United States General Accounting Office

GAO

Report to the Honorable
Byron L. Dorgan, U. S. Senate

June 1999

TELECOMMUNICATIONS

Impact of Sports Programming Costs on Cable Television Rates

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GAO/RCED-99-136

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United States
General Accounting Office
Washington, D.C. 20548

Resources, Community, and
Economic Development Division

B-280705

June 22, 1999

The Honorable Byron L. Dorgan
United States Senate

Dear Senator Dorgan:

The rates that subscribers pay to receive cable television in the United States have increased at several times the general rate of inflation over the last few years. Cable operators have attributed these increases to inflation; programming costs; system upgrades, including increases in the number of channels; and other factors. However, some cable operators have attributed increases to the cost of acquiring sports programming, in particular. In terms of viewership, sports programming is among the highest-rated programming on cable television.

This report responds to your request that we provide information on the role that sports programming played in recent increases in cable rates. Specifically, you asked us to provide information on (1) the extent to which sports programming costs are contributing to higher cable television rates; (2) how prices paid for sports programming differ for small and large cable operators; (3) the extent to which sports programmers require cable operators to bundle (i.e., combine) sports programming with other cable programming and how this practice affects cable rates; and (4) whether the salaries of players in major professional sports have risen over the last 4 years, and if so, whether this has contributed to increases in cable rates.

To respond to your request, we reviewed recent studies and public documents and interviewed representatives from a cross-section of the cable television industry, including cable companies, programming networks, federal and state regulatory agencies, and industry trade groups. Also, we interviewed representatives of major sports leagues. We reviewed the Federal Communications Commission's (FCC) studies of cable industry prices covering the years 1995 through 1998 and its 1998 inquiry into cable rate increases. We analyzed programming cost information we obtained on 15 cable companies from the FCC's and one state regulatory agency's public files and convened a panel of experts to discuss issues that you raised. In some cases, however, we were unable to provide a more definitive response to the research questions because of limitations on the availability of information on the costs cable companies incur for programming, the terms and conditions of programming contracts, and certain details covering the sale of sports rights contracts. For a detailed description of our methodology, see appendix I.

Results in Brief

The data we obtained on 15 cable systems and the results from the FCC's nationwide 1999 Report on Cable Industry Prices indicate that sports programming has had a limited impact on the rates subscribers pay for cable television service. Data on the 15 cable systems show that sports programming accounted for about 6.8 percent of the average monthly amount that the cable systems charged subscribers during 1997. Also, the FCC report indicates that sports programming accounted for 7.5 percent of the increase in a subscriber's average monthly cable bill from July 1, 1997, through July 1, 1998. However, some cable industry officials believe that the impact of sports programming costs on cable rates may increase as the result of recent contractual agreements between cable networks and major sports leagues.

Because of the limitations on the availability of information on prices paid for programming and on the terms and conditions of cable programming contracts, we cannot provide definitive judgments on the differences in what small and large cable operators pay for sports programming. According to industry officials, in some cases, small cable operators pay more than large cable operators for sports programming, such as when programmers offer discounts based on the number of subscribers a system has. However, not all cable networks that carry only sports or a combination of major sports and general entertainment offer such discounts. Furthermore, many small cable operators have been able to lower their programming costs by participating in the National Cable Television Cooperative—an organization that purchases programming on behalf of its members, most of which are small cable operators. However, officials of the Cooperative believe their organization does not always receive discounts comparable to those given to similarly sized, large cable companies.

Sports networks and networks that offer general entertainment and sports events frequently require cable operators to bundle their networks with other programming networks into service packages that are offered to cable subscribers. Opinions on bundling vary among officials in the cable industry, with some stating that bundling keeps cable rates down by providing an economically efficient means of distributing programming because it lowers transaction and equipment costs for both cable operators and subscribers. Others, however, believe that bundling limits the choices of cable customers and can result in higher cable rates for customers who are only interested in receiving certain types of programming.

