

Appendix

***CANADIAN
TELEVISION - AN
ENVIRONMENTAL
SCAN***

2014

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Commission (“CRTC”)

“Talk TV” Process

Broadcasting Notice of Consultation
CRTC [2014-190](#)

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Foreword: Purpose and Mandate of Report

This report was commissioned by the Alliance of Canadian Cinema, Television and Radio Artists (ACTRA), Canadian Media Production Association (CMPA), Canadian Media Guild (CMG), Friends of Canadian Broadcasting (FRIENDS) and UNIFOR to provide an unbiased third-party perspective on the technological, consumer, competitive, financial and regulatory environment facing television, and the sector's prospects for the future, for collective submission to the Canadian Radio-television and Telecommunications Commission (CRTC) in its formal review of the television system¹.

In response to the Commission's stated objective of defining a framework for the "future of television", the commissioning parties believed it important to provide some perspective on what that future might hold, in the short and medium term, and what the implications could be for the system, different players within it, and their capacity to support Canadian programming (including programming of national interest "PNI" and local programming) and other objectives of the *Broadcasting Act*.

The author notes, with appreciation, that within this mandate, he was given wide latitude to investigate and opine on the matters contained herein. Accordingly, the report reflects the research and views of the author, and should not be necessarily construed as representing the views of the commissioning parties.

¹ Broadcasting Notice of Consultation CRTC 2014-190
<http://www.crtc.gc.ca/eng/archive/2014/2014-190.htm>

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1. Study Approach

"If you don't know where you are going, you will probably end up somewhere else"

Laurence J. Peter

- 1.1. The approach devised for the study at the outset was to identify and examine the primary factors and trends affecting Canadian television, and from that develop different seven-year (medium-term) revenue "outlooks" or "scenarios" for the Canadian Television System.
- 1.2. Primary factors identified and examined included:
 - a. The state of the Canadian rights market;
 - b. Technology trends and impact;
 - c. Consumer viewing habits;
 - d. Advertising revenue;
 - e. Subscription numbers and revenues; and
 - f. Other factors, such as outstanding significant benefits packages and the impact of consolidation and vertical integration.
- 1.3. As is further discussed below, in the author's view, industry trends are sufficiently clear to forecast revenues fairly definitively over a three-year horizon (2014-2016).
- 1.4. Over a "mid-term" seven-year horizon, the author's view is that the best way of constructing a useful analysis is to consider a series of "outlooks", positing different best-case and worst-case scenarios for the system, depending on such considerations as "gradual change" or more "material change", relatively *status quo* regulation, or more fundamental changes to regulation (as contemplated in the CRTC Public Notice).
- 1.5. As is also evident from this analysis, linear impact from change affecting the industry cannot be assumed over the medium to long term. Rather, it is quite possible that the characteristics of the Canadian television system lend themselves more to "tipping point" impact. Such tipping points are not, however, assumed or modeled over the study horizon.
- 1.6. From the revenue forecasts and outlooks, the study estimates Canadian programming expenditures (CPEs) – an important indicator of the system's ability to support the objectives of the *Broadcasting Act*.
- 1.7. In addition, given the importance of the Canadian television system to the broader production and creative sector, the study extrapolates from these revenue and CPE outlooks to provide estimates of economic impact (on employment and GDP) of proposed regulatory changes using standard economic multipliers.

2. Visions of the Future of TV

“The future is already here – it’s just not evenly distributed.”

William Gibson

“The content of a new medium is an old medium.”

Marshall McLuhan

- 2.1. Broadband Internet and shifts to “on-demand” TV consumption are turning our “closed” broadcasting system into an open one, with massively increased opportunity for disintermediation, bypass and piracy.
- 2.2. Digital technology and the Internet is not significantly decreasing Canadians’ overall appetite for TV (in fact, it is arguably increasing it), nor is it materially reducing TV production costs².
- 2.3. What broadband Internet has done is added a degree of both competition and complementarity to, what many consider, the “golden age of TV”³.
- 2.4. Initiated by the launch of cable (specialty) and pay services, and perhaps enhanced by the added urgency of over-the-top television (OTT⁴), today’s television programming has never been stronger.
- 2.5. Ironically, while television (including, according to the CRTC Notice, the Canadian TV System) is “thriving”, the traditional TV system could also be on the verge of collapse.
- 2.6. The latter, because traditional linear TV, most particularly conventional TV, appears to be very much on the wane, and in shifting to other platforms, threatens to take both TV advertising and subscription revenues with it.
- 2.7. While stating as recently as October, 2012, that it continues to see Internet platforms as “complementary”, the Commission also speculated in a 2006 Section 15 Report to government on *The future environment facing the Canadian broadcasting system*⁵ that:

² The primary impact of digital has been on equipment and distribution. A lesser impact would be marketing and promotion. The Internet’s erosion of revenues and viewing in the regulated system is a core theme in this study.

³ For some interesting articles on the “golden age of TV” see [TV’s Golden Age Is No Illusion](#), Tom Hawking, [flavorwire.com](#), May 7th, 2014 and [Golden Age of the Small Screen: TV as the New Literature](#), Tory Hayward, [atthefestival.wordpress.com](#), May 22nd, 2014. See also [HBO’s take](#), Broadcast Empire: The TV Revolution, New York Ideas, May 6, 2014.

⁴ Commonly used to refer to the delivery of TV programming over the Internet without a cable or DTH distributor being involved in the control or distribution of the content.

⁵ <http://www.crtc.gc.ca/eng/publications/reports/broadcast/rep061214.htm>, para 368.

Given the evidence before it, the Commission considers that while traditional distribution, television and radio undertakings will continue to have a significant place in the lives of Canadians for the foreseeable future, new audio-visual technologies will have an increasing impact over time⁶.

- 2.8. The Commission's 2006 report, while perhaps somewhat wrong on timing, nevertheless remains still relevant to the decisions facing it today:

The need to balance economic and cultural goals and the continued tension between maximizing consumer choice and promoting Canadian choices will only increase as the Canadian broadcasting system becomes more open.

...

[G]iven the evidence of this proceeding with respect to the speed and acceptance of technological change, it would be prudent for policy makers to assume that a potential for material economic impact on broadcasting undertakings exists over the medium term.

Accordingly, the Commission considers that within the next three to seven years, public policy action will need to be taken if it is to have the desired effect. Corrective action taken beyond this time may be ineffective.⁷

- 2.9. For any commentator, timing of future change is, perhaps, the hardest factor to gauge. The CRTC is not the only party to get this wrong. A 2010 Report funded by the C.D. Howe Institute noted the former while doing the latter in calling for "fundamental regulatory change" given its view that:

Although it is difficult to predict how quickly consumer behaviour will change with the arrival of technological alternatives, it seems reasonable to assume that there will be significant changes within four to five years⁸.

- 2.10. In the extreme, views of the future often suffer from an excess of technological determinism on one hand, or denial on the other. In any event, while we may have a good handle on new consumer technologies and their impact, we can never fully predict their rate of adoption.

- 2.11. Non-controversial observations on "the future of TV" would be that:

- It's not going to fundamentally change overnight;
- There are forces that suggest the fundamentals of the system will stay in place for decades; and

⁶ Also interesting, eight years later, are stakeholder concerns cited about *imminent threats* and calls for *immediate action* – from the industry for increased flexibility and de-regulation; from the CBC and cultural sector for "new ways" to ensure production and exhibition of high-quality Canadian programming.

⁷ Ibid, para 407, 433 & 434.

⁸ *Scrambled Signals: Canadian Content Policies in a World of Technological Abundance*, C.D. Howe Institute Commentary, Lawson A.W. Hunter, Q.C., Edward Iacobucci, Michael J. Trebilcock, January, 2010.

- There are also forces that suggest that the TV system as we know it in Canada could cease to exist within the decade.

2.12. But we actually know more:

- That consumers are largely creatures of habit who do not change these habits unless something materially better comes along, and even then it takes time⁹;
- That TV is a habit that Canadians like in increasing amounts;
- That the Internet is not (yet) changing the TV programming form factor - in fact the opposite. In this "golden age of TV", TV is dominating, if not changing, the Internet (not the other way around);
- That incumbent broadcasters and BDUs are now largely vertically integrated players with a commercial interest in maximizing content (traffic) in all its forms, linear and on demand, regardless of means of electronic distribution (including within the system and not);
- That quality television content is expensive, and not (for most viewers) something for which user-generated content ("UGC"¹⁰) can substitute;
- That, the world over, the current territorial-based value chain of television content production through curation through distribution generates the wealth necessary to fund volumes of quality content not easily replicated through OTT models; and
- That the regulatory framework that sustains a Canadian broadcasting system is neither immune to changes in television, nor bound to simply fall victim to them.

2.13. Accordingly, this report has been prepared on the premise that it is possible to:

1. Identify with some precision the major viewing, advertising and subscription trends that are impacting TV today, and extrapolate from them to provide a reasonably accurate short term forecast for system revenues and support of Canadian programming; and
2. Identify the key disruptions that could have an even more material impact on TV in the seven-year horizon and, combined with the extrapolation of trends identified in '1' above, create plausible best- and worst-case scenarios for the system over this period.

⁹ This being a truism in older viewers - not necessarily so in younger viewers. But it also speaks to the system's ability to successfully play "catch-up", as long as it introduces better alternatives that are there as people gravitate to them.

¹⁰ UGC can refer to any form of collaboratively produced content, but in the video context, generally refers to creative content created by an individual or individuals outside of professional routines and practices and made available on the Internet for public viewing (usually, free).

- 2.14. Also inherent in this report is the belief that the television regulatory framework can continue to adapt to accommodate change, while still ensuring that core objectives of the Broadcasting Act are met – be it for three years, seven years or longer.
- 2.15. Beyond the decade, we know that the Internet may well have the capacity to accommodate mass TV-like volumes of video consumption, but whether this is the route TV distribution will take, or whether "TV" will start to be about something different than TV programs as we know them today, is a matter of much speculation. The history of media suggests that the Internet will ultimately change the form of TV, not only its distribution. Such a time frame, however, is well beyond any regulatory horizon contemplated in this process, and hence beyond the scope of this Report.

3. Canadian TV Rights Market

"It's the content, stupid"

Various

- 3.1. A companion study by the author, also submitted in this process, reviews the State of the Canadian Program Rights Market (Rights Study). It concludes that, although pressures continue to mount, the Canadian rights market remains sound, and, barring material regulatory disruption, should remain so through the short to medium term at least.
- 3.2. This would mean that the vast majority of multiplatform TV rights would continue to be bought and sold in Canada, separately from other jurisdictions – be it from the US, or other countries – for the foreseeable future. As a consequence, the system would continue to generate sufficient viewing and revenue to allow it to contribute to Canadian programming and other objectives of the *Broadcasting Act*, at a level consistent with recent years, for some time.
- 3.3. The Rights Study nevertheless notes that there are scenarios that could have a material effect on such an outlook - the immediate risk being regulatory, the medium to long-term risk being technological/competitive.
- 3.4. Of particular note is that many, if not most, of the key regulatory measures that support, and help ensure, a separate Canadian program rights market are under review in this proceeding. These include simultaneous substitution, barriers to entry of foreign services, genre protection, and predominance of Canadian specialty and pay services,
- 3.5. Given this “regulatory risk” to the maintenance of a separate Canadian program rights market, the report suggests that a “cautious, even conservative, approach to review of such measures might therefore be warranted.” The potential impact of these regulatory changes informs the medium-term scenarios in the present report.
- 3.6. Over the medium to long term, the Rights Study identifies a number of potential technological/competitive tipping points that could have a disruptive impact on the Canadian rights market¹¹. These are not seen as likely or inevitable over the seven-year horizon of the present report, but do inform medium-term scenarios.

¹¹ Discussed in section 10, below.

4. Technological Change

"We tend to overestimate the effect of a technology in the short run and underestimate the effect in the long run"

Roy Amara

"Technological change is not additive; it is ecological"

Neil Postman

- 4.1. The digital revolution in communications started with the roll-out of digital (multiplex) telephone transmission in the 1950s, and has gone through multiple phases since. In each phase, be it digital cable or broadband Internet, the digital revolution brought increased processing power and cheaper storage to provide greater speed and capacity – manifesting itself in greater choice, convenience and quality for the consumer.
- 4.2. Given the changes we have seen in the last 60 years, it is pretty safe to say, "we're not done yet".
- 4.3. Broadband Internet is only a decade old. Many of the sites and apps we use daily are well under ten years old – in OTT, most under five.
 - Even Google, which pre-dates broadband Internet, is only 15 years old;
 - YouTube is 9 years old;
 - Facebook (in its public form) is 8 years old;
 - Twitter is 8 years old;
 - Hulu (available only in the US) is 6 years old;
 - Netflix Canada, launched in September, 2010, will turn 4 at the time of the CRTC hearing.
- 4.4. The rapidity with which media platforms like Google, YouTube and Facebook have entered the public consciousness and become seemingly ubiquitous can fool us. Because we are now used to such rapid adoption of the new, because we hear about it so much, we assume that its impact on the "old" is, or will be equally rapid.
- 4.5. We are usually wrong.
- 4.6. Just because a new technology has been invented, doesn't mean it is readily available, doesn't mean it will be adopted, doesn't mean it will be used, doesn't mean it will be used a lot, and doesn't mean its use will replace or destroy something pre-existing. A fundamentally disruptive technology certainly can do this, but this is the exception rather than the rule.

- 4.7. And even when it does, it takes time, often a remarkably long time¹².
- 4.8. In media, our experience has not been one of replacement. Indeed it is oft said, “no medium replaces another”.
- 4.9. True, although perhaps more soothing than insightful. Disruption does not require replacement to be devastating. (Just ask print.) The more interesting interaction between new and old media is that in which *each medium finds its own efficiency*. We will discuss this in the next section.

The Ability of Broadband Internet to Replace Broadcast Distribution

- 4.10. Internet-based one-to-one high-quality video transmission, while technically inefficient compared to broadcast (one to many) transmission, is becoming economically viable on a TV-like scale. The last few years have demonstrated that the technological barriers to OTT are largely falling to the wayside. The only remaining barrier is the very capacity of the Internet to accommodate video consumption of TV scale and quality.
- 4.11. Video currently accounts for 78% of all US Internet traffic, and is expected to account for about 84% in four years. Numbers in Canada would be similar¹³.
- 4.12. This is despite the fact that, today, relatively few consumers use broadband Internet for the majority of their TV/video consumption.
 - Sandvine reports that the top 15 percentile stream 54% of traffic, 100 hours of video a month¹⁴.
 - These would appear to be “cord-cutters” (or “cord-nevers”) and while less than 1% of users, they represent a majority of usage.
 - By contrast, according to Sandvine, a “typical” ISP subscriber streams nine hours of video a month. These would include the majority of Netflix subscribers, who subscribe to both Netflix and a traditional TV distributor.
- 4.13. While it is a given that today’s Internet cannot absorb TV levels of traffic, the 40% annual capacity growth levels of the Internet in recent years could, if this continues, accommodate a gradual shifting of traffic from BDU to Internet delivery¹⁵. Indeed, if recent capacity growth rates were to continue, in a decade

¹² It took the automobile and tractor nearly 50 years to dislodge the horse from farms, public transport and wagon delivery systems. Perhaps more relevant, it took about 15 years for DVDs to replace VHS.

¹³ The U.S has more OTT services but Canada has more online video consumption. Cisco [annual Internet traffic forecast](#) as reported in [Online Video to Make Up 84 Percent of Net Traffic, Cisco Says](#), Amy Schatz, recode.net, June 10th, 2014.

¹⁴ *Global Internet Phenomena Report*, 1H 2014, Sandvine, p. 7

¹⁵ This is not to suggest that the costs and challenges for BDU/ISPs are trivial, or recent growth trends a given going forward. Within a given amount of bandwidth, a number of techniques, including various approaches to caching, can also be used to optimize online delivery of popular video content, that reduces the need to resend the same program across the full network, every time a new viewer requests it. See, for example:

the Internet would be able to accommodate 29 times as much video as it does today¹⁶, more than enough to absorb all TV consumption.

- 4.14. Of course it is not that simple, and not likely to happen that way. Live “linear” broadcasting will exist as an appropriate means to receive and distribute many types of television programming well beyond the decade. And with the installed base of broadcast equipment, many current consumers will be content to continue their current habits into the foreseeable future¹⁷.
- 4.15. That said, the shift to on-demand and online will continue, and BDU/ISPs will accommodate it¹⁸. And as BDUs lose their regulated monopoly as distributors of TV, they gain a potentially higher-margin business as ISPs to video-hungry Internet consumers¹⁹.
- 4.16. Broadband Internet, and its suitability for on-demand and on-the-go video, is not the only factor that is driving OTT, but it is the key enabling one. Other factors include:
- Shifting consumer entertainment budgets;
 - Data collection and analytics; and
 - Piracy and bypass.

<http://gigaom.com/2012/03/10/carriers-must-prepare-for-the-flood-of-online-video/>.

Interestingly, while technology exists to “broadcast” (point to multipoint) programming across the Internet, this has yet to be deployed, at least not in North America. For now, at least BDU/ISPs allocate bandwidth as between ISP and BDU services as they deem appropriate.

¹⁶ This is simply a mathematical truism. Nevertheless, a growth rate of 40% may be conservative. So-called “Nielsen’s law” states that Internet bandwidth grows by 50% per year. See <http://www.nngroup.com/articles/law-of-bandwidth/>.

¹⁷ An illustration of this: David Purdy, Senior Vice President, Content at Rogers Communications reminded attendees at the 2014 Telecom Summit that Rogers still has more than 100,000 analog subscribers, June 16, 2014.

¹⁸ Part of Netflix’s genius is in reporting bandwidth speeds to push ISPs to provide better service, improve the customer experience of OTT, and in the result, encourage more people off BDU services onto OTT.

¹⁹ In December, 2010, just after the launch of Netflix, Louis Audet, CEO of Cogeco Inc., was quoted as saying:

“What we’ve implemented now are bit cap rates that when people stream more, they eventually exceed their rate and we charge for surplus usage. The revenue that could be lost, because less programming is bought, for example, or maybe some people decide to forego their TV service and then stream more, will be found on the Internet side. So I think cable wins one way or the other.

Cogeco’s Louis Audet on wireless, expansion, and why Netflix doesn’t keep him up at night, LESLEY HUNTER, Cartt, December 13, 2010.

“Potentially” is nevertheless a key word here. The ISP business is a far more capital intensive business than the BDU business, with continuing investments in increasing network capacity “last mile” upgrades (fibre to the curb (FTTC) and fibre to the home (FTTH)). Regulatory/political pressure to reduce wholesale rates, if not retail rates, is another factor.

Consumer information and entertainment spending

- 4.17. One of the notable consumer developments over the last few decades has been the increase in consumer spending on home-based or personal entertainment²⁰. “Cocooning”²¹, combined with consumer electronics pizzazz, has led to consumers spending more of their disposable incomes on information and entertainment devices, and associated content, to the detriment of other consumer spending categories, like clothing and travel.
- 4.18. For a long time, the consumer electronics industry has succeeded with a strategy of pushing “the next best thing” – HDTV, bigger and bigger flat screens, 3D (which didn’t take off) or 4K²² (the current effort).
- 4.19. According to at least one analyst, “the decade of the device” is coming to an end. Global sales of smartphones, tablets, PCs, TV sets and videogames, which have almost doubled since 2007 to reach over \$750 billion sales in 2014, are expected to plateau, and cap at \$800 billion by 2016²³.
- 4.20. As consumer budgets for entertainment can be expected to increase, the opportunity for more spending on content is clearly a positive one for the Canadian broadcasting system – under the right conditions, including regulatory conditions.

