some services, or ask for relief from their conditions of licence and Canadian programming expenditure commitments. To some extent the consolidation initiatives that will result in the swallowing up of Alliance-Atlantis and CHUM constitute a recognition of the need for greater strength in dealing with BDUs with less protection from regulation. If the result is fewer subscribers for fewer Canadian services and lower payments per subscriber, clearly Canadian programming will receive less support. The program production community might wonder what they would get in return for allowing any relaxation of the distribution stipulations or obligations - what would be a quid pro quo for BDUs in terms of their contribution to the Canadian programming.
- **More financial contributions for less regulation?** While the regulatory fingers can possibly retain the validity of the regulatory dike for some years, eventually

[43] Broadcasting Decision CRTC 2007-112, CBUT Vancouver – New Transmitters, 17 May, 2007. http://www.crtc.gc.ca/archive/ENG/Decisions/2007/db2007-112.htm.
[44] CRTC Three-Year Work Plan 2007-2010, April 24, 2007 http://www.crtc.gc.ca/eng/BACKGRND/plan2007.htm.
[45] See David Elder, Bell Canada,, Panel presentation at Insight Conference in Ottawa on Broadcasting, May 1, 2007. This means that the CRTC would only intervene after the BDU makes the commercial decision and would establish a dispute resolution process if an affected broadcaster had an issue with it. See: http://www.insightinfo.com/Conferences/brochures/brochure.cfm?product_code=TCC07109.
[46] See Digital Migration Regulations, as established by the CRTC in 2006

there will need to be thinking about what it can do in the increasingly non-linear world. In part to address this issue, the CRTC has initiated an internal review of new media. For a start, the CRTC will always have a say in the access issue for Canadian content, e.g. to prevent undue preference by BDUs for their own content. On an ex post basis, the CRTC could roll back any actions in which Canadian content and Canadian services are being denied access in favour of foreign services and foreign programming. It would not be similar to the ex ante guarantee of priority access as exists today for Canadian TV services. Yet the two worlds of traditional and new media will be running side by side for some time, if not for the foreseeable future. It will be incumbent on the BDUs, then, to put together some appropriate replacement support for Canadian programming.[47]

- BDUs will themselves encounter increasing competition from broadband wireless and Internet carriers, i.e. broadband ISPs. While concepts like priority carriage would be difficult to contemplate, payments to content funds – say a new media component of the CTF – could be considered. In the wireless sector, cell phone carriers are familiar with the 2% of revenues that should be dedicated to Canadian R&D. A content "surcharge" on revenues earned for transmitting content would be a logical possibility, although it would be difficult to pinpoint that portion of broadband use that would be allocated to content services. If it depended on some form of pay-per-use or subscription fee, the value of any surcharge would likely be modest because that would constitute only one source of revenues for such services.
- A broadband ISP surcharge would bring some form of equivalency to the BDU sector, in the sense that both BDUs and broadband ISPs would be contributing to the funding of Canadian content. Of course, it is acknowledged that the major BDUs – cable and satellite – are in communications groups that also operate broadband ISPs. Therefore, any form of additional financial contribution by BDUs/ISPs would likely be resisted.
- There might be less resistance if the form of contribution would be more palatable to broadband ISPs. For example, if it could be in the form of equity investment in new media content companies, or in projects for which there is some potential return, it could be more acceptable. Since, this is another form of preliminary bargaining on terms of trade for this new sector, the programming content producers' interests would need to be considered as well.

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29. Broadcasting Public Notice CRTC 2006-23: Digital Migration Framework. February 27, 2006. http://www.crtc.gc.ca/archive/ENG/Notices/2006/pb2006-23.htm.

[47] Although he did not commit to more funding, Darren Entwhistle, CEO of Telus, has suggested an expansion of the scope of funding: "…CRTC-mandated levies on distributors should be directed to all manner of production funds…. new funds to support creators working with new media. We need to incent a stronger Canadian presence in this emerging arena."