Over a 4-year period (1994-98), the average player's salary in each of four major professional sports leagues—the National Football League (NFL), Major League Baseball (MLB), the National Basketball Association (NBA), and the National Hockey League (NHL)—has increased by a range of 14 to 64 percent, depending on the sport. During the same period, the prices cable networks pay to carry major professional sports events have also increased as have the rates subscribers pay for cable television. However, the opinions of sports and cable industry officials differ on the extent to which players' salaries have contributed to cable rate increases. Some officials believe the increases in salaries have caused the increases in the fees associated with the rights to televise sports events, which have in turn led to increases in cable rates. Others believe that players' salary increases are simply a reflection of increased consumer demand for sports programming and thus should be viewed as an effect, rather than a cause, of cable rate increases.

Background

Cable television is the major provider of subscription television programming in the United States, serving over 65 million subscribers as of June 1998. Overall, there are about 11,000 cable systems nationwide, most of which are owned by multiple system operators (MSO)—companies that own two or more systems. The top 10 MSOs serve more than 70 percent of the subscription television video market and have from about 1.3 million to 13.1 million subscribers. In contrast, many individual cable systems are quite small. Over 6,000 systems have fewer than 1,000 subscribers. Cable television companies compete with other providers of subscription television services, such as direct broadcast satellite companies.[1]

Sports is an important part of cable programming. Sports programming, such as MLB and NFL games, is referred to as "marquee programming" because of its attractiveness to cable viewers. Cable television systems carry sports programming aired by broadcast stations and by cable networks, including cable sports networks. Included among the 40 cable

[1]Our forthcoming report, Telecommunications: The Changing Status of Competition to Cable Television (GAO/RCED-99-158), analyzes the status of competition in the subscription television market; the extent to which ties between cable companies and program suppliers may be affecting the development of competition; and the key factors that may influence the development of competition in the future.

sports networks are national sports networks, such as ESPN; regional sports networks that carry games of local sports franchises as well as other sports programming, such as Fox Sports Northwest; specialized sports networks, such as the Golf Channel; and sports news channels, such as CNN/SI. (App. II provides a list of cable sports networks.) In addition, other cable networks, such as the TNT and FX networks, offer a mix of major sports programming and general entertainment. Cable systems pay for programming they obtain through licensing fees that they pay to cable networks and through copyright fees that they pay for obtaining distant broadcast television signals.

Generally, sports programming, as well as most other cable programming, is offered by cable operators as part of one or more bundled service packages, or "tiers," with each tier consisting of additional channels provided for an additional cost. The lowest-priced tier is called the basic tier and includes the retransmission of local broadcast signals; public, educational, and governmental channels; and any other channels chosen by the cable operator. Many cable companies also offer one or more "enhanced basic" tiers (also called cable programming services tiers) that include advertiser-supported cable networks (such as ESPN, the USA Network, and MTV) and may also include news and special interest services. For an additional amount, cable operators also offer premium services, such as Home Box Office or Showtime, and pay-per-view services, such as professional boxing and movies.

From July 1995 through July 1998, cable television rates have increased faster than the general inflation rate as measured by the Consumer Price Index.[2] For example, according to the Bureau of Labor Statistics, between June 1997 and June 1998, cable rates rose by 7.3 percent, while the Consumer Price Index increased by 1.7 percent. However, because many cable companies increased the number of channels they offered during this period, increases in cable rates are lower on a per channel basis. For example, according to the FCC's May 1999 Report on Cable Industry Prices, average monthly rates for cable companies not facing effective

[2]Rates for basic cable service are subject to regulation by states or localities. In some cases, the state regulates cable television through a state commission or advisory board. In other areas, cable is regulated by local government entities, such as a city cable commission, city counsel, or board of supervisors. The FCC had authority to regulate the rates cable companies charged for the cable programming services tiers; however, the authority expired on March 31, 1999.

competition[3] increased by 6.9 percent during the 12 months ending July 1, 1998, but by only 1.6 percent when considered on a per channel basis. The average monthly cable rate charged by noncompetitive companies as of July 1, 1998, was $30.53, of which $27.88 was for programming services and $2.65 for equipment rentals.[4]

The Extent of Sports Programming's Impact on Cable Television Rates Was Limited

Available data on 15 cable systems in 1997 indicate that, in general, sports programming accounted for about 29 percent of the cable system operators' programming costs and about 6.8 percent of the monthly amount that the cable systems charged to their subscribers.[5,6] Furthermore, recent FCC studies have found that increases in sports programming costs have been a relatively minor contributor to higher cable rates.[7] However, sports programming costs may have a greater impact in the future when the increased costs of recent contract agreements with major sports leagues are more fully reflected in cable operators' rates.