Data Collection and Analytics

- 4.21. The 1:1 transactional nature of the Internet makes it inherently a medium where data collection and analytics can rule.
- 4.22. This capability is used in many ways – from targeted advertising to the analytics Netflix and others use to anticipate appetite for content, and in the future, effectively ‘choose it for you’.
- 4.23. There are also serious downsides – loss of privacy and the enabling of identity and other online theft being two.
- 4.24. In terms of implications for the TV system, this means that, from the get-go, OTT can do things that traditional TV can only dream of – and then take years to achieve. Dynamic ad insertion²⁴ and complete demographic and other metrics

²⁰ This is not true in every sub-category, but is true in aggregate. For example, average household spending on cable and satellite TV increased 52.5% from 2002 to 2011, while spending on home entertainment equipment and services decreased by 34.3%. [The Current State of Family Finances](#), Vanier Institute, 2011-2012 report.

²¹ A term, coined in the 1990s by Faith Popcorn, to refer to the apparent trend of individuals socializing less and retreating into their home more. It is less used today (perhaps because it runs contrary to the wireless industries’ interests) but remains at least somewhat relevant.

²² A next-generation TV format with horizontal [resolution](#) more than twice that of HDTV.

²³ TMT Predictions 2013, Duncan Stewart, Deloitte.

²⁴ That is, in VOD or even linear programming, the ability to change an ad “on the fly”. Currently, for BDU VOD, the ad that is put in, stays in, unless the whole video is replaced. BDU dynamic ad insertion is at least a year away in Canada.

for advertisers are no problem for OTT. For TV, they are technologically quite doable in digital systems, and have been talked about for years, but either not made available to programmers or not enabled²⁵.

Piracy and bypass

- 4.25. Piracy and bypass have always been part of the Canadian broadcasting system. The system was founded on the premise of discouraging Canadians from viewing US over-the-air (OTA) signals, in favour of Canadian. It worked. Not because US signals weren't available, but because Canadians started to choose Canadian signals instead²⁶.
- 4.26. Cable turned the Canadian broadcasting system into a "closed system". For most Canadians, you didn't get TV unless you went through cable. Then the "death star", US DTH, challenged that in the 90s. Estimates at the time were that as many as a million Canadians were subscribing to "grey market" or pirate US DTH, costing the system \$300 million or more a year.
- 4.27. Today's OTT challenge is both similar and different. Canadians' ability to bypass is arguably greater – no need to get a satellite dish, most Canadians already have broadband, and if so inclined, could pirate much of their TV programming, or subscribe to US Netflix.
- 4.28. That most Canadians don't can be attributed to at least three factors:
- Nothing out there can replace the entirety of their current Canadian TV offering;
 - They value their current TV offering and it's easier to stick with it; and
 - All things being equal, they'd rather be law-abiding.
- 4.29. In aggregate, it's hard to see the piracy and bypass challenge the system faces today as greater than the US DTH "death star", and certainly not greater than back at the founding of the system. For each act of piracy and bypass, there can be an equal and opposite response, be it technological, or better still, providing viewers with a user-friendly, cost-effective, legal alternative²⁷.
- 4.30. As we have previously discovered, the main issue is not the technological capability of bypass or piracy, but the circumstances that either encourage or discourage it.

²⁵ The Notice addresses questions relating to STD data metrics. If only in illustration of how long the industry has been talking about dynamic ad insertion, see: ANALYSIS: VOD's future is in advertising, GREG O'BRIEN, Cartt, July 5, 2007.

²⁶ There were essentially two phases to this. Pre-cable, it was just about giving the "choice" of Canadian OTA services. Post-cable, that choice exploded, by virtue of numerous regulatory policies that were able to give preference to Canadian – simultaneous substitution, priority carriage, predominance of Canadian, barriers to entry of foreign services etc. All are at issue in this proceeding. Arguably, we are now entering a third phase. Not as easy as with the "closed-system" of cable, but hopefully easier than when we were all OTA.

²⁷ This is explored in more depth in the Rights Study.

Content production

- 4.31. In theory, digital reduces production costs. Everything is cheaper. The cameras, the editing machines, the storage, the sharing, the distribution. In practice, it depends.
- 4.32. Rather than reducing overall production costs, digital has led to their increasing bifurcation, if not polarization.
- 4.33. On one hand is user-generated content, or UGC. Produced very cheaply by amateurs or solo entrepreneurs, this content is the bread and butter of YouTube. Its professional equivalent is factual series production and small-market local news produced for as little as \$2,000 to \$5,000 an hour using green screens, in studio settings, and minimizing on-site costs.
- 4.34. On the other extreme is prime-time series drama competing in the US and with US equivalents. To compete with the best, it must look like the best, leading to ever-increasing Canadian drama budgets, with \$2 million per hour now typical, and considerably higher budgets no longer rare.
- 4.35. Canadians' expectations of TV programming have not really changed. For a full, lean-back entertainment experience in the evening, Canadians want the best picture, the best quality. At other times of the day, or for a quick news hit, screen size and resolution are far less important.
- 4.36. In the result, there is no evidence that the Internet is changing the TV programming form factor – in fact the opposite. In this "golden age of TV", TV is changing the Internet. Or, rather, the Internet is becoming TV.
- 4.37. More and more TV content is exhibited online. More and more apps and devices synch or merge the Internet and Traditional TV. Recent examples include:
- Three small American cable companies announce a deal that will put Netflix on their TiVo cable boxes;
 - Videotron launches "the app that will change TV forever", combining online content with cable set-top box functionality, as an intended one-stop, platform-agnostic TV portal;
 - Amazon announces a landmark deal with HBO that will put past seasons of hit HBO shows on its Prime service; and
 - Rogers is rumoured to be about to launch its own OTT service, Showmi.
- 4.38. This has led many to conjecture that, from a content perspective, the future of TV is "much like the present"²⁸.

²⁸ See, for example, [The Future Of TV May Look A Lot Like The Present](http://www.huffingtonpost.com), www.huffingtonpost.com, April 29, 2014.

- 4.39. Whether ultimately true or not for content, the statement certainly does not appear to apply to distribution.
- 4.40. Changes in consumption patterns are having a clear impact on revenues of broadcasters and broadcast distribution undertakings (BDUs), held back only by the demographic bulge of the baby boomer generation, strength of incumbent business models and the ability of incumbents to retain exclusive rights²⁹ to popular content, from sports to drama.

²⁹ This is a major difference between radio and TV. Radio's primary content – music - is non-exclusive. It is therefore easier for new Internet-based music disrupters to duplicate this value proposition, than it is for OTT to duplicate TV.

5. Consumer Empowerment

"I want to watch what I want, when I want, where I want, and how I want."

Stereotypical Consumer Refrain

"People think they want choice, but they often don't know how to handle it."

Dilip Soman

Convenience, Choice and Quality

- 5.1. Over the past four decades, consumer desire for convenience, choice and quality have driven the broadcasting system from OTA local signals alone, to the multi-channel universe, to on-demand via VOD and OTT.
- 5.2. For the first time in decades, Canadians now have real alternatives to Broadcasters/BDUs for drama and information programming, can satisfy many of their news needs in other ways³⁰ and are really only wedded to Broadcasters/BDUs for live sports³¹.
- 5.3. Convenience now means on-demand and everywhere, choice means a good variety of programming that appeals to "me", "when and where I want it", and quality means highest production standards or something short, sweet or compelling.
- 5.4. While all of this is achievable within the Canadian broadcasting system, amazingly, even today, Canadians take little advantage of it *within the system* – let alone outside of it. Only 47% of homes have a PVR, and 94% of weekly viewing is still to linear scheduled programming³².
- 5.5. Nevertheless the shift to on-demand is real and accelerating, and, whether it be regulated VOD and PVR viewing, or online and OTT, it risks reductions in

³⁰ While TV news remains the single source used by most, the shift to online news consumption continues. A 2012 US study found that people using social-networking sites as a source for news had grown from 9% to 19% in the last two years. [Pew study: News consumption up via mobile, social media](#), Dan Farber, [news.cnet.com](#), Sept 27, 2012. Canada and the US have similar social media penetrations and are assumed to have similar news consumption habits. [Canada Neck and Neck with US on Social Network](#), eMarketer, June 12, 2014.

³¹ This is not to suggest sports isn't available online. It is. But as an extremely popular and live form of television programming, it inherently lends itself to broadcast TV, and can be more readily controlled by rights holders.

³² TVBasics 2013-2014.

regulatory contribution. OTT only exacerbates that anticipated reduction³³, but within the system, the damage becomes more containable³⁴.

5.6. Thus, as significant as the ramifications of “on-demand” consumption within a BDU environment ultimately are, it is Internet-based bypass through OTT that raises the major concerns for the system.

5.7. Indeed, the mere act of cord shaving through, for example, the loss of a pay TV subscriber to Netflix Canada can reduce Canadian content expenditure by roughly \$2.05 per subscriber per month³⁵.

5.8. From the consumer perspective, there are two key enablers of OTT use:

- Broadband penetration; and
- Smart TV (or some other form of OTT enabled set-top box (STB) penetration.

5.9. CRTC 2010 statistics placed Canadian broadband (1.5 Mb/s and higher) penetration at 75% as at 2012, up from 70% in 2010, and 62% in 2009³⁶. (Availability is almost ubiquitous.)

5.10. Netflix’s initial consumer device requirement was met through a variety of Internet-enabled boxes, whose initial purpose may have had little or nothing to do with watching TV (from Wiis, Xboxes and Blu-ray players, to dedicated OTT boxes (in Canada, AppleTV, Boxee, Roku, and now Chromecast). Thus even before the rise of Smart TVs, Netflix was able to count on half of consumers being able to access the service via their TV, without a computer³⁷. A Smart TV makes this easier. Estimates place the penetration of Smart TVs at roughly 25% today, growing to 40% by 2015³⁸.

³³ On-demand services can have shelfspace requirements, but obviously not exhibition quotas. Moreover, historically, the CRTC has imposed a lower CPE requirement on BDU VOD services (5%) than pay services (an average of 18%) or specialty services (37%) [CRTC Statistical Summaries, 2013]. OTT has no CPE requirement, but, Netflix, for one appears to have historically spent 5% of its revenues on Canadian content, mostly library.

³⁴ As the CRTC recognized in its group licensing policy, exhibition requirements will become less effective in an on-demand world, but expenditure requirements need not. Applying a group CPE to all broadcast activities (30% under the Group licensing policy) effectively makes at least some on-demand viewing (currently PVR) a regulated extension of linear broadcasting, captures revenues for group contribution approach, and helps minimize negative impact.

³⁵ [Market Impact and Indicators of Over the Top Television in Canada: 2012](#), March, 2012, Peter Miller and Randal Rudniski, at section 3.1.

³⁶ CRTC 2013 [Communications Monitoring Report](#), section 5.3. 5 Mbps and higher broadband had a penetration rate of 62%.

³⁷ [Market Impact and Indicators of Over the Top Television in Canada: 2012](#), March, 2012, Peter Miller and Randal Rudniski, at section 1.1.

³⁸ [Connected TVs Reach One in Four Homes](#), Jan 3, 2013, eMarketer (North American estimate).

- 5.11. The fact that North Americans possess Internet-enabled TV capability does not mean they take advantage of it. Current connected TV penetration stands at approximately 35%, and is expected to grow to 50% by 2016³⁹.
- 5.12. As significant as this sounds, in corollary, it suggests that 50% of Canadians won't even have set themselves up to properly watch OTT by 2016.
- 5.13. More important than technological capability is the question of adoption.
- 5.14. TV viewing levels remain strong, with adult Canadians still watching on the order of 24 hours a week of television, and spending 17.6 hours on the Internet⁴⁰, relatively little of it OTT viewing.
- 5.15. That said, an increasing number of Canadians are taking advantage of OTT, either instead of (cord-cutting and cord-nevers) or in addition to subscribing to a BDU (cord-stacking):
- In November, 2013, Convergence Consulting Group estimated that 400,000 Canadian TV subscribers out of 11.8 million had cut the cord since 2011, or about 3.5% of the market.
 - A February 2014 Ipsos Reid poll found that three quarters of Canadians still pay for TV through a cable, satellite or IPTV provider, half of whom also pay for video content through another source (such as iTunes, Netflix and sports subscription services, like NHL GameCenter).⁴¹
 - According to a fall 2013 MTM survey, 42% of respondents watched TV online in the past month, 29% of English Canadians are Netflix Subscribers, 26% of respondents said they used their TV to access online content, and an alarming 16% of respondents said they were either somewhat or very likely to abandon their TV service and opt for free or cheaper alternatives.⁴²
- 5.16. Moreover, there are major and increasing differences among demographics, with adults 18-34 watching only 16.6 hours of TV a week, adults 25-54 watching 21.1 hours and adults 55+ watching 32.4 hours.⁴³
- 5.17. More material are the trend lines. As Deloitte has revealed, the lowest quintile of English-language TV viewers is watching significantly less TV than it did in 2009 and 2010 – from a high of 5.9 hours to a current expected low of 3.9

³⁹ *Ibid.*

⁴⁰ TVBasics 2013-2014.

⁴¹ As reported in Huffington Post, [Cord-Cutting Nation? 1 In 4 Canadians Not Paying For TV](#), Michael Oliveira, 04/15/2014.

⁴² Per Huffington Post, [Netflix Subscribers Now Nearly A Third Of English Canada](#), and http://www.huffingtonpost.ca/2014/01/24/cord-cutting-canada_n_4657345.html Michael Oliveira, 04.06.2014 and 01/24/2014.

⁴³ TVBasics 2013-2014. Not surprisingly, time spent with the Internet is reversed. Adults 18-34 spend 30 hours a week online; adults 25-54 spend 22 hours and adults 55+ spend 11.6 hours.

hours. Meanwhile, the highest English-language TV watchers are watching even more TV – from a low of 52.1 hours in 2009 to a high of 58 hours in 2014⁴⁴.

- 5.18. Francophone viewers, on the other hand, remain relatively consistent in maintaining their higher viewing levels (25.6 hours adults 18+) across all quintiles.
- 5.19. The implications of this go well beyond the notion of light, mostly younger viewers, watching less; and heavy, mostly older viewers, watching more. Light viewers watching less TV are almost certainly supplementing their traditional TV watching with OTT. For now, evidence suggests that, rather than cord-cutting or cord-shaving, such viewers are cord-stacking (i.e. adding OTT services).
- 5.20. That such increasingly-light viewers might be more prone to cord-cutting and shaving is self-evident.
- 5.21. Where this eventually goes is speculation, but speculation that can nevertheless be informed by looking at principles of media efficiency.

Media Efficiency

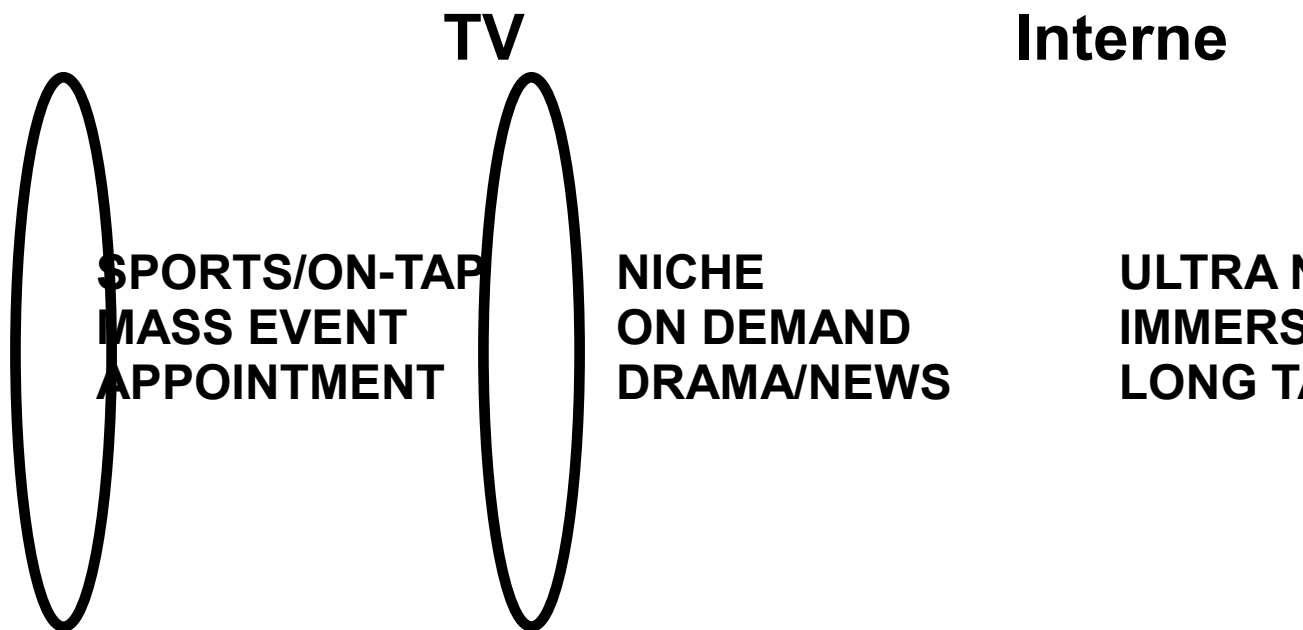


Figure 5.1: Media Efficiency – TV vs. Internet, 2005 – 2015+

⁴⁴ TMT Predictions 2013, Duncan Stewart, Deloitte.

- 5.22. A Venn diagram is a simple but effective way to examine the efficiency of media. The above diagram looks at the efficiency of TV vs. the Internet. The area of overlap in the middle is where both can claim reasonable efficiency. Today, that includes an array of on-demand content, drama and news in particular, as well as streaming and on-demand niche, but not ultra-niche, programming. On the left is where TV reigns: the mass event (be it sports or something “manufactured”), the appointment, or just the “always on tap”. On the right is where the Internet reigns, the ultra-niche and long-tail content (be it UGC or professional), and immersive interactive experiences (gaming, for example).
- 5.23. The middle area of overlap is where the key battles play out. Battles with studios and OTT over rights to popular drama and entertainment programming. Battles with myriad other news sources (print, radio and online) over the future of TV news. Battles over ethnic programming. Battles over piracy and the grey market.
- 5.24. Technologically, as discussed above, the Internet now delivers as good if not a better experience than television:
- Smart TVs make it easier to watch OTT on a big screen;
 - The role of the channel as “curator” is being replaced by analytics and OTT recommendations on the one hand, and Social TV⁴⁵ on the other;
 - VOD on OTT is almost seamless - with good broadband, as good as VOD on IPTV and without any of the lags and delays typical of cable⁴⁶;
 - Catch-up and binge TV viewing are changing the TV experience. Viewers now know that if they miss a show or a season they will be able to catch up – or just wait, and it will likely be on Netflix;
 - “Good enough TV” is available on OTT – maybe not all the best shows, but enough for many light viewers; and
 - Social, multiplatform (Twitter, Facebook etc⁴⁷) and mobile TV further extend the TV experience.
- 5.25. Taken to a logical extreme, this suggests that eventually, all that will be left on traditional linear TV is sports, breaking news, and other live events. Everything else will move to on-demand – either via BDU VOD or OTT – with the battle between the two favouring OTT.
- 5.26. But this would be falling into the trap of technological determinism – certainly over the medium term on which this study is focused.
- 5.27. A more reasonable perspective would be to suggest that the core efficiency of TV, combined with incumbency and consumers’ aversion to sudden change, give traditional TV players plenty of scope to maintain a dominant position in the

⁴⁵ Social TV can both enhance consumer ability to find what they want and enhance the experience through interaction while watching.

⁴⁶ Caused by the simple fact that legacy digital cable STBs run on standards and chip sets that are a decade or more old.