- The CRTC is already reviewing the way in which the CTF is financed and operates, as well as reviewing the regulator's role in protecting/enhancing Canadian new media content. The CTF is the de facto terms of trade arbitrator for TV programming between the broadcaster and independent producer. As multi-platform rights increase in importance, this terms of trade role will flow into new media in any event. The question is whether the CTF will be handed responsibility for the financing of content for which broadcast rights are ancillary rather than primary.
- **Searching for the right "quid" for the less regulation "quo":** Changes in BDU regulations and exemption orders for unlicensed broadband and mobile ISPs could be considered one part of the bargain for BDUs and exempted ISPs. Increased flexibility could be granted, as long as there is protection from access "abuse," and in return for more supply side financial contribution from BDU/ISP operators, i.e. more money for content providers. In access rules it might be a combination of prescribed requirements and an ex post redress system. Many details would need to be worked out as to increased financial commitment, but it would begin with BDU regulations and proceed from there to obtain some form of financing from broadband ISPs following its reflections on new media and the CTF. In this way, the CRTC would be a facilitator rather than a drag on the transition to an era of on-demand services and multiplatform exhibition.

4.2 Terms of Trade Under Regulatory Purview

In its recent decision on over-the-air broadcasting policy, the CRTC recognized that new platform rights were growing in importance for broadcasting content. The CRTC announced that it would require conventional broadcasters to bring forward draft or completed terms of trade in the context of their next licence renewal applications.[48] Thus, as in the case of the UK, the regulator will presumably step up if other mechanisms do not work with respect to terms of trade.

- **CTF still the trend setter in terms of trade:** The CTF has evolved over a decade in a more vigorous fashion than many funding institutions. The CTF's board composition ensures a continuous review of the method of allocation and guidelines for the terms of agreements between broadcasters and program producers. In this process, the CTF is the key to determining acceptable terms of trade between these two sets of interests. The challenge to the CTF launched by Videotron and Shaw was another twist in stakeholders seeking major changes in the way in this allocation process, leading to the current review by the CRTC.

[48] Broadcasting Public Notice, May 17, 2007. http://www.crtc.gc.ca/archive/ENG/Notices/2007/pb2007-53.htm.

- **Challenges in determining terms of trade in new media while it is still evolving:** The problem with new media rights is that as an emerging sector, and it is unclear what the value of different rights are, how they should be exploited and who should get the primary benefits. Thus far, terms of trade provisions on the new media side of productions have led to a sometimes debilitating war between broadcasters and producers.[49] The challenge is to decide first how to carve up the spoils when the value of specific rights is not clear. In today's evolving market environment it is not clear who is better able to exploit the rights – the broadcaster or producer. While there are some emerging business models, potential values or various platforms are still difficult to estimate. Broadcasters, producers, and creators/performers are loath to give up any potential rights.
- **Broadcasters have key assets** Broadcasters have the legal and technical infrastructure, promotion and marketing platforms, and financial resources to make longer term investments in new rights exploitation. However, they are not comfortable about risking more than nominal investment where the ROI is far from established. This lack of clarity means that the opening position of broadcasters is that they want all rights for little or no payment, and only pay if and when these rights are exploited. With little investment at stake, there is not a huge incentive to go after some of these ancillary markets.
- Yet broadcaster groups know that they have to develop the capability to exploit new platforms in the future. With experience some broadcasters have learned that they have differing interests for multiple platforms. They might want only the broadcast rights for some product and yet want all rights for other product. As content producers in their own right for some products, broadcasters are also making deals with new platform distributors. Thus, broadcasters are beginning to understand what new platform investments make sense and what does not. As they become more serious about new platform rights exploitation, particularly on a global scale, they have the ability to invest in marketing and rights management systems to monitor and keep track of the rights they own for which markets. That investment can be an advantage to Canadian producer partners.
- **And so do producers:** Savvy producers with sufficient financial resources are able to exploit new media rights, but many producers are not so well endowed. Producers may need to pool their resources if not outright merge with other producers to attract new capital for this purpose. While consolidation is not an easy solution for independent production companies, there may be ways of sharing resources (like law firms as suggested by one observer) to develop the expertise and business models to take advantage of these markets.