[3]The Communications Act of 1934, as amended, directs the FCC to annually publish statistical reports on the average rate of a number of items, including basic cable services, of cable systems that the Commission has found are subject to effective competition compared with those that are not. Whether effective competition exists is determined using any one of four criteria. For example, effective competition is deemed to exist where the franchise area is served by at least two unaffiliated multichannel video programming distributors, each of which offers comparable video programming to at least 50 percent of the households, and at least 15 percent of the households subscribing to programming services offered by a multichannel video programming distributor subscribe to services other than those offered by the largest multichannel video programming distributor. 47 U.S.C. 543(k),(l).

[4]The rate for programming services includes programming in the basic tier and most popular cable programming services tier. Equipment rentals include charges for remote control units and converters (electronic devices that shift channels transmitted by a cable system to other channels on a subscriber's television set). According to the FCC's report, rates for competitive cable companies increased by 5.8 percent overall during the 12-month period ending July 1, 1998, and by 3.6 percent when viewed on a per channel basis. The average monthly cable rate charged by competitive companies as of July 1, 1998, was $28.71, of which $26.12 was for programming services and $2.59 for equipment rentals.

[5] Detailed information on the fees that cable system operators pay for cable television programming is difficult to obtain because of its proprietary nature. As a result, our ability to fully assess the impact of sports programming costs on cable television rates was limited.

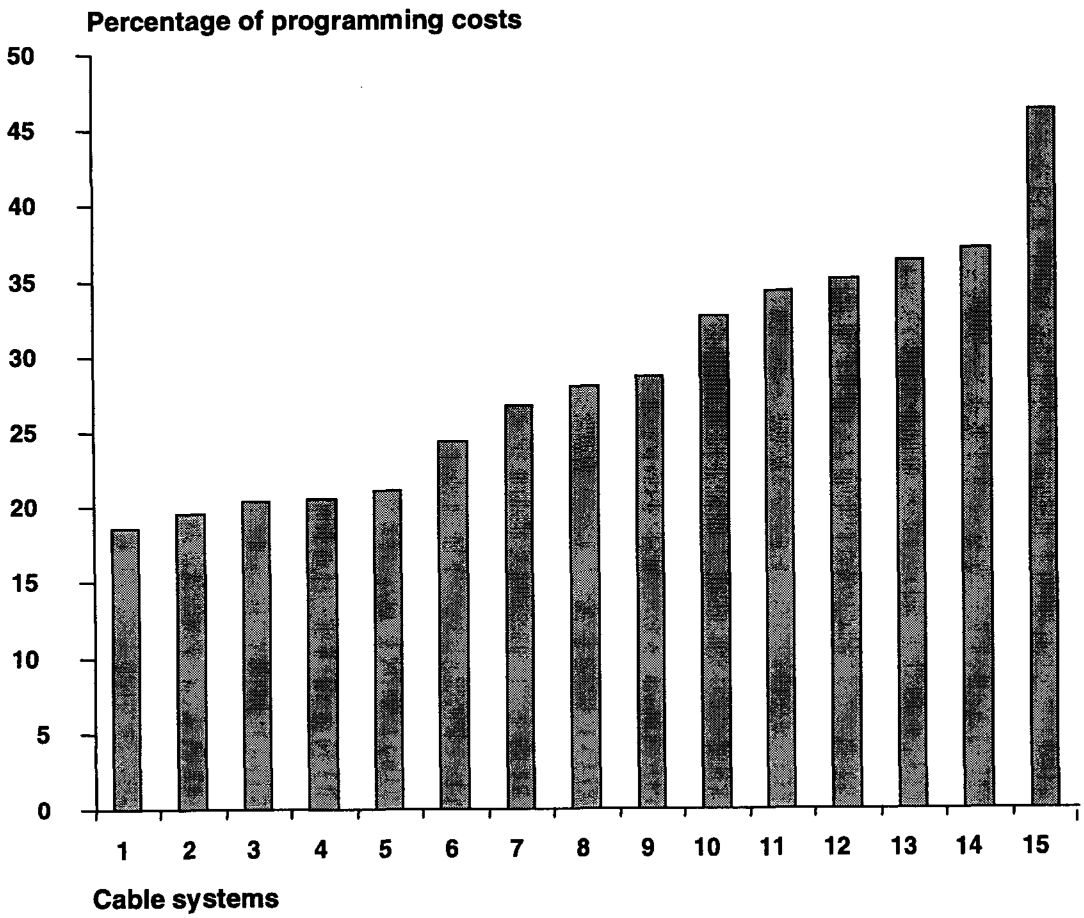
[6] Total programming costs accounted for about 23.8 percent of the monthly cable bills that the 15 cable systems' subscribers paid. Aside from programming costs, subscribers' bills include costs for system upgrades, channel additions, new equipment, and inflation.