⁴⁷ http://lostremote.com/its-not-tv-its-facebook-tv_b43976

Canadian TV landscape. The leverage that Canadian TV has should not be dismissed.

TV is Video, but is Video TV?

- 5.28. A clever and seemingly simple question, but actually one that may well – over the long term – decide the future of TV⁴⁸.
- 5.29. The silo approach of the Venn diagram above is all nice and good – if viewers care about the distinctions between different genres of video, and between video and TV. But what if, at the end of the day, they don't? What if at the end of the day, all they want to is to be entertained and informed in the ways, places and on the platforms of their choice – and that if something is not available, or too expensive, they'll just pick something else? What if, among all these other factors, "quality" as we have come to define it in television (i.e. expensive) is not so important after all?
- 5.30. A rather scary prospect for the TV sector, with the leading "scarer" being YouTube Channels.
- 5.31. Most people (read "adults") would not consider YouTube Channels to be TV, but for millions of young people, they effectively are, only more personal, and therefore better.
- 5.32. YouTube Channels can replace or supplement TV watching, and are morphing YouTube from two-minute cat videos to 10- and 20-minute programs that encourage binge viewing, returning to the same "channel" and "channel surfing" for similar content.
- 5.33. In a key algorithm change in 2012, YouTube seeded this transformation, by re-optimizing its search engine for time watched, rather than just "views" (i.e. clicks on a video, regardless of length of watching).⁴⁹
- 5.34. The top YouTube channels today consist of a mix of professional music and video sites (Vevo, etc), YouTube "stars" and aggregators (Maker Studios, Machinima) with a heavy leaning towards gaming.
- 5.35. The top YouTube channel worldwide as of May 2014 is hosted by an English-speaking Swede, currently living in Italy - "PewDiePie" (Felix Kjellberg) - whose videos largely consist of him playing video games while commenting - including screaming, swearing and other antics. His 6-10-minute videos, produced on average daily, have earned him 27 million subscribers, and a reported \$4 million in annual revenue. Kjellberg has described his approach this way:

⁴⁸ Credit for the question goes to Will Richmond, www.videonuze.com, June 16th, 2014.

⁴⁹ YouTube also invested heavily in YouTube channels, as noted in the Rights Study (and got a lot of attention as a result), but this algorithmic change may have been the more significant.

“Unlike many professionally-produced shows, I think I’ve established a much closer contact with my viewers, breaking the wall between the viewer and what’s behind the screen ... What I and other YouTubers do is a very different thing, it’s almost like hanging around and watching your pal play games. My fans care in a different way about what they are watching.⁵⁰”

- 5.36. The success of YouTube Channels has not been lost on major players. NBCU has a channel for *The Tonight Show* with Jimmy Fallon (#6). Disney has an animation channel (# 37)⁵¹. In June, 2014, DreamWorks Animation officially launched DreamWorksTV, a YouTube channel aimed at families, with a mix of animated and live-action original series⁵².
- 5.37. Canada has four channels in the top 100, WatchMojo (#12, anime), VanossGaming (#22), wearebusybeavers (#74, kids) TheBajanCanadian (#98, gaming) – none recognizable TV brands or entities⁵³.

Regulatory Change

- 5.38. While occasionally expressing their irritation with the restrictions imposed in the Canadian broadcasting system, Canadians have historically been tolerant of the “cons”, in appreciation of the “pros”, including local news and Cancon generally.
- 5.39. The Commission has in turn historically seen its role as one of looking after the interests of Canadians as “consumers, creators and citizens”, with the trade-offs that go along with serving these different needs.
- 5.40. That the Canadian broadcasting system is “an act of political will” is simply a reality. The impact of regulation on the Canadian broadcasting industry can neither be taken for granted nor ignored.
- 5.41. Had Canadian ownership and Canadian content requirements not been introduced, there is little doubt that Canada’s broadcasting system would be a mere 51st-state extension to US broadcasting, with little more than local news and information programming produced here.

⁵⁰ *YouTuber 'PewDiePie' Is Making \$4 Million A Year*, Erik Kain, www.forbes.com, June 18th, 2014.

⁵¹ [Top 100 Most Viewed YouTube Channels Worldwide](#), May 2014, Joshua Cohen, June 19, 2014, Tubefilter

⁵² [DreamWorks Animation Launches YouTube Channel with Shrek, Original Series and More](#), variety.com, June 16th, 2014. While not the same as posting original content to your own channel, it is worth noting that in Canada, children’s producers like DHX and Nelvana are increasingly choosing to “register” and garner advertising revenue from content placed on YouTube, rather than issue “take-down” notices. See Rights Study for more.

⁵³ As identified in the top 100 list cited above. No attempt has been made to verify Canadian ownership or whether there is investment from or affiliation with Canadian broadcasting players.

5.42. The regulatory proposals tabled in this proceeding would, if all implemented, constitute a significant shift away from the Canadian broadcasting system of the past, in favour of one where Canadians would experience less regulatory intervention and, apparently, enjoy greater “choice and flexibility in selecting” the programming services they want to receive.

5.43. The regulatory proposals under consideration include:

- **A small basic.** Depending on the level of adoption, presumably this would lower the penetration of non-priority carriage services currently on basic;
- **Pick-and-pay.** That is, options from à la carte to pick-a-pack to provide more “consumer choice”. Depending on whether the Commission imposes some kind of pricing regulation, this would evidently lead to an increase in cord-shaving;
- **Elimination of predominance of Canadian requirement.** This would limit the “forced” packaging of Canadian services with foreign services, and result in lower penetration of Canadian services;
- **Revised rules for the entry of foreign services.** This would lower the standards of entry and reverse the onus, It would likely result in an increase in direct entry of foreign services; and
- **Elimination of simultaneous substitution.** This would materially reduce advertising revenues to the conventional broadcasting sector.

6. Advertising Revenue

"TV is about selling eyeballs to advertisers."⁵⁴

Izzy Asper

"With no ads, who would pay for the media? The good fairy?"

Samuel Thurm

- 6.1. Internet advertising continues to experience phenomenal growth. The most recent estimates put 2013 Internet advertising revenues in Canada at \$3.8 billion, surpassing total TV advertising at \$3.6 billion, for the first time. The UK is the only other major country in which Internet advertising has passed TV.
- 6.2. Of particular concern to Canadian broadcasters are major increases in video and mobile advertising – video ad spending grew by 47.7% in 2013.
- 6.3. Canadian Internet advertising revenue is projected to reach as high as \$7.2 billion by 2018, with an average annual growth rate (13.9%) - exceeding the global growth rate by three percentage points⁵⁵.
- 6.4. As the size of the overall advertising pie generally tracks GDP growth⁵⁶, the effect of the Internet's phenomenal growth is a "squeezing" of advertising revenues for traditional media, regardless of whether traditional media's usage actually changes.
- 6.5. With conventional TV already experiencing revenue declines as a result, it is only a matter of time before specialty follows, possibly within five years.
- 6.6. In assessing the degree of future impact, five phenomena come into play:
 1. The "unlimited" nature of Internet advertising inventory. In essence, advertising on the Internet monetizes human activity that has either never been monetized before, or monetizes it better than traditional media. The monetization of search (formerly done in libraries and yellow pages), of correspondence (Gmail) and of personal interaction (social media) have all created new and now, huge volumes of advertising inventory, some of which are still barely being tapped. Indeed, this provides traditional media with a key advantage – scarcity of inventory on mass audiences. That may be enough to keep traditional media going. It is unlikely however, to be enough to prevent losses;

⁵⁴ Izzy Asper may not have coined this quote, or said it exactly this way.

⁵⁵ PWC, *Global Media and Entertainment Outlook 2013 as reported in [Online ad revenue tops TV in Canada: PwC](#)*, Josh Kolm, Stream Daily, June 9, 2014.

⁵⁶ See for example, PWC (2009), *Global Media and Entertainment Outlook 2009*, at pp 15-16.

2. The capacity of online and mobile activity to replicate traditional media activity and advertising. As already discussed, new digital media do not have to replace traditional media to have a major impact. Replicating, extending, or morphing, and then creating analogous advertising vehicles is enough. Display and classifieds particularly devastated print; local and mobile has the potential for a higher impact on radio; and video will hit TV more than other traditional media. (Search continues to hit everyone);
 3. Lag between time share and revenue share. Even if consumer adoption of digital media were to slow down (a development no one anticipates), just the effect of Internet ad spending catching up to its time share will drive these revenues up to the detriment of traditional media, including TV;
 4. Demographic realities. As TV loses younger demographics, it will lose advertising even if overall viewing remains the same (i.e. older demographics watch more TV). Advertisers court younger consumers. TV and radio advertisers buy a 25-54 demographic. Gains in 55+ will not make up for losses in 25-54; and
 5. The further consequence of viewing losses to OTT. If and when there are perceptible drops in TV viewing, there will be further advertising losses⁵⁷.
- 6.7. The inexorable shift to Internet advertising will therefore continue for the foreseeable future – if not reducing incumbent revenues, then certainly curtailing growth.

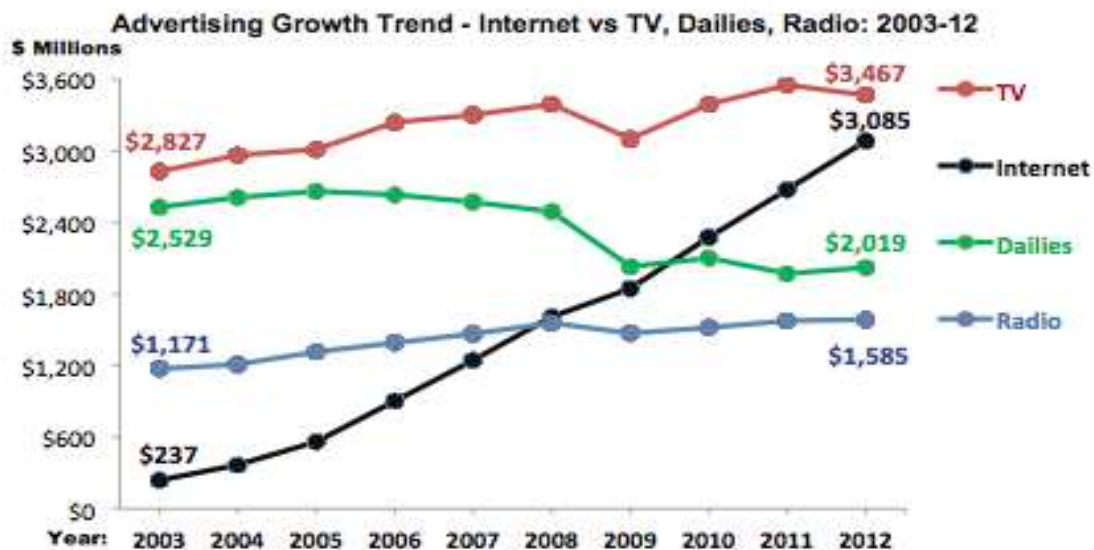


Figure 6.1: Traditional Media vs. Internet Advertising 2003-12

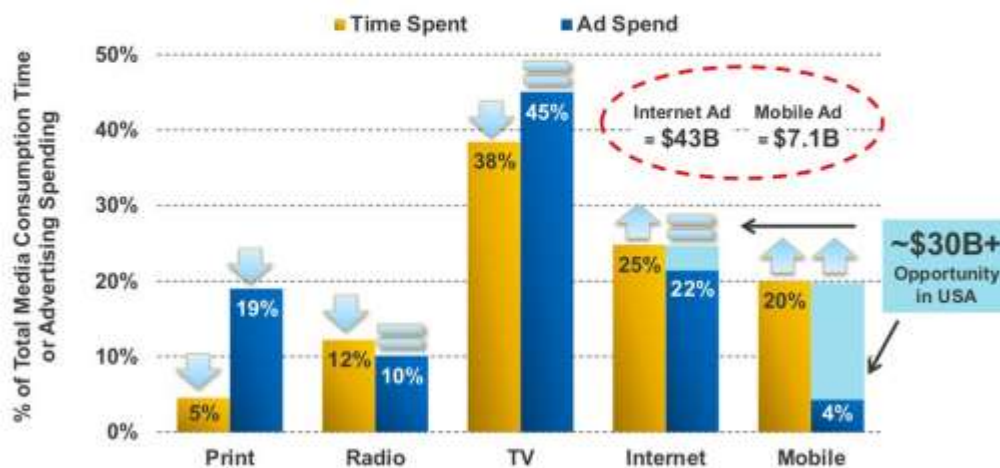
Source: IAB Canada

⁵⁷ Note that all phenomena are reflected to varying degrees in the outlooks examined in this study, except that for the last one, material losses in viewing to OTT are not assumed in the “best-case” outlook.

- 6.8. The Internet does not have to diminish TV viewing to have a major material impact on TV advertising. It is a simple matter of math. Indeed, it is virtually impossible to see how such growth, flexibility and sheer magnitude of online advertising, combined with the exponential growth of mobile, can be accommodated without ultimately forcing material reductions in *all* traditional media categories.
- 6.9. The lag between time share and revenue share will particularly help mobile, but also continue to help Internet advertising.

**Remain Optimistic About Mobile Ad Spend Growth
Print Remains Way Over-Indexed**

% of Time Spent in Media vs. % of Advertising Spending, USA 2013



@KPCB Source: Advertising spend based on IAB data for full year 2013. Print includes newspaper and magazine. \$30B+ opportunity calculated assuming Internet and Mobile ad spend share equal their respective time spent share. Time spent share data based on eMarketer 7113 (adjusted to exclude outdoor / classified media spend). Arrows denote Y/Y st% in percent share. 15

Figure 6.2: Media Time Spend vs. Advertising Spend US 2014

Source: Mary Meeker, Kleiner Perkins Caufield & Byers Venture Capital Presentation, May 28, 2014

- 6.10. In Canada, mobile media appear to occupy roughly 10% of consumer time but only 2% of media spend⁵⁸ – probably the largest gap between time spend and media spend of any media category. Time spent with online video is also assumed to exceed advertising share by a 3 to 5 times margin.
- 6.11. However, for television in Canada, the story is not all bad news. TV per-capita ad spending in this country is almost half what it is in the US⁵⁹. And the

⁵⁸ The 2% media spend is based on a 2013 IAB mobile revenue projection. Time spend is an estimate, and assumes a slightly lower level than in the US.

⁵⁹ Source TVB. \$103 in Canada annually vs. \$198 in the US. This has been a truism for some time. It is in the realm of possibility that this fact alone could allow TV advertising to

Canadian specialty advertising market is further under-developed compared to conventional⁶⁰. Thus while conventional TV in Canada can be expected to continue its revenue decline, fortunately, this differential could continue to sustain material specialty advertising growth for three to five years.

Clutter, effectiveness and alternatives

6.12. Issues of advertising clutter and effectiveness also play heavily in the advertising story for TV. Marketers of television are quick to speak to the medium's effectiveness, including its:

- “Unbeatable scale and reach” – the highest of any medium in Canada – ideal for advertisers seeking a quick impact in the marketplace;
- “Ownership of prime time” – it reaches audiences when they are most receptive to ads; and
- “Emotional engagement” - it stimulates more of consumers' senses than any other medium⁶¹.

6.13. What promoters of TV don't tend to speak about is its more than 12 minutes of advertising per hour – a figure that advertising-supported OTT will need to start to approach if it is to generate the revenues to compete head on. Many believe, however, that this is unlikely – that consumers' tolerance for Internet advertising diminishes almost as soon as it starts – and that unlimited inventory is ultimately a curse that will lead to “peak advertising”, that is, a theoretical point at which Internet advertising ceases to grow with increased vehicles and inventory, but rather declines.⁶²

6.14. Which is a reason why the trend of advertisers trying to reach their customers more directly, through social media and through branded entertainment, seems only destined to increase.

continue to grow in Canada, despite all other negative factors. The familiarity of TV and relative scarcity of inventory could make the difference. Another measure is per-capita ad spend. According to eMarketer, Australia has the highest at \$452, followed by the UK at \$450. The US is fourth at \$404. Canada is sixth at \$393. These figures suggest Canada has largely closed its historic per capita gap with the US, in large measure because of Internet growth that has exceeded that in the US: *Australia Ranks First in Ad Spend per Person*, [Felix Richter](#), Statistica, September 25th, 2013.

⁶⁰ According to figures developed for the CAB Radio Council, print is the most overvalued of the four largest media in Canada, with 464% more ad spending than time. By contrast, Radio is 52% undervalued, TV 19% and Internet 12%. RadioAhead Presentation, 2013.

⁶¹ TVBasics 2013-2014.

⁶² See *The Theory Of Peak Advertising And The Future Of The Web*, Tim Hwang and Adi Kamdar, Nesson Center for Internet Geophysics, October 9, 2013.

6.15. And which is also where Netflix comes in. By using an entirely subscription-based model, Netflix is conditioning its subscribers to the notion of ad-free television. This could yet be the biggest enduring impact of Netflix⁶³.

7. Subscription Revenue

Cable TV is "just starting to cost too much."

CEO of Time Warner Cable Inc.

- 7.1. TV in the US reportedly costs an average of more than \$78 per month on cable or satellite⁶⁴. Canada appears to be cheaper – in the order of \$65 per subscriber per month⁶⁵ (nonetheless, still rising) - a big difference being retransmission consent deals in the US and sports costs⁶⁶.
- 7.2. Sports in the US are reportedly responsible for half the cost of cable. "Runaway sports rights" and "runaway sports salaries", new pro and college games, are variously blamed⁶⁷. In Canada, the cycle is in full swing. TSN raised rates a few years ago, and with the NHL now at Rogers, Sportsnet and other Rogers sports properties are expected to follow suit.
- 7.3. It is easy to forget in this context how relatively new subscription revenue is to Canadian broadcasters. As little as 15 years ago, specialty subscription revenues were on the order of \$500 million, well exceeding specialty advertising. Today they are at about \$1.9 billion, but, with the exception of sports, have largely plateaued. Few new services are launching, and all services have largely lost their ability to raise rates. Increases in revenues for specialty now come almost exclusively from advertising – not easy, when the major OTT competitor is advertising free, and competition for advertising is fierce.

⁶³ Netflix considers its ad-free approach as central to its model, akin to a "premium" service. There is the argument that if/as ad-supported competitors grab market share, it could change.

⁶⁴ Based on SNL Kagan figures per *Why Your Phone, Cable & Internet Bills Cost So Much*, [Stacy Curtin, Daily Ticker](#), Sep 24, 2012. Some reports put average US cable costs at as high as \$90 per month: [How your rising cable bill is making sports teams and star players rich](#), March 31, 2014, Warren Grimes, LA Times. The FCC tracks average monthly price of expanded basic service (the combined price of basic service and the most subscribed cable programming service tier excluding taxes, fees and equipment charges) which it puts at \$64.41 at end 2012.

⁶⁵ Source: Author, CRTC Statistical Summaries & Boon Dog Professional Services Inc.

⁶⁶ That said, on an "apples to apples" basis, the precise gap is hard to assess.

⁶⁷ [Cable TV Costs Too Much \(TWC, DISH, DTV, LMCA, DIS, NWS, NFLX\)](#), 24/7 Wall St., December 3, 2012.

- 7.4. Subscription revenue is challenged by cord-shaving, cord-cutting and cord-nevers. Cord-cutting/cord-nevers are small but real, although up until now hidden by natural BDU subscriber household growth. Cord-shaving is indicated by declining pay-TV penetration.
- 7.5. For BDUs and the system, sports is a proven anchor – probably the reason most cited by consumers for not cord-cutting. But for non-sports watchers, even at Canada’s far lower level of cross-subsidy, the notion that \$20 of their cable bill is going to sports might be reason enough.
- 7.6. The promise of unbundling, be it through pick-and-pay or pick-a-pack, is that by giving more choice, and perhaps taking a small revenue hit, the system becomes stronger.
- 7.7. The risk, however, is high. Consumer expectations for low per-channel fees would no doubt be dashed. And an outcome of less choice at the same price is not unlikely if expectations of protecting Canadian jobs are to be met⁶⁸.
- 7.8. In the best-case scenario, unbundling would reduce cord-cutting at the expense of a moderate amount of cord-shaving. In the worst-case scenario, it would exacerbate both.