[49] Of course, producers have to settle with creators, which led to a crisis in the production industry this past winter when ACTRA had to settle with the CFTPA. In the background was the US industry determined to see that no damaging precedents were established.

- Some independent producers begin with new media concepts and work back into conventional programming. In doing so, they have been at the front lines and have developed the experience in creating appropriate rights contracts with broadcasters. They have even been of help to broadcasters by bringing together different parts of broadcasters' organizations to integrate their interests (e.g. programming, sales, and promotion/marketing). Their experience should pave the way for traditional program producers to obtain appropriate terms with their broadcaster and other customers.
- **Incentives for experimentation and risk sharing:** If there is real emphasis on accommodating the two interests and if both broadcasters and producers are prepared to take some risks, Canada will indeed lead the way in creating "360" content, i.e. whose rights are exploited in all platforms. The creative guilds and unions are important parties in this equation as well, of course, particularly for live action programming. It is a new world and all sides have to take risks on terms of trade so that there is enough flexibility in the terms of trade to encourage innovation in the exploitation of all platforms. There should be a realization that not all producers will be in a position to exploit rights and in some cases, they may be better off ceding these rights but making sure they are compensated for any benefits accrued by the broadcasters. There will also be occasions when the producer and its web presence should be the appropriate platform for exploiting Internet and other rights. Any new terms of trade will require that deal level flexibility to make the commercial decisions that will most advance the content concept.
- **Increased access by vertically integrated merits cautious attention:** Opening up the CTF to support content owned by BDUs or vertically integrated broadcasters is a concept that would draw forceful reaction from independent producers. Yet integrated production/distribution companies are the foundation of some globally powerful program production entities in Europe, the Far East, and Latin America – in addition to Hollywood. Should a Canadian broadcaster which has made substantial investment in programming development and foreign distribution be restricted from accessing production financing and from leveraging its ability to schedule such programming on its own networks?
- If the regulatory system is to become more incentive driven, then such a question should be raised. If the BDUs and broadband ISPs are to be expected to put more in the CTF-equivalent pot, then perhaps those with initiatives that meet its objectives should be considered.
- **CTF for new media outside of broadcasting rights as the primary market?** As noted earlier, the CRTC is already reviewing the way in which the CTF is financed and operates, as well as reviewing the regulator's role in protecting/enhancing

Canadian new media content. The CTF is the de facto terms of trade arbitrator for TV programming between the broadcaster and independent producer. As multi-platform rights increase in importance, this terms of trade role will flow into new media in any event. The question is whether the CTF is handed responsibility for the financing of content for which broadcast rights are ancillary rather than primary. If the CTF were able to finance new media expenditures as well, it would have a major role in officiating between the two main parties in the terms of trade.

- Carving out a slice of funds from existing CTF programming funds for non-programming would certainly meet with opposition from independent producers. Therefore, it is presumed that if the CTF were to take on this responsibility more money would be forthcoming, either from government or from an expanded net of BDUs and broadband ISPs (as per the discussion above).

4.3 Public funding alignment with the emerging new television realities

CRTC regulation can influence the demand, e.g. oblige broadcasters to spend money on and air Canadian content, and oblige BDUs to carry Canadian programming services on favourable terms. CTF financial support and tax credits (and for feature films, the feature film fund) at the federal level and tax credits at the provincial level are supply side incentives. Together they have combined to develop an economic environment that produces thousands of hours of programming (over 2000 hours of priority programming in drama, children's, documentary, and variety through the CTF). One result is that at least the audience market share for Canadian programming has been retained over the last decade – at a time when the number of channels and therefore the viewing options has expanded every year.[50]

- **Financing incentives to produce programming of greater return:** The problem with the existing program support model is that it will become less effective with the declining leverage of the demand side. As on-demand and online distribution picks up, the CRTC will be less able to influence the demand side of the support system. Therefore, any redesign of the supply side support programs should take that into consideration.