[7]We were unable to determine whether there were any changes in the quality of sports programming that may be related to increases in the cost of sports programming for the 15 cable systems or for the cable systems covered by the FCC's studies. However, according to the 1998 FCC report, the average number of channels that noncompetitive cable systems devoted to sports programming increased from 2.6 to 2.9 (11.5 percent) between 1997 and 1998.

Sports Programming Accounted for 29 Percent of Programming Costs at 15 Cable Systems

For the 15 individual cable systems we reviewed, fees cable operators paid to obtain programming from cable sports networks accounted on average for about 29 percent of total programming costs in 1997.[8] The costs ranged from about 18.6 percent to about 46.2 percent, as shown by figure 1.[9]

Figure 1: Sports Programming Costs as a Percentage of Total Programming Costs for 15 Cable Systems, 1997



Source: Programming cost information from 15 individual cable systems.

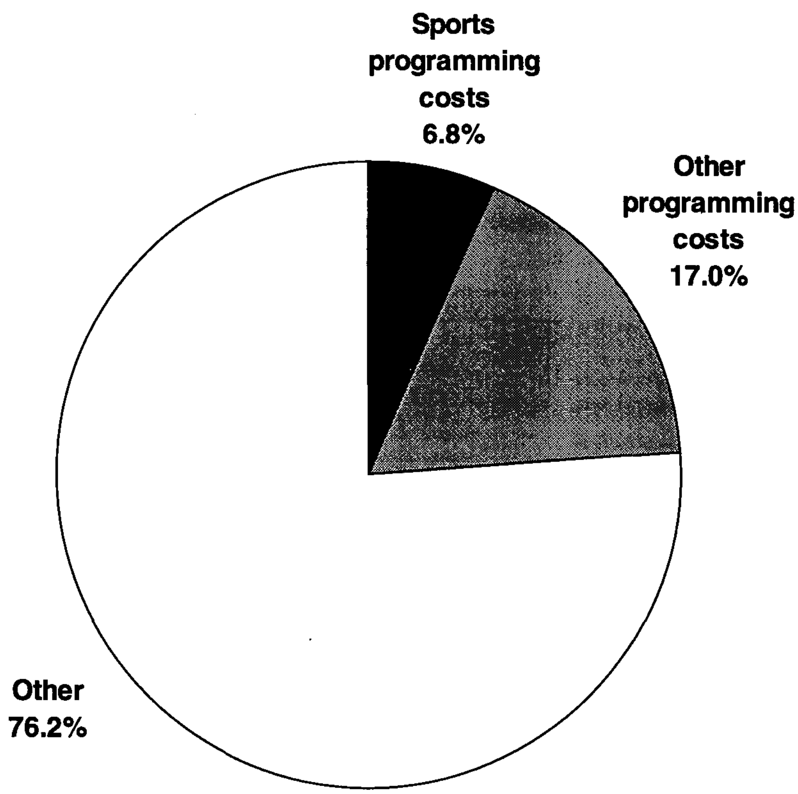
[8]Data on these systems are not necessarily representative of all cable systems.

[9]The fees cable system operators pay for sports networks tend to understate the impact of sports on cable rates because sports are also carried by other networks. However, data were not available to determine the degree of the impact of sports on the programming costs of these other networks.