⁶⁸ Throne Speech, October 16, 2013, as reported in *Federal government signals cable package unbundling in throne speech*, Etan Vlessing, Playback, Oct 16, 2013.

8. Other Factors

“There are known knowns; there are things that we know that we know. We also know there are known unknowns; that is to say we know there are some things we do not know. But there are also unknown unknowns, the ones we don't know we don't know.”

Donald Rumsfeld

A Rogers OTT Service – Showmi?

- 8.1. For a year or more, speculation on the launch of a Canadian broadcaster-led OTT service has circulated widely.
- 8.2. By early 2014, it had a name, Rogers’ Showmi – designed along the Hulu model, to extend the online viewing window of current shows plus provide access to older series and movie catalogues. The service would offer dynamic ad insertion in older episodes (once seven days after initial airing has passed⁶⁹), to directly measure viewership either online or on cable VOD. It would also perhaps include something Rogers is uniquely positioned to provide: sports⁷⁰.
- 8.3. With a national footprint, the opportunity for Rogers to make the service complementary to its own BDU offerings, but competitive to all other BDUs (or all other non-cable BDUs) is an interesting one.
- 8.4. If priced at roughly \$10 per month, perhaps with some integration with set-top boxes, it could be mostly complementary.
- 8.5. At \$30 per month, with a broader set of services (perhaps even streaming of off-air channels) and a sampling of NHL games, it might be an attractive option for cord-cutters and a competitor to other BDUs.
- 8.6. It may start as one and become the other.

Outstanding Significant Benefits packages

- 8.7. 2013 broadcast-year spending on significant benefits was \$108.8 million. \$315 million in benefits packages remain to be spent by 2019. All current outstanding benefits commitments total \$500 million, ending 2021.

⁶⁹ VOD and OTT viewing within seven days counts towards accumulated audience for advertising purposes. Beyond seven days, however, an ad generates no incremental revenue to the broadcaster.

⁷⁰ Rogers has yet to confirm whether the service is launching, but expectations are that it will launch this fall. See, for example, *OTT – Nearing an Inflection Point*, Canaccord Genuity, Aravinda Galappathige and Haesu Lee, June 3, 2014.

8.8. While annual expenditures from benefits vary from year to year due to timing of particular benefits packages, benefits provide a significant short-term buffer for the system, Cancon and independent producers. Over 80% are slated for screen/programming-related initiatives, the vast majority of this with independent producers⁷¹.

Consolidation and Vertical Integration

8.9. Consolidation, vertical integration (VI) and the resulting loss of ownership diversity in the broadcasting system are, to a large degree, an inevitable and necessary consequence of industry trends⁷².

8.10. The Commission's approvals over the past decade⁷³ of the acquisitions and mergers that led to the current state of affairs were largely based on the understanding that scale was necessary to compete, and that larger VI entities would have the capital to invest in the system, and in particular ensure the long-term survival of over-the-air television in Canada.

8.11. There's no doubt that scale and scope, particularly national coverage of OTA TV, has been of value.

8.12. While safeguards do exist, there remain potential unintended consequences. When content is a threatened but subsidiary play to broader distribution and Telecom ambitions, interests may not be aligned. Such unintended consequences of vertical integration need to be understood and mitigated. For example:

- How much money can major BDU/broadcasters lose on the conventional TV side (while still making money on specialty) before they make drastic cuts? How much upside on the ISP side can cover losses on the BDU side? Is TV Everywhere fee-for-carriage by another name?;
- If major conventional broadcasters were not owned by BDU VIs, would more free OTT content be available rather than behind pay walls (i.e. TV

⁷¹ Per BoonDog Professional Services Inc., April 30, 2014

⁷² Not everyone will agree with all aspects of this statement, but generally speaking, TV is a business of scale and scope everywhere in the world. Consolidation, particularly in conventional TV, and also in specialty TV has clearly improved companies' abilities to compete for and amortize the costs of national program rights. Now that that competition is against OTT, the author would argue that that scale is essential. Vertical integration is perhaps not as clear-cut. Telus is an example of a telecom/BDU in Canada that has not gone this route. And in fighting OTT, it should be a good thing, but may not turn out to be.

⁷³ These include CTVglobemedia Inc. purchase of CHUM Limited in 2007, Astral Media Radio G.P. acquisition of the radio and TV assets of Standard Radio Inc. in 2007, Rogers Media Inc. purchase of five Citytv stations in 2007, Shaw Communications Inc. purchase of the Canwest Global Communications Corp. television properties in 2010, BCE Inc. acquisition of full control of CTVglobemedia Inc in 2011 and BCE Inc. Acquisition of Astral Media Inc. in 2013.

Everywhere) that today may only be available to their own BDU subscribers?⁷⁴; and

- Are the profit margins of the ISP business sufficiently better than the BDU business to warrant supporting OTT even if it cannibalizes BDU service?

8.13. Whether vertical integration has allowed greater investment in the future viability of TV is another important question⁷⁵.

Investment community

8.14. For more than two decades, media in Canada has been a growth area and one that brought solid returns. At its height in 2000, the capitalization levels of the largest eight publicly traded media firms (including CTV, Canwest, etc) soared to \$25 billion⁷⁶. Today, the publicly-traded media sector is generally seen as comprised of Corus, DHX Media, Newcap, Torstar and Post Media with a market cap of under \$4 billion⁷⁷.

8.15. Most broadcast media assets are now held by vertically integrated entities whose primary business is distribution and/or telecommunications, more generally. Today, to cover media in Canada is to cover telecom.

8.16. Analysts and fund managers that cover or invest in companies in any sector pay attention to both short-term (typically quarterly) results and longer-term outlooks. If either or both are less than positive, they have a responsibility to act accordingly.

8.17. Telecom/media analysts and fund managers tend to be media-savvy, are relatively early technology adopters, and have kids who (like most kids) appear to be on their computers, tablets and smartphones all the time, and much less on TV.

8.18. Most telecom/media analysts and investors have already “turned negative” on conventional TV and many are starting to do so with radio⁷⁸. Specialty is seen

⁷⁴ See, for example, [Canadian Broadcasters Find Clever, Nasty Way To Slow Down Digital TV Revolution](#), Huffington Post Canada, Daniel Tencer, 03/08/2014. This issue is addressed to a large degree in the Rights Study. The current practice of a free seven-day catch-up window for OTA content seems commercially reasonable for all players, as broadcasters can easily monetize advertising. Beyond that, going behind a pay wall is the only practical way broadcasters can currently monetize additional rights costs.

⁷⁵ This is not to suggest that transactions such as Shaw’s acquisition of Global and Bell’s acquisition of CHUM’s NewNet Stations (now CTV-2) did not have significant value in ensuring the immediate viability of the stations, to the point of financial rescue.

⁷⁶ [Financialization and the “Crisis of the Media”: The Rise and Fall of \(Some\) Media Conglomerates in Canada](#), Dwayne Winseck Carleton University p 375.

⁷⁷ As it is not clear what Prof. Winseck included in the \$25 billion figure, this is likely an “apple to oranges” comparison. The point, however, remains that the media sector, from a financial investment POV is far smaller today than it was.

⁷⁸ This is beyond the fact that many were not convinced that VI and content acquisitions were the right strategy in the first place.

as vulnerable, and the attitude toward it risks turning negative, even though current results remain positive⁷⁹.

- 8.19. If or as broadcasting results start to soften, and the longer-term looks questionable, it should be no surprise to anyone that investor interest in media stocks would become limited to a narrower and narrower class of investors, and investor confidence in media-reliant stocks be shaken.
- 8.20. For companies like Bell, whose radio and TV assets represent perhaps 5% of the company's revenues and profits, this may not have a material impact. But for a Shaw, which already faces major IPTV competition, or a Rogers which has just put \$5.2 billion over 12 years into NHL hockey rights, it is likely to be a bigger factor. (And for all, having only recently purchased broadcast assets with an expectation of profits, the pressure on management to deliver margin, even in a flat market, is intense.⁸⁰)
- 8.21. Far bigger than broadcasting for VI companies, however is the distribution side of the equation. Price pressure and declining BDU subscription levels are the order of the day for Rogers, Shaw and Videotron, although not yet for Bell⁸¹. Decreases in BDU revenues and profits, without commensurate increases on ISP and wireless (or other categories), would be seen as all but unacceptable.

⁷⁹ As reflected in analysts' reports and per conversations with the author.

⁸⁰ Most recent evidence of this being Bell Media's June announcement of 120 staff cuts in summer, 2014, as "a result of financial pressure related to advertising and subscription challenges across our TV services". *Bell Media to cut 120 positions from Toronto TV group this summer*, Greg O'Brien, Cartt, June 23, 2014.

⁸¹ Declines in DTH would appear to be being more than accounted for by increases in IPTV subscriptions.

9. Assessment of Current Environment

They say that ninety percent of TV is junk. But, ninety percent of everything is junk.

Gene Roddenberry

9.1. As recently as October, 2012 the Commission stated:

The Commission does not consider that there is compelling evidence on the record to demonstrate that foreign, unlicensed competitors are having a significant impact on negotiations for program rights by Canadian broadcasters. In addition, the Commission noted in its report *Navigating Convergence II*, published in August 2011, that based on available data, Internet platforms continue to be complementary to the traditional broadcasting system⁸².

9.2. In a Report prepared for the Commission (in part by the author) in March, 2012, subscriber loss was recommended as the most useful and practical measure of shifts in the competitive balance as between OTT providers and regulated players within the Canadian broadcasting system.⁸³ Three types of tipping points, with associated thresholds, were suggested.

	Competitive impact	Material impact	Threat to viability
Pay TV	1% drop	10-15% reduction	40%+ reduction
Cat B Specialty TV	1% drop	5-10% reduction	15%-50%
Cat A Specialty TV	1% drop	15-30% reduction	40%-70%
BDU Subs/OTA TV	1% drop	5% reduction	25%-50%+

Table 9.1: Potential Tipping Points with respect to Subscriber Losses for Different Parts of the System

9.3. In assessing impact, the Report suggested that:

⁸² Broadcasting Decision CRTC [2012-574](#), para 62 (initial denial of BCE acquisition of Astral).

⁸³ *Market Impact and Indicators of Over the Top Television in Canada: 2012*, March, 2012, Peter Miller and Randal Rudniski, at section 3.

- Generally speaking, absent a re-packaging cause, any non-seasonally related drop in absolute subscription levels is likely to have OTT as a cause, at least in part. This is particularly true given that the march to increased subscribers has historically met no resistance, not from economic downturns, more-regulated services, or increased subscriber fees. Nevertheless, a consistent downturn, for at least three quarters (quarter over previous year's quarter), reaching at least 1% would appear to be a reasonable threshold necessary for conclusive evidence of competitive impact.
- 9.4. By this measure, it is reasonable to conclude that Canada is witnessing initial evidence of competitive impact of OTT.
- 9.5. Netflix passed pay TV in Canada in 2012 in terms of number of subscribers, is assumed to have hit over 3.5 million subs in 2013, and is projected to hit over 4.5 million by the end of 2014⁸⁴.
- 9.6. Pay TV is now down by 6% since Q2 2013⁸⁵.
- 9.7. According to CRTC broadcast-year numbers, BDU subscriber growth has decreased from an average of just over 2.5% in 2009, 2010 and 2011 to 1.5% in 2013⁸⁶. According to analyst calendar year numbers, BDU subscriber numbers have now plateaued with 0% growth in 2013⁸⁷. Data from Boon Dog Professional Services puts BDU growth at *-0.3% in 2013*.⁸⁸ A 1% drop would appear to be only a matter of time.
- 9.8. Accordingly, while aggregate revenues in the system have not declined⁸⁹, it is no longer reasonable to say "Internet platforms continue to be complementary to the traditional broadcasting system". Competitive impact is currently minimal, but it is present.

⁸⁴ *OTT – Nearing an Inflection Point*, Canaccord Genuity, Aravinda Galappaththige and Haesu Lee, June 3, 2014.

⁸⁵ *OTT – Nearing an Inflection Point*, Canaccord Genuity, Aravinda Galappaththige and Haesu Lee, June 3, 2014. Corus Movie Central Subs went from a high of 1,013,00 in Q2 2013 to 953,000 in Q2 2014. While quarterly variations are normal, such a large year over year drop is not. The current level is, in fact, lower than at any time since Q4, 2009. While it is possible numbers could rebound with a sudden influx of demand, this would appear to be more wishful thinking than likely.

⁸⁶ CRTC 2013 Statistical Summaries – [Broadcast Distribution](#). Note that such a *decline in growth* is a decline, just a less visible one, as it hits household growth first. In retrospect, it is fair to say that BDU *subscription growth* has been declining since 2011/12.

⁸⁷ Scotiabank estimates that BDU subscriber reached 0% in mid 2013, and that BDU penetration will have declined from a high of just over 81% in early 2012 to 80% in 1Q 2014. *Converging Networks*, Scotiabank, May 26, 2014.

⁸⁸ See also, for example, *OTT – Nearing an Inflection Point*, Canaccord Genuity, Aravinda Galappaththige and Haesu Lee, June 3, 2014. Data From Boon Dog Professional Services Inc.'s *Canadian Digital TV Market Monitor* shows -0.3% growth in 2013.

⁸⁹ Due to increasing TV advertising revenue overall and increasing BDU ARPU.

9.9. Even if overall impact to the system remains negligible over the short to medium term, shifts of revenue away from conventional television, or other sectors, may necessitate a rebalancing of obligations to ensure that public policy objectives, such as Canadian, including PNI and local, programming, are met.

10. Revenue Outlooks

*Theatre is life. Cinema is art. Television is future*⁹⁰.

Unknown

We should all be concerned about the future because we will have to spend the rest of our lives there.

Charles F. Kettering

The Purpose of Outlooks

- 10.1. The purpose of an outlook⁹¹ (be it a more specific, a shorter-term forecast, or a more speculative longer-term scenario) is not to say what *will* happen, but what *could*.
- 10.2. To be as useful as possible, outlooks typically identify assumptions and key factors – both so these can be challenged, and equally important, so we can understand what happens if we are able to change them.
- 10.3. Merely generating absolute worst-case and absolute best-case scenarios has little value to decision makers.
- 10.4. What can have value, however, is the development of different scenarios with a view to broadening the thinking of decision makers ... [and] devising plausible future narratives rather than probable outcomes; in other words, there are benefits to considering scenarios that [may be seen by some as having] a very low probability of occurring. The benefit of this exercise is that it forces decision makers to consider views of what may unfold that differ from the ‘official view’.”⁹²
- 10.5. Obviously, in this study, the purpose of modeling is as basic and as complicated as ‘what is the future of Canadian broadcasting’? Does it have a future? For how long? And, how much and how long can it be expected to continue to contribute to Canadian programming and other objectives of the *Broadcasting Act*?

⁹⁰ Actually, the real quote says “furniture”.

⁹¹ In this report, the term “projection” encompasses both forecasts and outlooks. “forecasts” refers to short term, more definitive, projections (i.e. here, 3 years). “Outlooks” refers mid to long term projections – in the present case, mid-term, seven-year projections.

⁹² *Strategic Risk Taking, A Framework for Risk Management*, Aswath Damodaran, August, 2007. FT Press, chapter 6 ([Probabilistic Approaches: Scenario Analysis, Decision Trees and Simulations](#)) at p.4. The author is not suggesting the current modeling is anywhere as sophisticated as that reviewed in this text, merely that some of the basic principles apply equally.

10.6. In this Report, there is a further objective: What are the possible consequences of the regulatory measures contemplated in the Notice – for the revenues of the Canadian broadcasting sector and its support for Canadian programming, and ultimately for employment and broader economic impact?

Core Assumptions

10.7. Detailed assumptions for the study's future revenue and CPE modeling are provided in Appendix 1.

10.8. Core assumptions used in modeling include the following:

- Where published forecasts are available, they are noted. If studies appear compatible but slightly different, one or an average may be used. If studies are materially different, they may either be used as “book end” scenarios, or one may be rejected on the grounds that it appears to be flawed. In any event, use in this Study will be noted;
- Given the methodology employed in the report, published forecasts generally used in this way are overall economic growth, subscription revenue, overall advertising (and to a lesser extent, media advertising), TV (conventional, specialty and online) advertising, Internet advertising (mobile⁹³, online, and the video subsector in particular) and outdoor advertising;
- TV advertising revenue projections have been based both on published forecasts and developed by deducting forecasts for Internet advertising revenue plus forecast outdoor revenue from overall advertising revenue and/or directly deducting a portion of online video advertising growth (on the assumption that this will affect TV more than other traditional media);
- Subscription revenue projections have been based on a combination of industry forecasts and modeling assumptions *viz* growth of households less cord-cutting and cord-shaving;
- For simplicity, CPE forecasts are used as a proxy for all broadcast contribution⁹⁴; and

⁹³ Mobile TV is not specifically modeled below. While it seems evident that mobile TV will play a bigger role going forward, it is very unclear what form it will take and what impact it will have. Broadcast mobile TV precedes OTT, but has had no material impact – any incremental revenues presumably included under online. Social TV will clearly have more and more of a mobile element; which impact is generally reflected in viewing assumptions. Mobile could grow TV audiences. It can also be argued that mobile favours short form video, which would suggest that any greater than anticipated impact might be negative.

⁹⁴ The author recognizes that while CPE may be the major *direct* contribution of players in the system, there are as, or possibly more, important *indirect* contributions made by many players (for e.g. BDU priority carriage and predominance of Canadian). Moreover, CPE is not the only “monetary” contribution. Technical and other costs to provide simulcast, priority carriage, closed caption and descriptive video come to mind here. That said, tracking CPE alone is seen as reasonable from the perspective of examining the capacity of the system to contribute, especially since many of the indirect contributions manifest themselves in revenue.

- CPE forecasts and outlooks have been based on aggregate averages within each major class of broadcasting service (conventional, specialty, pay, VOD, BDU). CPE percentages per category have been adjusted over time to reflect different assumptions on regulatory obligations and relief.

General Economic Outlook

- 10.9. The general economic outlook is important to both advertising and subscription revenue.
- 10.10. A positive outlook “lifts all boats” and arguably limits the potential damage that the growth in Internet advertising can do to TV. It also reduces an impetus that Canadians might otherwise have to cord cut or shave⁹⁵.
- 10.11. Most short term outlooks for Canada have become slightly more positive of late, with, for example the IMF, raising its 2014 prediction of real GDP growth to 2.3% (while leaving its 2015 number at 2.4%). The Bank of Canada’s projections are slightly more optimistic at 2.5% for both 2014 and 2015⁹⁶.
- 10.12. Private-sector average forecasts released by the federal government in June 2014, project real GDP growth of 2.2% in 2014, followed by 2.5% in 2015, 2.5% in 2016, 2.3% in 2017 and 2.2% in 2018⁹⁷.
- 10.13. Mid-term economic outlooks for real GDP growth in Canada therefore remain in the 2.2 to 2.3%⁹⁸ compound annual growth rate (CAGR) range through to 2018⁹⁹, and 2.2% CAGR through to 2020¹⁰⁰.

⁹⁵ Both of these being, of course, theories, but with some evidence. In the economic downturn of 2009, traditional media suffered advertising revenue losses, while Internet advertising continued to grow, albeit at a lower pace. And while in the past, cable subscriptions have shown remarkable resistance to change through economic downturns, this may not be true going forward.