- One could argue that in a more market driven system, the financial incentives for Canadian content production should be geared to projects with a higher ROI potential – presumably that would mean more exploitation of the new platforms. Not all programming with public support has to be "commercial" in this sense, nor does it all need to exhibit a full "360" view for Internet and mobile platforms.

[50] See the Summative Evaluation of the CTF for PCH with research support by Nordicity Group Ltd. October 19, 2005. http://www.pch.gc.ca/progs/em-cr/eval/2005/2005_11/CTF_eval_2005_e.pdf.

However, programming designed for multiplatform exhibition should increasingly become the norm to maintain and grow Canadian content.

- In a report commissioned by the four Ontario-based interactive and traditional TV producer associations cited earlier, recommendations were made to support content that (a) was likely to provide some return to the producer, and (b) was designed to leverage multiplatform and international rights.[51] The objective was to lead the producer community's current hand to mouth existence to one where they had more control over more distribution rights and earned more from each project. The desired result was to enable the producer to invest in development, "360" production, and exploitation of international markets.
- **Tax credit alignment and a new media tax credit: Federal and provincial tax credits for film and video production form an integral part of production financing.** The federal tax credit regimes are currently under review through official evaluations, and by the Audio-Visual Certification Office (CAVCO). There are three basic problems with the structure of the tax credits: (a) they pay after the fact, some 1-2 years after the expenditures have been incurred; (b) by and large they have not fulfilled their original objective of fostering corporate development of production companies, and (c) labour expenditures for the interactive component of projects, or content aimed at new media, are not eligible
- For the development of new media and new platform applications, it is logical to consider expanding the tax credit system to cover new media. Ontario and Quebec have new media tax credit regimes for new media, so there is some accumulated experience to help design a new media tax credit at the federal level.
- **Improving producer cash flow still a potential winner:** The production financing timing issue has been noted in various studies, and the cost of financing tax credits has been documented in several ways.[52] Various proposals have been put forward in industry reports to cut interim financing costs. Green paper 2006 put forward a number of approaches to support the financing of productions, ways in which more would stick with production companies' balance sheets. This approach is in keeping with the need for the production sector to invest in development,

[51] Economic Study for the Film, Television and Digital Media Sector in Ontario; October 4, 2006, by PricewaterhouseCoopers in association with Nordicity Group Ltd., commissioned by Film Ontario, the Ontario Producers' Roundtable, the CFTPA, and NMBA (now Interactive Ontario).

[52] At the recent NFB Doc Summit in Toronto, Peter Raymont of White Pines Pictures provided the costs for a documentary project – showing that for $123,500 in federal and provincial tax credits, the interim financing and related charges totaled some $32,000. This figure was 6.4% of the total project budget of $498,000. See *Tax Credits: a Promise Betrayed,* April 27,2007.

innovation, and trade – rather than produce strictly for the Canadian television market.[53]

- With respect to the corporate financing objectives, current CTF guidelines reserve a small part of the tax credit for the producer by not allowing it to be included in the financial structure of individual projects. That is a start, and further actions in this regard may be expected from the outcome of the various reviews and evaluations.

4.4 Role for the Public Broadcaster

Green paper 2006 suggested as an option a mandate review of the CBC, much like the BBC's charter is reviewed every decade.[54] Whatever the process, a review would point to the importance of the CBC role to create (or cause to create) programming that is of high quality, but not necessarily as commercial as programming for the private sector has to be – albeit half of CBC's TV budget does come from commercial revenues.

- **In the new world of diminishing demand side support, the role of public broadcasting is more critical for traditional and new platforms:** Commercial media companies grow larger through consolidation, and CBC cannot expect to keep up on that score. As shown earlier, the CBC is now somewhat diminished relative to its more consolidated commercial competitors – at least in terms of revenues as a proxy for reach and promotional leverage. CBC cannot marshal as large a promotional vehicle as can the two large private groups (assuming the

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[53] The specific items suggested for consideration in Green Paper 2006 are listed below. To this date, none of these measures has been seriously considered or implemented.