The monthly sports programming costs for operators of the 15 cable systems ranged from 74 cents to about $3.00 per subscriber per month. The number of sports networks carried ranged from one to four and included ESPN, ESPN2, regional sports networks, and the Golf Channel.

As shown in figure 2, sports programming costs on average represented about 6.8 percent of the average monthly amount that the 15 cable systems charged to their subscribers for cable programming. The percentage ranged from about 3 percent at a system that carried only one sports network to over 12 percent at a system that carried four sports networks. Other programming costs accounted for an additional 17 percent of the monthly amount that the 15 cable systems charged subscribers.

Figure 2: Percentage of the Average Monthly Amount That the 15 Cable Systems Charged to Their Subscribers That Was Attributable to Sports and Other Programming Costs, 1997



Source: Monthly programming cost information on 15 cable systems.

The FCC's Study Found a Similar Impact of Sports Programming on Cable Rates

In an effort to identify the sources of recent cable television cost increases, in 1998 the FCC conducted an inquiry of the top six MSOs that provide services to approximately 67 percent of all cable subscribers. In general, the FCC inquiry's results were similar to what we determined for the 15 cable systems. The MSOs reported to the FCC that sports programming, in general, accounted for 26.7 percent of the total programming fees charged to cable system operators, compared with about 29 percent for the systems we reviewed. While the FCC inquiry's results did not include information on the extent to which sports programming costs contributed to a subscriber's average monthly cable bill, it did include an analysis of the extent to which sports and other programming costs contributed to increases in subscribers' cable rates from July 1, 1995, through July 1, 1996, and from July 1, 1996, through July 1, 1997.[10]

Programming Costs Have Contributed to Cable Rate Increases, but the Impact of Sports Programming Costs Was More Limited

Data collected by the FCC indicate that total programming cost increases have been a substantial contributor to cable rate increases. For example, the 1999 Report on Cable Industry Prices shows that, on average, for noncompetitive systems, rate increases attributable to programming costs were about 33.6 percent from 1997 to 1998 and 24.4 percent from 1996 to 1997.[11] The FCC's 1998 inquiry determined that between 1996 and 1997, programming costs accounted for 28.2 percent of the increase in subscribers' cable rates for four of the MSOs that responded.[12] Both reports also identified other factors that contributed to cable rate increases, such as inflation, upgrades, and channel additions.

However, compared with the impact of programming costs on cable rate increases, the impact of sports programming costs has been limited. The 1999 Report on Cable Industry Prices shows that for noncompetitive systems, sports programming accounted for about 22.4 percent of the increase in programming costs, or 7.5 percent of the increase in cable rates, between 1997 and 1998. Between 1996 and 1997, sports programming accounted for about 19.6 percent of the increase in programming costs, or 4.8 percent of the increase in cable rates. Similarly, the FCC's 1998 inquiry showed that between 1996 and 1997, sports

[10]Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming, Fifth Annual Report, Appendix F (1998).