⁹⁶ This contrasts with projected US growth at 2.8% and 3% and global growth of 3.6% and 3.9% respectively. As reported in [IMF upgrades Canada’s economic forecast](#), Dana Flavelle, Toronto Star, April 8, 2014.

⁹⁷ [Background: Results of the Department of Finance’s June 2014 Survey of Private Sector Economists](#). Government of Canada, June 17, 2014

⁹⁸ These are “real” GDP growth figures that take into account inflation, as used by most economists, particularly for forecasting. Nominal GDP growth of no more than 4.2% will be used as the base reference in this study, as for simplicity the industry tends to use current dollars when looking at advertising share and projections.

⁹⁹ TD Economics, [Long Term Economic Forecast](#), March 20, 2014. “Canada’s economy still has excess capacity, particularly in the labour market, and low inflation. As the economy accelerates, inflation is expected to grind higher reaching the 2.0% target by the end of 2015. The Bank of Canada is likely to increase interest rates very gradually, reaching 1.50% by the end of 2015, 2.00% by the end of 2016, 3.00% by end of 2017, and 3.50% at the end of 2018.”

¹⁰⁰ See, for example, [Ontario’s Long-Term Report on the Economy](#), which averages five 2010 to 2030 Canadian Private-Sector Projections at 2.2% Average Annual Growth, Chapter 2, Table 5.

10.14. Nominal GDP, which includes inflation, is projected in the Federal government survey at 4.3 % in 2014, 4.3 % in 2015, 4.5 % in 2016, 4.4 % in 2017 and 4.2% in 2018.

10.15. This gives an outlook for nominal GDP through to 2018 of 4.4% CAGR, perhaps 4.5% CAGR through to 2020, assuming increasing inflation.

Outlook for the Canadian Advertising Market

10.16. The media advertising market in Canada increased by a CAGR of 3.2% between 2006 and 2012, with television advertising overall increasing by a CAGR of 1.7%. By contrast, Internet advertising grew 22.8% CAGR over the same period¹⁰¹.

10.17. Growth in the media advertising market over the 2006-2012 period was lower than nominal GDP growth of 4.3% CAGR by one point.

10.18. This kind of differential between nominal GDP growth and advertising market growth seems now to be an increasing reality. A November, 2013, Scotiabank Report provided a detailed historic advertising spending to nominal GDP analysis. It charts Canadian advertising spending to nominal GDP since the mid 1990s, and its drop from an average of 1.04% in the 1995-99 period to 0.84% in the 2000-2008 period to approximately 0.78% more recently¹⁰².

10.19. The analysis appears to put a myth to the notion that new digital media, by stimulating new categories of online and mobile, are increasing overall advertising budgets¹⁰³. While it doesn't necessarily support the notion of "peak advertising", it would suggest that growth in overall advertising (relative to GDP) will likely be lower going forward.

10.20. Thus, while as in the past, there may be considerable variation year to year¹⁰⁴, the analysis suggests a Canadian advertising spending to nominal GDP ratio of as low as 0.7% from 2014 to 2020.

10.21. If one assumes that declines in 2009 were largely cyclical, and that 2013 was just a soft year, one can posit a more positive outlook. If one assumes that advertising growth is slowing and that 2013 was not just an anomaly, a more negative outlook is warranted.

10.22. Scotiabank's November, 2013 projections reflect a positive outlook in forecasting year-over-year growth in the advertising market of 3.2% in 2014.

¹⁰¹ Source: TVB.

¹⁰² *Progress Amid Digital Transformation, A Macro Perspective on the Trends Impacting Investments in the Media Sector*, Scotiabank, Equity Research Industry Report, November, 2013.

¹⁰³ It seems the opposite may in fact be happening. The plethora of inventory is keeping rates low, and ability to target making buys more effective.

¹⁰⁴ There are many reasons for year-to-year variation, including election campaigns, Olympic years, lags and the sectors contributing to GDP growth.

- 10.23. PwC's June, 2014 outlook¹⁰⁵ is even more bullish – projecting a 4.6% growth in total entertainment and media advertising spend in 2014 and 5.1% CAGR in total entertainment and media advertising spend from 2013-2018.
- 10.24. Depending on the scenario, this analysis assumes a range of 3% to 5% CAGR for the Canadian advertising market for 2014-2020.

Outlook for Television within the Canadian Advertising Market

- 10.25. As already noted, conventional television's advertising decline (at least in real dollar terms) would appear to be both ongoing and irreversible. Conventional now joins print, and it would appear radio, as the first traditional media victims of the massive growth of Internet advertising.
- 10.26. While not necessary for conventional TV's losses to continue, the growth in Internet video advertising would seem to have particular impact. Increasing online video viewing combined with increasing volume of advertising on Internet video (rates are now comparable) could drive video advertising up by as much as 30% CAGR through to 2020¹⁰⁶.
- 10.27. These same pressures should, however, also push up the growth of both online TV advertising and VOD advertising – as soon as dynamic ad insertion comes on line.
- 10.28. The consensus on specialty advertising is that it will continue to grow for at least three years, possibly through to 2020. The author views the latter as an optimistic outlook.
- 10.29. Again, while not necessarily integral to forecasts of declines in TV advertising, the potential for material losses in TV viewing remains another factor. At low levels, cord-cutting and shaving, alone, will not necessarily have a material impact on advertising revenues. Cord-shaving may have more to do with cutting channels that are not watched, than migrating viewing to OTT. Even cord-cutting is likely to primarily involve already-low TV viewers, so reductions in advertising should be disproportionately less than subscriber losses might otherwise suggest¹⁰⁷.
- 10.30. Plausible best-case and worse-case scenarios for conventional and specialty TV advertising, absent major regulatory change, are provided below.
- 10.31. The best-case scenario makes the following key assumptions:
- No tangible TV viewing losses;
 - Strong growth in the overall advertising market of the order of 5% CAGR;

¹⁰⁵ PwC, *Global Media and Entertainment Outlook 2014-2018, Global and Canadian Highlights, June 2014*.

¹⁰⁶ PwC's global projection 2013-2018 is 23.8% CAGR. PwC's Canadian projection is 30.9%.

¹⁰⁷ Based on Deloitte quintiles, we assume that in today's initial stages of cord cutting, a 1% loss of subscribers would cause as little as a 0.1- 0.2% loss in TV advertising revenue. If/as cord cutting starts to hit beyond 10% losses, it would be affecting higher viewing quintiles and would have a more direct effect on advertising.

- High, but declining, low double-digit growth of Internet of 13.5% CAGR, including high growth of video internet advertising of 28% CAGR;
- Conventional TV advertising revenue flat;
- Superior growth in TV online revenues of 17% CAGR; and
- Continued growth of specialty advertising revenue through to 2020¹⁰⁸.

10.32. As a result, in this best-case scenario, while conventional TV advertising is flat, TV advertising still grows by 1% GAGR to 2020, due to 2.5% growth in specialty. Inclusion of TV online advertising revenues would increase overall TV system advertising growth to over 10% CAGR by 2020¹⁰⁹.

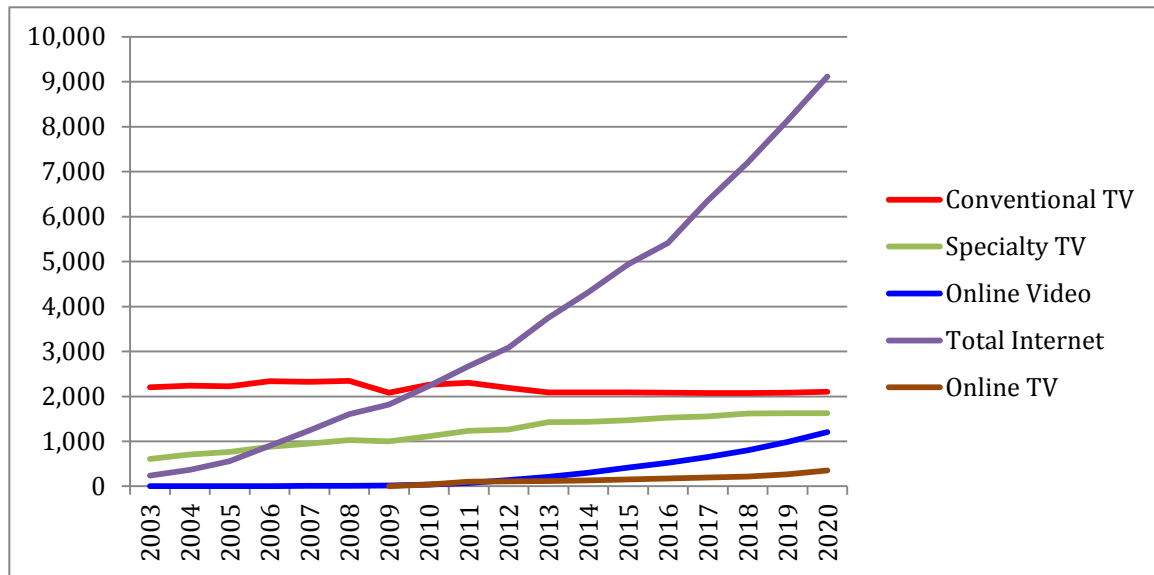


Figure 10.1: Television Advertising Revenue Outlook - Best-Case - 2013-2020

10.33. The worst à-case scenario makes the following key assumptions:

- Lower growth in the overall advertising market of the order of 3% CAGR¹¹⁰;
- Relatively high, but declining, low double-digit to high single-digit growth of Internet advertising of 10% CAGR including slightly less high growth of video internet advertising of 23% CAGR;
- Faster early growth in TV online revenues but still 18% CAGR;
- Conventional TV follows the Internet's impact on traditional media advertising revenue plus 50% of online-video advertising growth comes at expense of conventional TV; and
- Specialty TV advertising revenue follows the Internet's impact on traditional media advertising revenue pro-rata, plus suffers losses from cord cutting,

¹⁰⁸ The best case is similar to PwC's 2013-2018 projections, extended out to 2020. Note that in all charts the vertical axis is in millions of dollars (Cdn), and the horizontal access is year.

¹⁰⁹ It should be noted, however, that these revenues may not all accrue to broadcasters; they may be shared with BDUs or other parties.

¹¹⁰ Equivalent to PwC 2014-2018 projections.

cord shaving, and migration of TV consumption to OTT. Cumulatively, this translates into specialty advertising revenue losses in 2016, flattening specialty growth from then on.

10.34. In this plausible worst-case scenario, conventional TV loses 14% of its advertising revenues by 2020, while specialty TV loses 2%, for a total TV loss of 9%. Growth in TV online advertising revenues reduces overall TV advertising reductions to less than 2%.

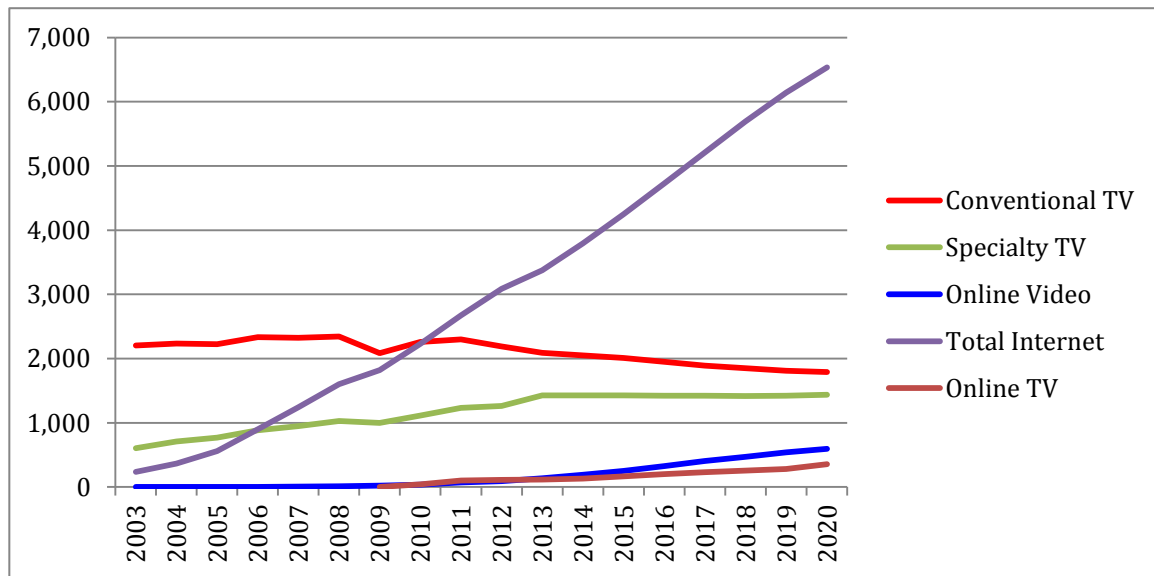


Figure 10.2: Television Advertising Revenue Outlook - Worst-Case - 2003-20

Outlook for Subscription Revenue

10.35. Projections for subscription revenue depend on assumptions for both cord-cutting and shaving.

10.36. Gradual losses in BDU subscribers are expected, consistent with current data and growth reductions of the last three years. Subscriber losses are offset in part by increases in BDU revenue per subscriber (typically framed as average revenue per unit or ARPU).

10.37. As a result, BDU subscription revenues continue to rise, until at least 2016.

10.38. In a best-case scenario, we assume:

- Subscriber losses growing to 0.9% per year by 2019, and totaling 4% by 2020 (to roughly the same level they were in 2010);
- ARPU continuing to rise a total of \$4.89 through to 2018, reflecting pass through of increased sports channel costs and TV Everywhere;
- Overall BDU subscription revenues remaining flat;
- Moderate cord-shaving of 1% a year further contributing to an overall 10% loss of specialty and pay subscription revenue by 2020.

10.39. In a plausible worst-case scenario, we assume:

- Subscriber losses growing to 1% per year by 2017, and totaling 6% by 2020 (to roughly the same level they were in 2008);
- Baseline ARPU rising only \$2 through to 2016, as BDUs absorb most of the cost of increased sports channel fees (or negotiate down the costs of other channels) and TV Everywhere;
- Overall BDU subscription revenues declining by 8%;
- Mark-up on pay TV being reduced by 15% to lessen cord-shaving of pay packages (an overall impact of \$0.50 in ARPU); and
- Cord-shaving, from the cancellation of packages, contributing to an overall 15% loss of pay TV revenue and 18% loss of specialty subscription revenue by 2020.

10.40. Plausible best-case and worse-case scenarios for TV subscription revenue, absent major regulatory change, are provided below.

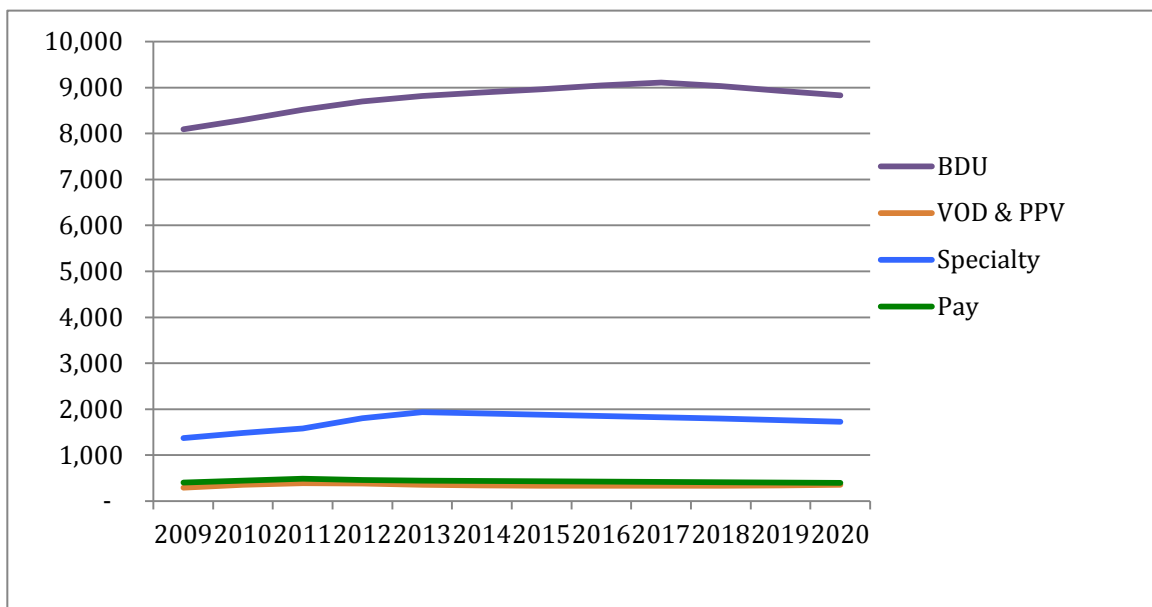


Figure 10.3: Subscription Revenue Outlook - Best-Case - 2009-2020

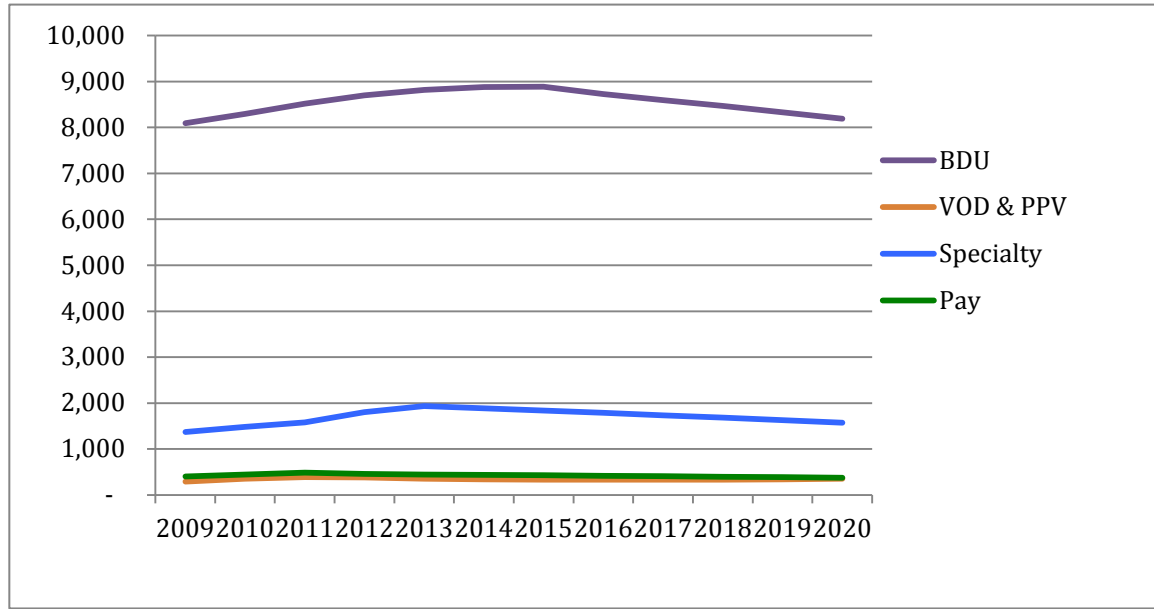


Figure 10.4: Subscription Revenue Outlook –Worst-Case – 2009-2020

Broadcasting System Revenue Outlooks

10.41. Based on the above business outlooks, we look at three 2013 to 2020 scenarios for different sectors of the system, combining subscription and advertising revenues, and now including the potential impact of regulatory changes resulting from the CRTC's Talk TV proceeding. To summarize, the three scenarios examined¹¹¹ are:

- **Best case** - (that is, from a broadcast industry perspective) a favourable, largely status quo, regulatory climate, and modest negative impact from OTT
- **Business worst case** - plausible worst-case OTT impact, with favourable regulatory climate
- **Regulatory worst case** - business best case plus unfavourable regulatory climate, such as introduction of pick-and-pay, removal of simulcast etc.:

10.42. In the 2013 to 2016 time frame, in the best case, revenues in the system still grow by 2%; in the worst case the system loses 3% of its revenues. This small difference in overall impact between scenarios is not surprising. Plausible worst-case OTT impacts would take longer than this to materially affect the aggregate ability of the system to generate revenue and contribute. Even fundamental regulatory change would take longer than this to implement and show results.