- Support interim financing of television productions, which would reduce the financial burden on independent producers;
- Strengthen the Canadian capacity in market intelligence of new platform business models, changes in foreign country production incentives and other policies, and trends in the relative growth of programming market segments;
- Improve financing mechanisms to support foreign sales, such as gap financing and foreign receivables insurance. The effect would be to grow the available markets for financing of production;
- Take steps to enhance treaty and non-treaty co-production opportunities for television production – by focussing efforts on fewer markets, negotiating changes in treaties that could improve Canadian prospects, and in limited cases negotiating new treaties;
- Address recoupment policies with Telefilm's equity investments in production to reward new market and platform development investment.

[54] Another example is the review of the Bank Act every 10 years in Canada.

proposed acquisitions are approved). Yet somehow, for the CBC to be an effective public broadcaster in traditional and new media, it has to fashion an appropriate role in this combination of linear, on-demand, multiplatform and new media world.

4.5 Limitations of Governance

Policy changes are difficult to make in almost any political environment, unless there are specific crises, or new initiatives are being taken. Last year's Green Paper put forward a number of suggestions, but there has been no particular action at the federal level with respect to them. So, we conclude either that they were not priorities, or different approaches are being contemplated. We understand that the Green Paper has no standing per se, but do again suggest that they should be considered as they would generate more money for the production system. We also understand that the nature of policy making in this area is very complex, and developing new initiatives is not easy.

- **While the Internet age cries for a new integrated approach to support Canadian content, it is almost impossible to do:** With such a rapidly changing environment it is of course difficult to make predictions about how it will all affect the Canadian broadcasting and programming structure and success. No government or regulator can be expected to make policy on what might happen; of course, this is a guarantee that government and the regulator will always be behind the curve.
- Even with perfect foresight and time to devise an integrated master plan, the governance of Canada's support institutions does not facilitate central direction. Critically important public agencies like the CBC and NFB have their own mandates and autonomy. The funding agencies like Telefilm and the CTF are linked to government through contribution agreements and board participation. This governance structure means that the Minister of Canadian Heritage has some power, but it is cumbersome to exercise it. Direction to the regulator by the Minister is an exceptional circumstance tool that is seldom used lest the regulator's independence is compromised.
- The coal face of government intervention, then, is largely at the level of the agency administration and regulation. Faced with the need to review and set guidelines, the CTF becomes the terms of trade arbitrator between broadcasters and producers. Faced with applications for new licenses, changes in existing licenses, and approvals of acquisitions, the CRTC makes policy through incremental decisions. The CRTC also has the opportunity to review buckets of regulation policy from time to time to determine whether and how they should be changes. However, it cannot lurch to every beat of the technology drum.

4.6 Concluding Observations for Policy and Regulation

- We have discussed the health status of the Canadian broadcasting system. We find that it is living in a strange time where there are many threats, and that the media business is changing rapidly – but that audiences, advertising, and subscriber revenues are not collapsing. Yet the broadcasting system is inexorably moving toward more of an online/on-demand focus.
- The CRTC is ploughing through an ambitious regulatory policy agenda, and staging the decision-making in manageable bites. It will make discrete decisions on various components of the sector. These decisions can constitute incremental improvements or a more fulsome redesign of specific sets of regulation. Thus far, the decisions have been leaning toward the incremental end of the spectrum, in the general direction of incentives within a need for stakeholders to live up to their responsibilities. Whether the next rounds of policy and licence renewal decisions should show a more radical shift is the subject of the debate.
- We would like to see a more cohesive supply-side strategy from public financing, one that basically accepts that television and new platforms form a continuum of outlets for content. However, the practical constraints to the development of an integrated strategy mean that it will be up to each of the relevant public agencies to figure it out and make the appropriate adjustments – mainly the CBC, the CTF, and tax credit policy. Measures to facilitate the financial positioning of the independent production sector are part of our wish list, both for traditional as well as new media content development. The agenda is certainly unfinished there. Finally, asked by the CRTC to come up with agreements, we look toward broadcasters and producers to resolve terms of trade for a widening array of traditional and new media rights.