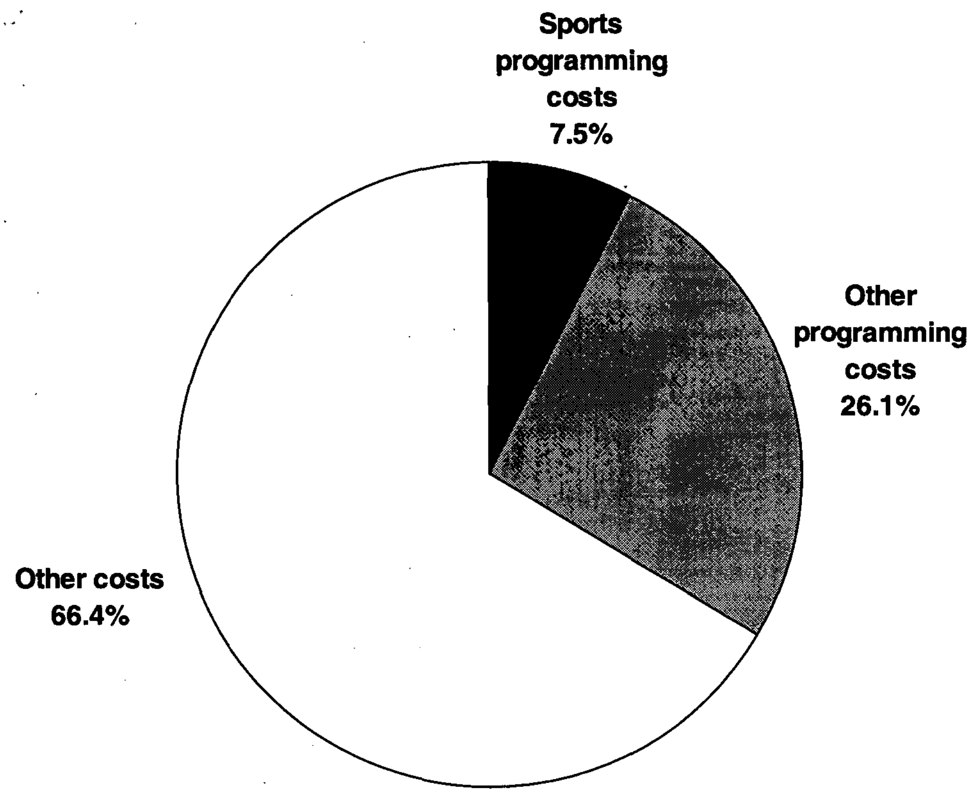
[11]Most of the respondents to the FCC's 1998 price survey were noncompetitive systems. Results were similar for competitive systems.

[12]While the FCC's inquiry included six MSOs, only four provided complete information covering the topic.

programming accounted for about 5.3 percent of the total increase in rates. Other programming subcategories that both reports identified as contributing to cable rate increases included news, children's, and other types of programming.[13]

Figure 3 shows the reasons cable systems reported for increases in subscribers' average monthly rates, according to the 1999 Report on Cable Industry Prices.

Figure 3: Factors Affecting Cable Rate Increases, 1997-98



Note: Other costs include inflation, channel additions, system upgrades, and new equipment.

Source: 1999 Report on Cable Industry Prices, FCC.

[13]The 1998 inquiry showed that news, children's, and other types of programming accounted for 1.2 percent, 3.2 percent, and 17.6 percent, respectively, of the increase in rates from 1996 to 1997.

In comparison, our analysis of programming cost increases for 12 cable systems found that sports programming accounted for about 32.8 percent of the total increased programming costs between 1996 and 1997.[14] For 1998, the projected increases for sports programming at 14 cable systems[15] averaged about 24.1 percent of total programming cost increases.[16]

The Impact of Sports Programming Costs on Cable Rates Could Increase in the Future

While historically sports programming costs have generally had a limited impact on cable television rates, the impact could increase in the future. As we describe later in this report, in the last 3 years, each of four major sports leagues has signed contractual agreements that have increased the amounts that cable networks pay for the cable rights to the leagues' games. According to several MSO officials, the impact on costs of these contractual agreements is beginning to be reflected in the prices MSOs are being charged by the programmers for the sports events. For example, ESPN's Executive Vice President for Administration told us that cable operators were notified in April 1999 that ESPN would increase its programming license fees on August 1, 1999. According to the official, the August 1 increase is based on several factors, including the value of the network to consumers and local advertisers; the increasing costs associated with ESPN's obtaining the cable rights to highly valued sports programming, such as NFL games; and the relatively high cost of producing and televising live sports entertainment. The official stated that the net impact of the rate increase on cable operators will depend on each operator's contractual agreement with ESPN. These agreements include varying discounts and incentives that enable cable operators to reduce program licensing fees. In addition, to help offset licensing fee increases, ESPN has increased the amount of advertising time that it makes available to cable operators to sell during ESPN programming. ESPN estimates that taking into account discounts, incentives, and the growing amount and value of ESPN's local advertising sales inventory, the net impact of its wholesale rate adjustments in each of the last 2 calendar years will average about 10 cents per subscriber per month.

[14]Information for 1996 was available only for 12 of the 15 cable systems.

[15]Information for 1998 was available only for 14 of the 15 cable systems.