¹¹¹ A fourth scenario was considered but is not included. It would have combined a conceivable regulatory plus business worst case, but would not necessarily be a mere mathematical addition of the two. There are arguments that would suggest that in a business worst case, proposed regulatory changes would not have as significant an effect. There are also contrary arguments to the effect that the two together would push the system past tipping points faster, and therefore have a more devastating effect.

10.43. Over the 2013 to 2020 time frame, we see as a best case, system revenues continue to climb to 2017, when they start to decline, returning to their 2013 revenue level by 2020. In the worst case, system revenues start to decline immediately, for a total decline over the same period of 9%.

10.44. It should be noted that these are regulated system revenues, excluding broadcaster online revenue. Should these be included, the picture improves slightly. Overall revenues would increase by over 2% in the best case, and decrease by 7% in the worst case.

10.45. In the regulatory worst case, we assume changes are introduced in the 2015-2016 time frame. They are assumed to have minimal effect on BDU subscription levels, but material effects on BDU and subscription revenues and conventional and specialty advertising revenues. The result of this regulatory worst case in aggregate is a loss of system revenues of 30% by 2020. Inclusion of online TV revenues would reduce this loss by 2%.

10.46. Plausible scenarios for TV system revenue, including that reflecting major regulatory change, are provided below:

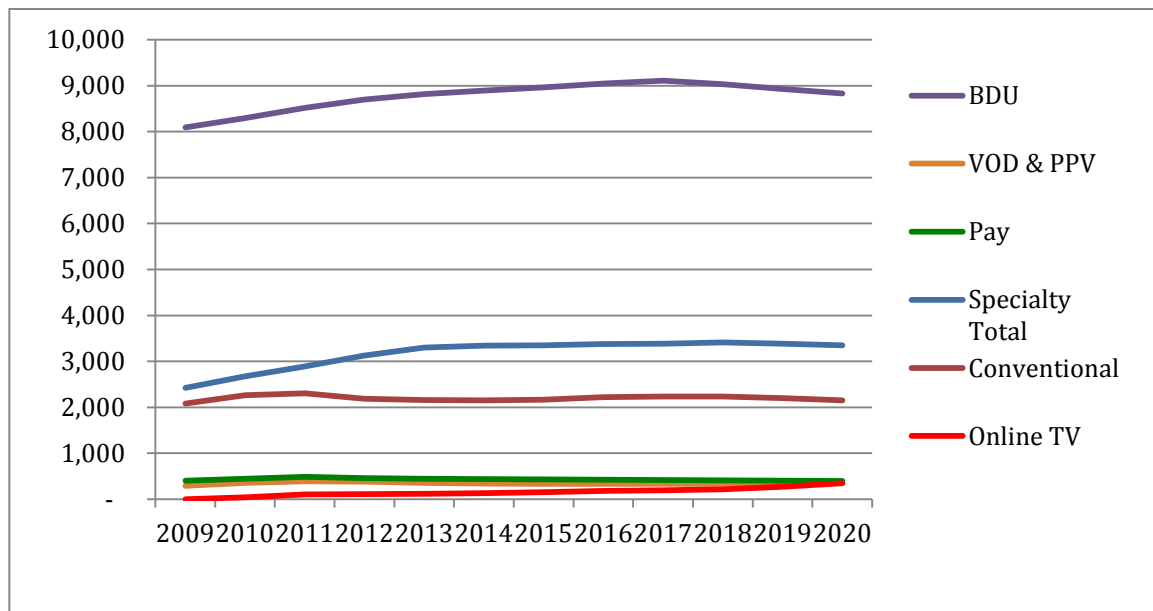


Figure 10.5: System Revenue Outlook – Best Case – 2009-2020

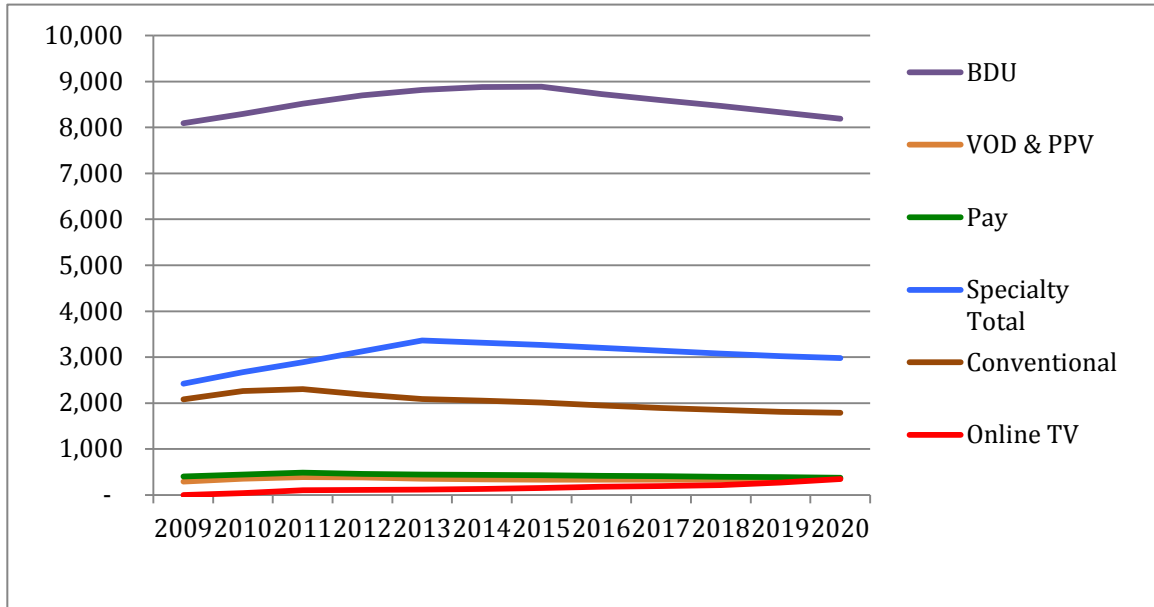


Figure 10.6: System Revenue Outlook - Business Worst Case - 2009-2020

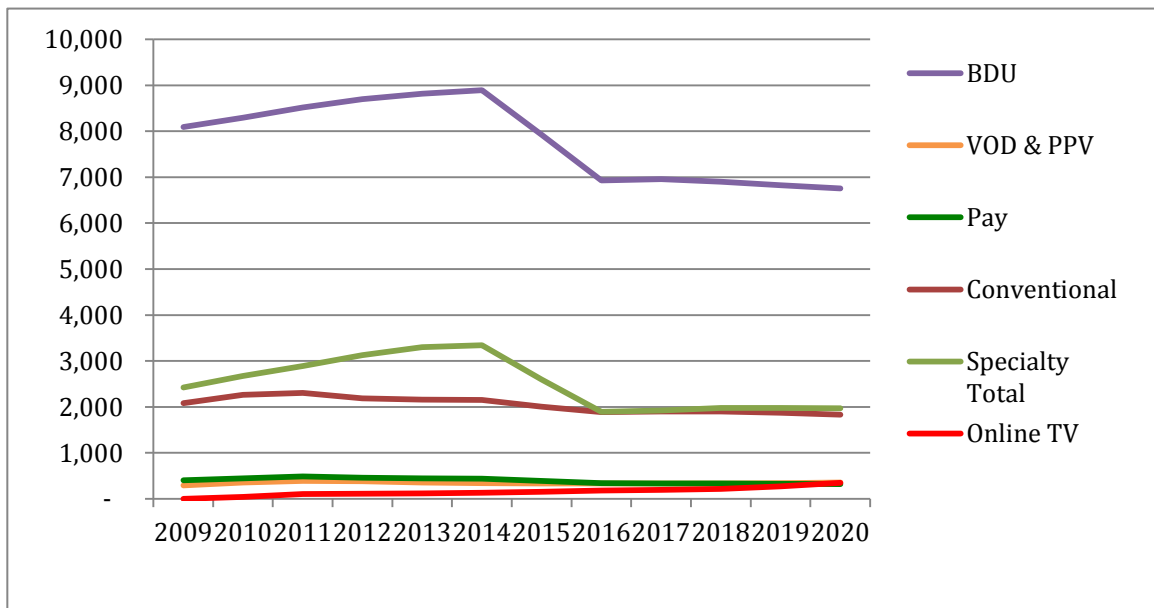


Figure 10.7: System Revenue Outlook - Regulatory Worst Case - 2009-2020

10.47. Based on this examination of plausible scenarios, regulatory impact has the potential to be greater and more negative than competitive/technological impact over the 2014-2020 timeframe.

Impact on Canadian Programming Expenses

10.48. Reflecting the CPE contributions of various elements of the system we can estimate aggregate CPE expenditures going forward¹¹². As potential impacts tend to affect programmers more than BDUs, and programmers have higher CPE requirements, impacts tend to have a disproportionate overall impact effect on aggregate CPE:

- In the best-case scenario, we see aggregate CPE contribution peak at 2017/18 and decline back to 2014 levels by 2020;
- In the business worst-case scenario, we see aggregate CPE contribution decline starting in 2014, reaching an over all decline of just over 10% by 2020;
- In the regulatory worst-case scenario, we see aggregate CPE contribution declining by over 40% by 2020.

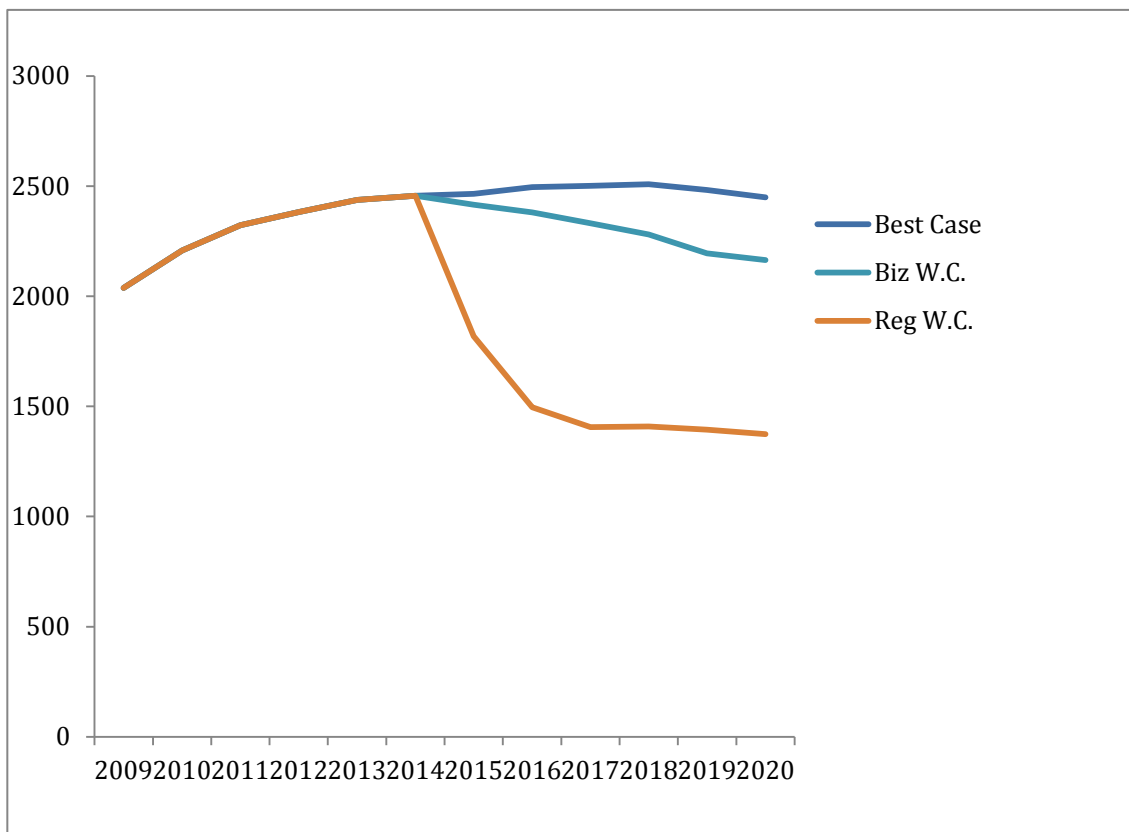


Figure 10.7: CPE Outlook – Three Scenarios – 2009-2020

¹¹² CPE here refers to aggregate programmer CPE expenses and BDU 5% contributions

Disaggregation of impact

- 10.49. Within the overall industry numbers presented above, there is tremendous variation among sectors, players and markets. We know that within the BDU sector, cable and satellite are more vulnerable to losses than IPTV.
- 10.50. We know that as between French-language and English-language TV, virtually all impacts, regulatory and technological, would be lower in French Canada. Not only are French Canadians less interested in US OTT services, they have fewer French-language TV services, but more BDU packaging options to choose them.
- 10.51. We also know that VI players are much better-positioned to weather business challenges than independents, They have more ability to cross-subsidize, more ability to negotiate the best rates, and more ability to trade with other VI players. A small independent cable operator, local TV station or specialty service has few such abilities.
- 10.52. Finally, of all sectors, conventional TV will generally remain the most directly challenged by potential losses in advertising revenue, but is not necessarily the most challenged over all. In certain regulatory and worst case business scenarios, specialty TV could suffer greater overall revenue losses. Similarly, while pay TV is the more immediately challenged by cord shaving, there are scenarios that would see specialty TV more challenged going forward.

Potential Tipping Points

- 10.53. It should be reiterated that the above analysis does not take into the account the possibility that certain “tipping” or “inflection” points might be reached that fundamentally disrupt the broadcasting system.
- 10.54. Among the more disconcerting potential “tipping points” identified in the Rights Study are¹¹³:
- a. Material losses in BDU subscribers to piracy or OTT services;
 - b. Material losses to BDU and broadcaster revenue due to regulatory change;
 - c. Bypass of the Canadian broadcasting system by major programmers (e.g. AMC or HBO Go direct to Canadians); and
 - d. OTT disruption from a major player like YouTube which purchases or is otherwise granted global rights to television programming but sells advertising market-by-market.
- 10.55. The difficulty with tipping points is that what characterizes “material” is often not known until a threshold has passed, and in retrospect, been identified.
- 10.56. As Canaccord Genuity asks,

¹¹³ Additional information about potential tipping points and OTT can also be found in the April 15, 2011, RBC Report and [Market Impact and Indicators of Over the Top Television in Canada: 2012](#), March, 2012, Peter Miller and Randal Rudniski.

The key question for us, however, is what the picture looks like 3-5 years from now. Would there be an inflection point in the sliding sub growth line towards a 5% decline or greater, which would potentially have significant repercussions for broadcasters that rely on subscription revenues for nearly 50% of their top line. If so, what could trigger such an inflection point?

10.57. Or more specifically (stemming from Deloitte's quintile research and in comparing English and French speaking viewing):

the reduction in the TV viewing hours by the bottom 20% in English-speaking Canada is very much the result of the emergence of online TV. Consequently, the question is (also alluded to in the [Deloitte] report) – if the viewing hours of the bottom 20% continue to fall, is there a point at which that segment of consumers starts to discontinue cable?¹¹⁴

10.58. The potential effect of such tipping points adds both to the uncertainty of any medium- to long-term projections, and the need to avoid unnecessary regulatory risk. We simply do not know whether a 5%, 10%, 20% or 40% loss in subscribers or revenue is “just” a direct loss, or whether it would trigger further declines or consequences that compound these impacts dramatically.

¹¹⁴ *OTT – Nearing an Inflection Point*, Canaccord Genuity, Aravinda Galappaththige and Haesu Lee, June 3, 2014.

11. Assessing Broader Economic Impact

“The art of economics consists in looking not merely at the immediate but at the longer effects of any act or policy; it consists in tracing the consequences of that policy not merely for one group but for all groups.”

Henry Hazlitt

11.1. The television system is part of a broader film and TV ecosystem in Canada that, as at 2011, was estimated to support 260,000 full-time equivalent workers (FTEs), to generate \$13 billion in labour income for Canadians and \$20 billion in GDP for the Canadian economy¹¹⁵.

11.2. While elements of the system may not appear related (e.g. cable distribution vs. theatrical exhibition), it is generally accepted that Canada’s strength in film and TV production, and broader creative and ICT sectors is, at least in part, due to its strength in each of these component elements¹¹⁶. This has two diametrically opposite potential consequences:

- Losses in one area can be some times made up in another, e.g. reductions in DVD sales, manufacturing or rentals can be made up for in increased online, cable VOD or pay TV revenue, or reductions in domestic production can be made up for through gains in foreign service production; and
- Losses in one area can drag down the whole system, e.g. reductions in broadcaster revenue will typically result in reductions in Canadian production.

11.3. The resilience or vulnerability of the system to impacts on any one element depends both on where on the value chain¹¹⁷ impact occurs, and what if any

¹¹⁵ *The Economic Contribution of the Film and Television Sector in Canada*, Nordicity, July, 2013, commissioned by CMPA and MPA-C. The complete value chain of film and TV of production through exhibition and distribution (including, for example, media manufacturing and DRM, online and physical sales) was included in this analysis. Approximately half of this economic value is accounted for through spin off benefits, including indirect economic impact (that associated with the sector’s procurement from other sectors of the Canadian economy) and induced economic impact (the wider impact on the Canadian economy that arises from the respending of labour income earned at both the direct and indirect stages).

¹¹⁶ See, for example, the Ontario Ministry of Tourism and Culture’s [Ontario’s Entertainment and Creative Cluster: A Framework for Growth](#), 2010.

¹¹⁷ Important work was done on value chain analysis, particularly changes due to technology, the role of gate keepers and risk mitigation, by David Keeble and Richard Cavanagh *et al* for the Department of Canadian Heritage in 2007. There has been much more consolidation and vertical integration since then (potentially changing the nature of some gate keeper interests), but as a framework for analysis it remains relevant, (A precursor to this work was done by Keeble for CAB: [The Evolving State of Audio-Visual](#)

substitute activity benefits, as well as more general economic factors, such as level of unemployment and Canadian dollar exchange rate.

- 11.4. While the regulator cannot influence general economic factors, it can have a huge role in determining both the level and type of economic contribution of those within its purview and whether any substitute activity contributes to a greater, lesser or equivalent extent.
- 11.5. We have therefore modeled the economic impact of the proposed regulatory changes discussed above¹¹⁸
- 11.6. The following section provides an analysis of the economic impact of the various regulatory scenarios assessed in this report. In particular, we examine the impact of (i) the removal of simultaneous substitution regulations for conventional broadcasters, and (ii) the adoption of a pick-and-pay regime accompanied by lower barriers of entry for non-Canadian programming services.
- 11.7. For each scenario, we begin with the baseline forecast of revenue (2014-2020) in each segment of the Canadian broadcasting sector developed in section 10 above. We then apply the above model of revenue impact that would accompany changes in the regulatory regime. On the basis of that revenue impact we then model the economic impact in terms of employment (in FTEs) and GDP.

Total regulatory impact

- 11.8. We begin by combining the impacts associated with the removal of simultaneous substitution, and pick-and-pay and lower barriers to entry – including the impacts on both the broadcasting and production sectors – to arrive at an assessment of the total regulatory impact.
- 11.9. We estimate that the adoption of a new regulatory regime would result in an annualized loss of 31,460 FTEs of employment in 2020 (Table 1), including 13,440 FTEs in the broadcasting and production sectors (i.e. direct impact) and an additional 18,020 FTEs in other sectors of the Canadian economy (i.e. spin-off impact).
- 11.10. The loss of revenue and employment associated with a new regulatory regime would also result in an annualized loss of \$2.9 billion in GDP for the Canadian economy in 2020. This total GDP impact would include a loss of \$1.6

[*Technology and Implications for Business and Policy Models in Canada*](#), September 1, 2006, submitted to the in response to the government's Section 15 request for a report on The future environment facing the Canadian broadcasting system. Broadcasting Public Notice CRTC 2006-72).

¹¹⁸ Specifically the modeling is of the "Regulatory Worst Case" Scenario noted in Section 10 above. Details on methodology are found at Appendix 1 (end). Ratios have relied on: MPA-C/CPA (2013), The Economic Contribution of the Film and Television Sector in Canada, and CPA (2013), Profile 2013: An Economic Report on the Screen-based Production Industry in Canada.

billion in GDP in the broadcasting and production sectors (i.e. direct impact) and a loss of \$1.3 billion in GDP in other sectors of the Canadian economy (i.e. spin-off impact).

11.11. By way of comparison, this estimate of projected losses represents approximately 12.1% of 2011 industry FTEs and 14.5% of 2011 industry contribution to Canada's GDP¹¹⁹.

Table 1 Overall economic impact, broadcasting and production sectors (all figures represent changes in relation to baseline levels)

	2014	2015	2016	2017	2018	2019	2020
Employment (FTEs)							
Direct	0	(7,180)	(12,820)	(13,700)	(13,780)	(13,610)	(13,440)
Spin-off*	0	(9,710)	(16,990)	(18,300)	(18,420)	(18,240)	(18,020)
Total	0	(16,890)	(29,810)	(32,000)	(32,200)	(31,850)	(31,460)
GDP (\$M)							
Direct	0.0	(838.3)	(1,597.1)	(1,658.6)	(1,659.7)	(1,641.1)	(1,620.4)
Spin-off*	0.0	(693.6)	(1,250.7)	(1,329.2)	(1,336.4)	(1,321.9)	(1,305.3)
Total	0.0	(1,531.9)	(2,847.8)	(2,987.8)	(2,996.1)	(2,963.0)	(2,925.7)

Source: Author's estimates based on data from CRTC, PwC, MPA-C/CMPA (2013) and CMPA (2013).

* Includes indirect and induced impacts.

** Represents the sum of sum of Tables 2, 3 and 5, below

Removal of simultaneous substitution

11.12. We estimate that the removal of simultaneous substitution would result in a loss of 530 FTEs in the Canadian economy in 2015 (Table 2), increasing to an annualized loss of 1,050 FTEs by 2020. The 2020 employment impact includes the loss of 330 FTEs of employment at private conventional broadcasters (i.e. direct impact) and 720 FTEs of employment in other sectors of the Canadian economy (i.e. spin-off impact).

11.13. The loss of revenue and employment on account of the removal of simultaneous substitution would also result in the loss of \$68.3 million in GDP for the Canadian economy in 2015, increasing to an annualized loss of \$135.5 million in 2020. The 2020 GDP impact includes the loss \$79.1 million in GDP within the private conventional broadcasting segment (i.e. direct impact) and a loss of \$56.5 million in GDP in other sectors of the Canadian economy (i.e. spin-off impact).

¹¹⁹ 2011 is used because it is the year for which most recent such figures are available. Given limited industry growth since then, a percentage of today's equivalents would only be perhaps slightly lower.

Table 2 Economic impact of removal of simultaneous substitution (all figures represent changes in relation to baseline levels)

	2014	2015	2016	2017	2018	2019	2020
Employment (FTEs)							
Direct	0	(170)	(350)	(350)	(350)	(340)	(330)
Spin-off*	0	(360)	(740)	(740)	(740)	(730)	(720)
Total	0	(530)	(1,090)	(1,090)	(1,090)	(1,070)	(1,050)
GDP (\$M)							
Direct	0.0	(39.8)	(81.6)	(82.1)	(82.1)	(80.9)	(79.1)
Spin-off*	0.0	(28.4)	(58.3)	(58.6)	(58.6)	(57.8)	(56.5)
Total	0.0	(68.3)	(139.9)	(140.7)	(140.7)	(138.7)	(135.5)

Source: Author's estimates based on data from CRTC, PwC, MPA-C/CPMA (2013) and CPMA (2013).

* Includes indirect and induced impacts.

Pick-and-pay and lower barriers to entry

11.14. The adoption of regulations that permit pick-and-pay and lower barriers of entry into Canada's programming sector will impact revenue in both the BDU and broadcasting segments. With a 20% drop in revenue in 2015 (compared to the baseline forecast) and a subsequent 40% drop in revenue, the much larger BDU segment is expected to generate the more significant economic impact of the two affected segments. By 2020, the new regulatory regime would result in the annualized loss of 13,230 FTEs of employment across the Canadian economy by 2020, including 6,700 FTEs of employment lost at Canadian BDUs (i.e. direct impact) and 6,530 FTEs lost in other sectors of the economy (i.e. spin-off impact) (Table 3).

11.15. Lower revenue in the pay, specialty and VOD/PPV segments would result in the annualized loss of 4,630 FTEs of employment in Canadian economy in 2020, including 1,470 FTEs at Canadian programming services (i.e. direct impact) and 3,160 FTEs in other sectors of the economy (i.e. spin-off impact).

11.16. In total, a regulatory regime that includes pick-and-pay and lower barriers to entry would result in the loss of 17,860 FTEs of employment in the Canadian economy by 2020, including 8,170 FTEs within the broadcasting sector (i.e. direct impact) and a further 9,690 FTEs lost in other sectors of the economy (i.e. spin-off impact).

11.17. The loss of revenue and employment on account of a new regulatory regime would also lead to an annualized loss of \$896 million in GDP in the BDU segment in 2020 and a \$348.3 million loss in GDP in the pay, specialty and VOD/PPV segments. Altogether, the direct GDP impact loss would total \$1.2 billion in 2020. There would be an additional \$806.4 million in lost spin-off GDP in 2020. In total, therefore, a new regulatory regime would lead to a GDP loss of \$2.05 billion for the Canadian economy in 2020.

Table 3 Economic impact of pick-and-pay, and lower barriers to entry, broadcasting sector (all figures represent changes in relation to baseline levels)

	2014	2015	2016	2017	2018	2019	2020
BDUs							
Employment (FTEs)							
Direct	0	(3,350)	(6,820)	(6,930)	(6,870)	(6,780)	(6,700)
Spin-off*	0	(3,260)	(6,650)	(6,760)	(6,690)	(6,610)	(6,530)
Total	0	(6,610)	(13,470)	(13,690)	(13,560)	(13,390)	(13,230)
GDP (\$M)							
Direct	0.0	(448.1)	(912.9)	(927.7)	(918.8)	(907.2)	(895.8)
Spin-off*	0.0	(279.0)	(568.4)	(577.5)	(572.0)	(564.8)	(557.7)
Total	0.0	(727.1)	(1,481.3)	(1,505.2)	(1,490.7)	(1,472.0)	(1,453.5)
Pay, specialty, VOD/PPV							
Employment (FTEs)							
Direct	0	(740)	(1,490)	(1,490)	(1,510)	(1,490)	(1,470)
Spin-off*	0	(1,590)	(3,190)	(3,200)	(3,210)	(3,190)	(3,160)
Total	0	(2,330)	(4,680)	(4,690)	(4,720)	(4,680)	(4,630)
GDP (\$M)							
Direct	0.0	(174.8)	(352.2)	(352.2)	(355.0)	(352.0)	(348.3)
Spin-off*	0.0	(124.8)	(251.5)	(251.5)	(253.5)	(251.3)	(248.7)
Total	0.0	(299.6)	(603.7)	(603.7)	(608.5)	(603.3)	(597.0)
All broadcasting sector							
Employment (FTEs)							
Direct	0	(4,090)	(8,310)	(8,420)	(8,380)	(8,270)	(8,170)
Spin-off*	0	(4,850)	(9,840)	(9,960)	(9,900)	(9,800)	(9,690)
Total	0	(8,940)	(18,150)	(18,380)	(18,280)	(18,070)	(17,860)
GDP (\$M)							
Direct	0.0	(622.9)	(1,265.2)	(1,279.9)	(1,273.8)	(1,259.2)	(1,244.1)
Spin-off*	0.0	(403.8)	(819.9)	(829.0)	(825.5)	(816.1)	(806.4)
Total	0.0	(1,026.8)	(2,085.0)	(2,108.9)	(2,099.2)	(2,075.3)	(2,050.5)

Source: Author's estimates based on data from CRTC, PwC, MPA-C/CMPA (2013) and CMPA (2013).

* Includes indirect and induced impacts.

Impact on Canadian television production

11.18. Thus far, we have examined the economic impact associated with the effects that a new regulatory regime would have on the broadcasting sector, including the BDU and programming segments. Since the broadcasting sector is a major source of financing for Canadian television production, any loss of revenue in the former will also have a negative impact on the latter.

- 11.19. We estimate that lower revenues at private conventional, and pay and specialty services would cause these broadcasters to reduce their CPE by over \$898 million on an annualized basis, in 2020 (Table 4). Given that BDUs also contribute 5% of their revenue to CPE (i.e. to the Canada Media Fund, independent production funds and local programming), the loss of revenue in that segment would result in a \$176.5 million reduction in CPE by 2020. Altogether, by 2020, the Canadian broadcasting sector's CPE would be nearly \$1.1 billion lower than it otherwise would have been.
- 11.20. Given the current profile of production spending by Canadian programming services, we estimate that approximately two-thirds (66%) of the decrease in broadcasters' CPE would come from reductions in in-house production (i.e. news and sports) or spending on acquired programming (i.e. second window or syndicated programming, rights to sports programming). Since BDUs can assign up to 40% of their 5% annual revenue contribution to CPE to community programming, we have assumed that 40% of their decrease in CPE will also come out of in-house-type production.
- 11.21. The balance of broadcasters' CPE (34%) reduction and the reduction in BDUs' CPE contributions (60%) would come from decreases in the broadcasting sectors' financing of original Canadian programming. On that basis, by 2020, the new regulatory regime would result in a \$411.4 million decrease in the broadcasting sectors' financing of original Canadian programming.
- 11.22. The loss of production financing from the broadcasting sector (i.e. broadcast licence fees and CMF funding) also has a knock-on effect on the total financing for Canadian television production. Since federal and provincial tax credits are calculated as a percentage of total eligible labour, any reduction in financing – which would invariably lead to a proportional decrease in labour expenditures – would also result in lower levels of tax credit financing from federal and provincial governments.
- 11.23. Based on the current structure of financing for Canadian television production, we estimate that a decrease in financing from the broadcasting sector in the order of \$411.4 million in 2020 would result in a reduction of \$160.1 million in federal and provincial tax credit payments in 2020. After taking into the account the reduction in tax credit financing, therefore, the total amount of financing for production of original Canadian programming would decrease by \$571.5 million in 2020.

Table 4 Analysis of impact of CPE changes on total production financing (all figures represent changes in relation to baseline levels)

Row	Item	2014	2015	2016	2017	2018	2019	2020
A	CPE (\$M)							
B	Broadcasters	0.0	(556.4)	(818.1)	(913.5)	(919.2)	(910.2)	(898.4)
C	BDUs	0.0	(89.7)	(180.9)	(182.2)	(180.6)	(178.6)	(176.5)
D	Total [=B+C]	0.0	(646.1)	(999.0)	(1,095.7)	(1,099.9)	(1,088.8)	(1,074.9)
E	In-house production and acquired programming [=B×66%+40%×C]	0.0	(403.1)	(612.3)	(675.8)	(678.9)	(672.2)	(663.5)
F	Original programming [=B×34%+60%×C]	0.0	(243.0)	(386.7)	(419.9)	(420.9)	(416.6)	(411.4)
G	Tax credits	0.0	(94.6)	(94.6)	(150.5)	(163.4)	(162.2)	(160.1)
H	Total production financing [=F+G]	0.0	(337.6)	(481.3)	(570.4)	(584.4)	(578.8)	(571.5)

Source: Author's estimates based on data from CRTC, PwC, MPA-C/CPA (2013) and CPA (2013).

11.24. By 2020, a \$571.5 million decrease in production financing would lead to a loss of 12,550 FTEs of employment in the Canadian economy (Table 5), including 4,940 FTEs of cast and crew employment (i.e. direct impact), and 7,610 FTEs of employment in other sectors of the Canadian economy (i.e. spin-off impact).

11.25. Similarly, the loss in production financing and activity would also result in a loss of \$739.6 million in GDP in the Canadian economy in 2020, including \$297.2 million in direct GDP lost within the television production sector and a further \$442.4 million in spin-off GDP lost in other sectors of the Canadian economy.

Table 5 Economic impact on Canadian television production sector (all figures represent changes in relation to baseline levels)

	2014	2015	2016	2017	2018	2019	2020
Total production financing (\$M)	0.0	(337.6)	(481.3)	(570.4)	(584.4)	(578.8)	(571.5)
Employment (FTEs)							
Direct	0	(2,920)	(4,160)	(4,930)	(5,050)	(5,000)	(4,940)
Spin-off*	0	(4,500)	(6,410)	(7,600)	(7,780)	(7,710)	(7,610)
Total	0	(7,420)	(10,570)	(12,530)	(12,830)	(12,710)	(12,550)
GDP (\$M)							
Direct	0.0	(175.5)	(250.3)	(296.6)	(303.9)	(301.0)	(297.2)
Spin-off*	0.0	(261.3)	(372.6)	(441.6)	(452.4)	(448.0)	(442.4)
Total	0.0	(436.8)	(622.8)	(738.2)	(756.2)	(749.0)	(739.6)

Source: Author's estimates based on data from CRTC, PwC, MPA-C/CPA (2013) and CPA (2013).

* Includes indirect and induced impacts.

12. Public Policy Repercussions

“The Canadian Broadcasting System is an act of political will.”

Unknown

- 12.1. While it is outside the scope of this report to offer public policy recommendations, based on the foregoing, the analysis does suggest:
1. Business and public policy decisions, rather than technological or behavioural factors, are likely to have the greater impact on the health of the Canadian television system through to 2020;
 2. Given that major impacts to the system are unlikely to be felt for three or more years, there appears to be no urgency for major regulatory relaxation. Indeed, in this process, there may be a greater risk of public policy over-reaction to perceived consumer needs than under-reaction. (Over-reaction being defined here as major change to the regulatory framework; under-reaction being little or no change);
 3. In cases of significant doubt as to the best course of action, monitoring combined with the identification of pre-defined tipping points for regulatory change may be an appropriate way forward¹²⁰. Making decisions to be implemented three or more years hence would appear to be a less appropriate way forward;
 4. OTT will draw more and more revenue from the system over time. Today, it represents perhaps 2.5% of system revenues. By 2020 it could easily reach 10%.¹²¹ The implications of this cannot be ignored; and
 5. Business tends to act in its rational self-interest – but often more oriented to the short rather than the long term. When considering likely business actions, policy makers should recognize that broadcasting and telecommunications interests are not necessarily aligned (even more so than broadcasting vs. BDU interests). At certain tipping points, vertically integrated broadcaster/telecoms may have more to gain financially from a growing OTT sector than in maintaining a strong Canadian broadcasting system.

¹²⁰ This would be a stepping up, but essentially consistent approach to what the CRTC recommended to itself in 2006, and has instituted through its annual Monitoring, statistical summaries and various third party reports. The difference would be the need for more timely current information and the use of thresholds, such as when a service loses 5% of its subscriber base. See, again, [Market Impact and Indicators of Over the Top Television in Canada: 2012](#), March, 2012, Peter Miller and Randal Rudniski, at section 3

¹²¹ Based on estimates for Netflix plus other OTT. By 2020 it is assumed that Rogers Showmi, or an equivalent, is also established and drawing 1 million subs at \$20/sub.

12.2. The analysis suggests that, in the medium to long term, the impacts of technology as manifested in competitive and consumer trends will materially increase and force the hand of public policy. In the short term, however, the greatest risk to the system comes not from external nor technological threats, but from the fundamental regulatory changes being considered in this proceeding, including the loss of simultaneous substitution, the implementation of pick-and-pay and relaxation of barriers to entry of foreign services.

Appendix 1 – Modeling Assumptions

General

1. All figures are for the calendar year. Where calendar figures were not available, CRTC broadcast year figures have been used.
2. Given the methodology employed in the report, published forecasts generally used include overall economic growth, subscription revenue, overall advertising (and to a lesser extent, media advertising), TV (conventional, specialty and online) advertising, Internet advertising (mobile, online, and the video subsector in particular) and outdoor advertising.
3. Outlooks for the 2014 -2020 period include the following three scenarios:
 - a. **Best case** - a favourable, largely status quo, regulatory climate, and modest negative impact from OTT;
 - b. **Business worst case** - plausible worst case OTT impact, with favourable regulatory climate; and
 - c. **Regulatory worst case** – business best case plus unfavourable regulatory climate, primarily, introduction of pick and pay¹²² lower barriers of entry for non-Canadian programming services, and elimination of simulcast.
4. All models are conceivable and plausible, not extreme best- or worst-case scenarios. For example, while it may be theoretically possible that the revenues of the Canadian broadcasting system could fall by 50% to 2020, this is not a scenario contemplated in any worst-case scenario. Similarly, a worst-case scenario, does not take the worst-case of every contributing element; nor does a best-case scenario do the equivalent.
5. A more sophisticated model would involve weighted probability analysis based on data sampling. In the current case, reasonable assumptions have been applied.

Advertising

6. TVB summaries used are to 2012.
7. Internet advertising forecasts examined include IAB, PwC, and eMarketer. PwC outlooks are generally more aggressive¹²³.

¹²² The term “pick-and-pay” is used generally here. It assumes both or either of “pick-a-pack” and stand-alone à la carte. The author understands that some parties may view one or the other or the combination to be more damaging.

¹²³ For eMarketer see, for example, for mobile <http://www.emarketer.com/Article/Mobile-Grabs-More-Share-of-Digital-Dollars-Canada/1010694> (Mar 2014), and digital,

8. Best-case scenario 2013-2018 aggregate, online TV, Internet and overall TV advertising estimates are from PwC; projections through 2020 are the author's and follow similar trends. Conventional TV advertising growth assumed to be slightly lower than PwC projections; specialty TV growth assumed to be higher.
9. Business worst-case TV (conventional and specialty) advertising revenue projections (2014- 2020) have been developed by deducting forecasts for Internet advertising revenue plus forecast outdoor revenue from overall advertising revenue and/or directly deducting a portion of online video advertising growth (on the assumption that this will affect TV more than other traditional media)
10. It is assumed that cord shaving is modest enough to have no impact on advertising in the best-case scenario. Business worst case, specialty advertising decreases by an additional accumulating 0.5% per year starting in 2016.
11. Advertising revenue results include
 - a. **Best case** – aligns with PwC projections for strong overall advertising growth, and high Internet advertising growth. Projects modest specialty TV growth and flat conventional;
 - b. **Business worst case** – assumes more modest overall advertising growth, similar Internet advertising growth and that 50% of growth of Internet video advertising comes at the expense of conventional TV advertising. Minor specialty advertising declines are assumed to result from subscription declines; and
 - c. **Regulatory worst case** – major components of this include loss of 300 million in annual simulcast revenues on conventional TV, staged 15% loss of specialty advertising (7.5% in 2015, additional 7.5% in 2016) from introduction of pick and pay.
12. Outdoor advertising is the only traditional advertising category viewed as exempt from cannibalization from the Internet. It is in a class by itself, has little direct competition, and continues to exhibit healthy growth.
13. TV Internet online (increasingly video) advertising revenue has been identified separately and been apportioned back to TV in analyzing total economic impacts, as appropriate.