[16]Information, similar to that in the FCC study, on the other factors affecting rates was not available to us for the 15 systems.

Small Cable Operators Sometimes Pay More Than Large Operators for Sports Programming

Because of the limitations on the availability of information on prices paid for programming and on the terms and conditions of cable programming contracts, we cannot provide definitive judgments on the differences in what small and large cable operators pay for sports programming. According to interviews with industry officials, small cable operators sometimes pay more for sports programming because the small number of their subscribers limits their ability to take advantage of volume discounts or opportunities to obtain revenue, such as the sale of time used for advertising during cable network programming. Not all networks that carry only sports or a combination of sports and general entertainment programming offer volume discounts, however. Also, many small cable operators have been able to lower their programming costs by joining the National Cable Television Cooperative (NCTC), which aggregates its members' subscribers to collectively purchase programming. Nonetheless, NCTC officials believe that NCTC does not always receive discounts that are comparable to those given to similarly sized MSOs.

Small Cable Operators May Pay More If a Programmer Offers Volume Discounts

According to industry officials, small cable operators are likely to pay more for sports programming than large cable operators if a cable programming network offers price reductions, such as volume discounts, based on the number of a system's subscribers.[17] According to the American Cable Association (ACA),[18] such discounts exist because large cable operators have more negotiating power than small cable operators. Programmers have an incentive to have their programming available to the greatest number of subscribers possible because, as the number of viewers increases, so do programmers' revenues from licensing fees and advertising revenue. Therefore, cable operators with a large subscriber base can obtain greater concessions, such as volume discounts, from programmers than small cable operators.[19]

[17]Aside from volume discounts, some sports programming networks offer other incentives that can reduce programming costs. These include discounts for locating a programmer's network on the VHF band (i.e., channels 2 through 13), locating a network next to another programming network offered by the same company, and carrying on the channel lineup two or more affiliated networks that are owned by the same programming company.

[18]ACA, formerly the Small Cable Business Association, is a nationwide trade association representing approximately 300 small cable businesses that collectively serve more than 2.3 million subscribers.

[19]According to comments submitted to the FCC by Ameritech New Media, Inc., regarding cable television ownership rules, to be economically viable, a programming network needs to reach a critical mass of viewers, which has been estimated to be approximately 20 million subscribers. To reach that level, a programmer must reach agreement with one or more of the largest MSOs. As a result, the large MSOs possess significant leverage in negotiating price reductions.

Information we obtained indicates that the extent to which sports programming networks offer volume discounts varies. For example, one prominent sports programming network provided eligible cable operators with volume discounts ranging from 1 to 6 cents per subscriber. The lowest discount was for cable operators with 250,000 to 499,000 subscribers, and the highest discount was for operators with 1.5 million or more subscribers. The network's programming must reach at least 95 percent of the cable operator's subscribers for the operator to be eligible for a discount. Network officials told us that the number of subscribers needed to qualify for the discounts was recently lowered to assist cable operators in coping with programming cost increases.

However, another popular sports programming network and a few popular networks that offer a combination of general entertainment and major sports events[20] did not offer volume discounts as a way of reducing programming service fees. According to an official representing one regional cable sports programming network, the per subscriber programming costs for small and large cable operators are essentially the same because the network bases its licensing fees on the proximity of a cable system's subscribers to the sports event and on the percentage of a cable operator's subscribers receiving the service. Also, some industry officials told us that several popular networks that offer a combination of general entertainment and major sports events do not offer any volume discounts because they are widely distributed and few cable systems could afford not to carry them. The officials said that while volume discounting is a fairly common practice among cable networks, it tends to be used more by newer programming networks and those with limited distribution.

Small Cable Operators Are Likely to Have Higher Net Program Licensing Costs Than Larger Operators

According to industry officials, the net cost of sports programming may also be higher for small cable operators because they take in less in advertising revenue and are less able to take advantage of some of the other incentives that offset programming costs. Small and large cable companies generally receive a portion of the advertising time that is available within cable programming offered on their systems. For example, one sports network provides cable operators with 2 minutes of local advertising per hour during its programming, which represents a

[20]Programming networks that offer a combination of general entertainment and major sporting events include TNT, TBS, and FX.

revenue source for cable operators.[21] According to network officials, 80 percent of cable operators sell advertising during each 2-minute period. The officials also stated that to help cable operators cope with rising programming costs, the network recently increased the number of 30-second advertising units available during a 1-hour period. It also lowered the number of subscribers that cable operators' systems needed to be able to take advantage of volume discounts.