Subscriptions

14. Subscription revenue projections have been based on a combination of industry forecasts and modeling assumptions *viz* growth of subscriber fees and households less cord cutting and cord shaving.

<http://digest.dx3canada.com/2014/01/07/digital-marketing-spend-to-eclipse-tv-in-2014-says-emarketer/> (Jan 2014).

15. Baseline projections for BDU subscribers were provided by Boon Dog Professional Services Inc. for 2014 to 2018. Following trends of the last few years, they show an overall -0.6% CAGR for the period with losses of 0.4% in each of 2014 and 2015, 0.6% in 2016 and 0.9% in each of 2017 and 2018. The author considers these projections to be authoritative, and relatively conservative. They were, adjusted slightly upward, with 0.9% losses for each of 2019 and 2020 and a CAGR remaining at -0.6% for the best-case 2013-2020 scenario. For the business worst-case scenario, they were adjusted downward to a full -0.9% CAGR over the period, culminating in losses of 1.2% in each of 2019 and 2020.
16. Specialty subscription revenue is expected to continue to track subscriber growth with nominal rate increases, except in sports.
17. The Rogers NHL deal is expected to usher in increases in subscription fees for Rogers sports or sports-related channels, only partly compensated by decreases in rates for Bell sports or sports-related channels.
18. A recent Scotia Capital report noted the "substantial revenue gap between what TSN earns from distributors and what Rogers earns from its suite of Sportsnet-branded channels" and predicted that "Rogers will surely want to narrow that gap". Assuming Rogers would be successful in matching TSN/RDS's subscriber revenue, Scotia Capital estimated that RCI's Sportsnet would grow subscriber revenue over 20% CAGR over the next four years. Specifically, Scotia Capital stated "In 2011, before the TSN rate hikes, we estimate sports programming cost per subscriber was approximately \$3.66 per month. In 2013, the cost per subscriber rose to approximately \$5.41, which was an increase of 22% CAGR over the two-year period. In another two years by 2015, we estimate the cost will be \$7.21, which will be another 15% CAGR over two years." The current analysis reduces this increase in the per subscriber rate from 2013 to 2015 by 30% (given anticipated decreases in Bell sports service subscriber fees), putting it at \$1.26 per sub per month by 2015.
19. The other material expense increase anticipated for BDUs over the forecast period relates to TV Everywhere. For the last year or more, the major vertically integrated BDU/broadcasters are understood to have been selling packages of TV Everywhere rights to their conventional and specialty programming TV to other BDUs. As evidenced by the number of agreements that have yet to be concluded, the prices being proposed for the larger TV Everywhere packages are not necessarily insubstantial.
20. It is unclear at this point what the final pricing strategy and roll-out for TV Everywhere will be, including how "set-offs" between BDU/broadcasters will be determined. In the absence of more information, this analysis assumes an average \$3 cost increase to all BDUs for all TV Everywhere packages combined, phased in from 2013 to 2017.

21. Predicting BDU retail pricing of packages is difficult. As CRTC analysis has demonstrated, unlike wireless, for example, over a number of years, cable subscription fees have increased faster than the Consumer Price Index. As recently as 2012, when the average amount spent on cable and satellite TV services increased by 5%, inflation rose by only 1.5%¹²⁴. That over-indexing to CPI appears, however, now to be on the wane.
22. Going forward, the price sensitivity of cable consumers can only be expected to increase. Even absent CRTC mandated change, BDUs can be expected to recognize that the days of automatic annual \$1 and \$2 monthly increases, with no increase in value, are almost over.
23. While clearly of value, it seems unlikely that consumers will see TV Everywhere as an increase in value that merits higher subscription fees. It is more likely that consumers will see it as bringing cable up to the standards and norms of today - i.e. Something that may make them keep cable, but not something the specifically expect to pay for.
24. For the next three years at least (2014-2016), it is assumed that BDUs will seek to pass through increase sports and TV Everywhere costs. This analysis does, however, assume that BDUs will start to (selectively) resist their typical 100% mark-up on increases in subscription fees, and therefore assumes no more than a 50% mark-up on the Rogers-driven sports increment, and no mark-up on TV Everywhere.
25. This analysis assumes, in the best case, that subscribers will face a net increase of \$1.89 per sub per month by 2015 from sports plus \$3 by 2018 for TV Everywhere. In the worst case (for BDUs), BDUs choose to pass through only \$2 by 2015, absorbing the rest of any price increases, themselves¹²⁵.
26. The pricing of pay TV is another area where there may be particular pressure. Netflix is \$8 per month (soon, for new subscribers \$9). Canadian pay TV wholesale rates are not dissimilar, but with a 100% mark-up, become \$17-\$21 to the subscriber. That's a big difference. Some BDUs may be prepared to cut their mark-ups slightly if it helps maintain Pay TV subscribers. This is modeled in the worst-case scenarios and results in a further \$0.50 loss in ARPU, phased in between 2015 and 2016.
27. Losses due to cord shaving going forward are reflected in further reductions in ARPU. In a best-case scenario, it is assumed that pay TV penetration will continue to decline by 1% a year from 2014-2020. In a business worst-case scenario, this becomes 2% a year even with the reduction in retail price noted previously.

¹²⁴ Similar to above CPI increases have occurred in the US. [Report on Cable Industry Prices](#), FCC Docket NO 92-266, May 16, 2014.

¹²⁵ BDUs absorbing increased costs is the assumption made, for example, by Scotiabank in *Converging Networks*, Scotiabank, May 26, 2014. It is also possible that BDUs will find savings elsewhere.

28. We assume cord shaving also has a potential impact on specialty, with best case 0.5% annual subscription revenue declines from 2014 to 2020. In a business worst-case scenario, this becomes 1.5% annually.
29. Losses due to cord shaving going forward are also highly dependent on CRTC decisions being contemplated in this hearing, as discussed below.
30. For the purpose of modeling the regulatory worse case we assume a combined impact of 40% loss of specialty subscription revenues, (20% in 2015, additional 20% in 2016) from the above. That portion of BDU revenues attributable to the basic service and specialty services would suffer a similar impact. This would not have any impact on pay TV revenues or the BDU portion thereof.
31. It is assumed that advertising revenue on specialty revenues would suffer to the tune of a 20% loss both because of declines in overall viewing to specialty and loss of Canadian specialty services
32. VOD and PPV are projected to continue to decline through to 2015 when the introduction of dynamic ad insertion will start to increase advertising raising it from \$115,000 in 2013 to 20 million by 2020.
33. Similarly, TV online advertising (primarily from broadcaster OTT) is projected to benefit from dynamic ad insertion starting 2015 and grow at a 17% CAGR from 2013–2020.
34. Summary of subscription revenue scenarios:
 - a. **Best case** - BDU revenues assume gradual reduction in subscriber growth, consistent with previous years. Reductions in subscriber growth are offset in part by increases in BDU ARPU primarily from rate increases, but by 2018 [TBC], overall BDU revenues start to decline. Between 2013 and 2020, BDUs lose 5% of their subscribers. BDU price increases (in ARPU) exceed losses due to cord shaving leaving overall BDU subscription revenue still up 2%;
 - b. **Business worst case** - A business worst case scenario sees BDUs unable to raise prices, and a combination of cord nevers, cord shaving and cord cutting leading to a 10% net loss by 2020;
 - c. **Regulatory worst case** – A regulatory worst case scenario, including mandatory pick and pay and removal of current limits to entry of US services, leads to a 40% reduction in specialty service subscription revenue; 30% in advertising. Premium pay services, because of their high-end content and the fact that they are already highly discretionary, are assumed to be less vulnerable to revenue declines, but in this scenario would still see a 20% revenue loss over the same period. BDU subscriber numbers would not however drop from the best-case scenario.

Regulatory

35. Best-case regulatory assumptions, reflected in both best case and business worst case, are largely status quo, and include:
- a. No material overall revenue impact from:
 - i. Reduction of Cancon exhibition requirements on OTA to 50%
 - ii. Introduction of basic-basic
 - iii. Introduction of pick and pay (or assumes no introduction of pick and pay)
 - b. Genre protection is retained
 - c. Current rules on entry of foreign services are retained
 - d. Broadcasters claim digital content in eligible CPE expenditures, and digital revenues are included in regulated revenues
 - e. No other material changes to broadcast regulation (e.g. no new incremental broadcaster or BDU contributions, no new VI rules etc)
36. In the worst-case scenario, the CRTC would implement the following regulatory proposals under consideration:
- The elimination of simultaneous substitution;
 - A small basic. With a 20% or higher level of adoption, this would materially lower the penetration of non-priority carriage services currently on basic;
 - Pick and pay. Assuming the Commission imposes some kind of price regulation to keep stand alone channel costs down, this would clearly lead to an increase in cord-shaving. The Commission has itself noted that under pick and pay “Some channels might not survive”, “some jobs may be affected should services disappear” and “a decrease in the number of discretionary programming services or their revenues could lead to a decrease in the overall funding of Canadian programming”¹²⁶. Whether US channels would consent or not is an interesting issue¹²⁷. Media analysts in the US have estimated that half the total revenue in the television universe would evaporate in such an unbundled world, and that all but 20 channels would disappear¹²⁸;

¹²⁶ *Maximizing the ability of Canadian consumers to subscribe to discretionary services on a service by service basis*. Response to Order in Council P.C 2013-1167, 24 April 2014, <http://www.crtc.gc.ca/eng/publications/reports/rp140424e.htm>.

¹²⁷ It is generally believed that US channels that oppose unbundling in the US would accordingly not consent to it in Canada. This would reduce its impact. However, there is also the possibility that introduction in Canada could lead to its introduction in the US (as happened, in large measure, with the violence on TV and the V-Chip).

¹²⁸ *The Future of TV*, Needham Insights, July 11, 2013 as quoted in *New Challenges Chip Away at Cable's Pillar of Profit*, David Carr, New York Times, April 27, 2014. There is also the view that because it is “ruthlessly efficient at stripping cross-subsidies and allowing content to

and

- Revised rules for the entry of foreign services. This would lower the standards of entry, and likely result in an increase of direct entry of foreign services. Canadian services will stand the prospect of losing current affiliations with foreign services, including losing popular foreign programming, to the detriment of their revenues, profitability and ability to support Canadian programming. Meanwhile, more foreign services will come in directly, at initially attractive prices that could logically be expected to increase once Canadian competition is reduced or eliminated.

37. Measures not included in the regulatory worst-case model and, hence, assumed to not be implemented (or assumed to have negligible impact) are:

- Elimination of predominance of Canadian requirement. This would limit the forced packaging of Canadian services with foreign services, and result in lower penetration of Canadian services;
- Elimination of genre protection. This is assumed to either not be introduced or to have an impact already reflected in modeling of revised rules of entry;
- Reduction of Cancon exhibition requirements on OTA. This is assumed to go no further than 50% and to not have a material effect as it would neither reduce Cancon expenses nor have an observable impact on competitiveness.

38. Generally speaking, under pick-and-pay and basic-basic as an option, only 20% take-up might be assumed, with an average overall specialty subscriber fee decrease of 20%. That is, assuming no change in the rules to entry of foreign services, and maintenance of a predominance of Canadian services rule. If either or both of the last two assumptions were to change, a further material loss of subscription revenues would be a reasonable assumption – in the former case from BDUs replacing Canadian with cheaper foreign services, some Canadian services losing their US partner; in the latter case with Canadians choosing cheaper foreign services themselves. In either case, many Canadian specialty services (including, disproportionately, independent services) would suffer material losses of revenues, and some would fold.

39. In the current instance, we assume that the proposed change in the rules to entry of foreign services alone (that is not combined with removal of the predominance of Canadian services rule) reduces affected subscription and

shine on its own”, the Internet will ultimately trigger à la carte and hence “blow up” television, which has been the most dependable and lucrative business model in modern entertainment history.” *The End of TV and the Death of the Cable Bundle*, Derek Thompson, www.theatlantic.com, July 12th, 2012.

advertising revenues by as much as 20%. The combined impact of this and pick-and-pay approaches 40%¹²⁹.

40. Worst-case regulatory impacts, as reflected in the regulatory worst case can be summarized as follows:

- a. Incremental loss of annual simulcast revenues on conventional TV of \$300 million on \$2 billion of revenue or 15% of ongoing baseline revenue 50% of which occurs in 2015
- b. Staged 20% loss of specialty subscription revenues (beyond pay TV and basic service) and 10% loss of associated advertising (half in 2015, additional half in 2016) from introduction of pick-and-pay.
- c. Barriers to entry of foreign services are reduced (reverse-onus test is introduced), causing further 20% loss of subscription and advertising revenues (again, beyond basic service and staged), from Canadian specialty services losing key US partners and programming (and hence subscriptions and viewing) compounded by consumers and BDUs replacing Canadian with cheaper foreign services.
- b. Pay TV services are not affected by pick and pay, but lose 20% of revenues from reduced entry of foreign services (incremental cord shaving resulting from loss of popular program rights).
- c. Loss of genre protection causes no change to aggregate revenues (other than the potential link to entry test for foreign services, already addressed above), but reduces profitability of specialty services and eliminates certain independents¹³⁰;
- d. Small basic assumed to have \$25 price point, and that consumers availing themselves of pick-and-pay generally adopt it;
- e. No elimination of predominance of Canadian requirement;
- f. No material overall revenue impact from reduction of Cancon exhibition requirements on OTA to 50%.

¹²⁹ These scenarios are not easy to model. At 40%, the combined losses from pick-and-pay and increased entry of US services are still lower than some US projections for the introduction of pick-and-pay alone (projected 50% losses). There are arguments to suggest that, assuming BDU's retain price control, the introduction of pick-and-pay need not be overly damaging. However, pick-and-pay, combined with the loss of predominance of Canadian services and looser entry of US services could, however, well be a tipping point of devastating consequence. We therefore believe the current approach to be reasonable – and by no means an absolutely worst-case regulatory scenario.

¹³⁰ Loss of genre protection could, in a plausible worst case, increase competition for US programming, reduce profitability of popular specialty formats and increase the encroachment on territory owned by independents. The independents would not have the resources to compete head-on with the big players, but any good niches or programming they have would be stolen by the bigger players. The result could be fewer services, and (potentially) lower aggregate revenues.

Canadian Programming Expenditures

41. CPE forecasts and outlooks are based on aggregate averages within each major class of broadcasting service (conventional, specialty, pay, VOD, BDU). CPE percentages per category have, as appropriate, been adjusted over time to reflect different assumptions on regulatory obligations and the mix of services in a given category.
42. Best case CPE assumptions, reflected in both best case and business worst case, are largely status quo, and include:
 - a. Conventional – 30%
 - b. Specialty - Cat A – 33%; Cat B – 19%; Cat C – 55%; Average 38%
 - c. Pay – 18%
 - d. VOD – 5%
 - e. BDU – 5%
43. Worst case regulatory scenario CPE assumptions include:
 - a. Conventional – 30% dropping to 25% in 2017, as industry convinces CRTC that higher levels are unsustainable, given losses on specialty side etc
 - b. Specialty – similar, but staged, dropping to 30% starting in 2015 (following waves of renewal with big drop in 2017 from Group renewals)
 - c. Pay – 10%
 - d. VOD – 5%
 - e. BDU – 5%
 - f. Changes in overall CPE generated are also due to changes in revenues, VOD (or like) contribution and scope (including broadcasters claiming, or not, digital content within eligible CPE expenditures, and digital revenues being included in regulated revenues)

Economic Impact - Employment and GDP

44. The Economic modeling examines the “delta” between the best case and regulatory worst case to provide an estimate of the economic impact of regulatory proposals.
45. All economic impact estimates are based on the revenue-to-employment and revenue-to-GDP ratios implied by the economic impact analysis in MPA-C/CPA (2013), *The Economic Contribution of the Film and Television Sector in Canada*. These ratios are summarized in Table A-1. For more information on the methodology used to derive ratios, please see Appendices A and B of MPA-C/CPA (2013).
46. For the television production segment, the economic impact analysis is based on the ratios of total production volume, and employment and GDP implied by the economic data in CPA (2013), *Profile 2013: An Economic Report on the Screen-based Production Industry in Canada*. For more information on the

methodology used to derive ratios, please see Notes on Methodology in CMPA (2013).

Table A-1 Economic impact ratios

	Revenue (\$M)	Economic data		Ratio	
		Employment (FTEs)	GDP (\$M)	Employment	GDP
Direct impact					
BDU	8,588	27,700	3,706.2	3.23	0.43
TV broadcasting (excluding in-house production)	6,838	7,100	1,676.6	1.04	0.25
VOD/PPV	495	200	81.9	0.40	0.17
Canadian film and TV production*	4,076**	35,200	2,120	8.64	0.52
Spin-off impact					
BDU	8,588	27,000	2,307	3.14	0.27
TV broadcasting (excluding in-house production)	6,838	15,200	1,197	2.22	0.18
VOD/PPV	495	1,400	110	2.83	0.22
Canadian film and TV production*	4,076**	54,300	3,155	13.32	0.77
Total impact					
BDU	8,588	54,700	4,560	6.37	0.53
TV broadcasting (excluding in-house production)	6,838	22,300	1,695	3.26	0.25
VOD/PPV	495	1,600	134	3.23	0.27
Canadian film and TV production*	4,076**	89,500	5,275	22.0	1.3

Source: Author's calculations based on data from MPA-C (2013) and CMPA (2013).

* Includes Canadian TV production, Canadian feature film production and broadcaster in-house production.

** Total volume of production instead of revenue.

Appendix 2 – About the Author

Peter Miller is a lawyer and engineer with 25 years of creative and telecommunications industry experience, in both private practice and senior executive positions. Since 2005, he has acted as an advisor to select clients in both the public and private sectors, specializing in business and policy development, particularly in regards to digital media.

Peter's legal and consulting practice is largely focused on the media sector, but is wide-ranging in terms of the types of clients and nature of assignments. Clients have included numerous private entities, such as the CMPA, Corus, Shaw, Astral, Acadia, Newcap, Rogers Media and smaller independent and ethnic broadcasters, as well as numerous public entities, including the CRTC, Canadian Heritage, Competition Bureau, OMD and the Ontario Ministry of Tourism, Culture and Sport. Assignments themselves have varied from pure regulatory and public policy projects, to strategic planning and economic impact exercises.

In the past eight years, Peter has researched and authored numerous public and private reports relating to creative industries, including digital media trends, convergence and the future production and media landscape.

Background

Peter's professional background includes private practice in communications law, and senior broadcast executive positions.

From June 2008 to May 2009, Peter was Chief Operating Officer for S-VOX, the Vision TV group of companies. From 2002 to 2005, Peter held the position of Vice President, Planning and Regulatory Affairs for CHUM Limited, where he was the key strategic advisor on industry developments and growth opportunities for CHUM Limited, as well as being responsible for all facets of CRTC regulatory affairs and government relations. Prior to joining CHUM in 1998, Peter was Senior Vice-President and General Counsel to the Canadian Association of Broadcasters (CAB),

Peter Miller began his career in telephone network design at Bell Northern Research in Ottawa. His experience also includes serving as a Parliamentary Assistant in the House of Commons.

Peter is a frequent industry commentator who has been actively involved in numerous industry boards and committees. Peter is the current Chair of Interactive Ontario, past chair of the CAB Specialty & Pay Services Board, past treasurer of Canadian Digital Television and a current constituency member of the Centre for Addiction and Mental Health.

For more information on Peter, please contact him at info@petermiller.ca

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