However, according to officials representing small cable operators, the size of their markets limits their ability to sell advertising during the time allotted for local advertising. For example, NCTC officials estimate that a cable system needs at least 5,000 subscribers to break even with the costs incurred to develop an advertising sales and production department. They noted that most of their members' cable systems have fewer than 5,000 subscribers.

Net licensing fees for small cable operators may also be higher because small cable operators have difficulty taking advantage of, or negotiating for, some of the other incentives available to both small and large companies, such as marketing support—that is, funding to advertise programming networks—and cash or other incentives. However, the magnitude of these incentives is unclear. Representatives for small cable operators we spoke with stated that it is difficult for small companies to utilize marketing support money because they have limited markets and few media outlets on which to spend promotion funding. An industry official we spoke with also said that it is common practice in the cable television industry for programming networks, including sports programmers, to provide cash or other incentives to cable operators in return for airing promotional advertising in the local market. The official said that many small cable operators are unable to take advantage of these incentives because they do not have a sufficient number of subscribers to justify the investment necessary to sell, produce, and insert promotional advertising into cable programming.

[21]Total cable advertising revenues in 1998 were about $9.079 billion, including $2.214 billion for local and spot cable advertising, $305 million for advertising on regional sports networks, and $6.560 billion for advertising on network cable. For the six MSOs responding to the FCC's 1998 inquiry, the average local advertising revenues represented 7.9 percent of the average revenues of regulated cable systems.

Small Companies Can Now Purchase Programming Through the National Cable Television Cooperative

Many small cable operators now purchase sports and other types of programming collectively through NCTC, which negotiates master contracts with programming networks on behalf of its members. Currently, NCTC, which has about 925 cable operator members representing 6,300 cable systems, has contracts covering 85 programming networks. The combined amount of NCTC members' subscribers (10.5 million) would make it the third largest MSO. By purchasing programming through NCTC, small cable operators are capable of obtaining volume discounts comparable to those acquired by large MSOs. But, according to NCTC officials, NCTC does not always receive the discounts that a comparably sized MSO would receive. Industry officials told us that NCTC is still limited in its ability to negotiate the best possible terms with programming networks because large MSOs can promise delivery of a certain number of subscribers while NCTC can only promise to present offers to its members. In addition, according to ACA, while buying groups such as NCTC have had some success obtaining cost savings for national programming, they have not been successful in obtaining cost savings for local or regional programming, such as regional sports networks. Moreover, ACA has indicated that neither it nor NCTC has any assurance that current programmers will renew their existing NCTC contracts when they expire. Furthermore, some industry officials believe that because many small cable operators continue to have fewer opportunities for mitigating cost increases, in the near future, small cable operators will pay more than large operators as the higher costs of recently signed sports rights agreements are passed on to cable operators.

Cable Networks Generally Require Bundling, but Views on Its Effect on Rates Vary

Our discussions with cable industry officials and our analysis of information provided by cable operators indicate that sports networks and networks that offer a combination of general entertainment and sports events generally require the bundling of their programming with other cable networks on the basic or enhanced tiers of service. However, opinions on the effect that bundling has on cable rates were mixed.

Limited Information Indicates That Sports Networks Frequently Require Program Bundling

Information obtained from discussions with cable operators, cable programming networks, and other cable industry representatives indicates that sports networks and networks that offer general entertainment and sports events frequently require their networks to be bundled with other programming networks in specific tiers. For example, an official with a large MSO stated that most of the cable programming networks, including sports programming networks, require that their networks be located on the basic or enhanced basic tier of service. An official of a large MSO and major distributor of cable programming stated that sports programming networks pressure cable operators to bundle their networks with other programming networks because it increases the potential for viewers and, thus, can increase the network's advertising revenue.

Information we obtained indicates that the specific bundling arrangements required by networks vary. For example, one sports network required that its programming be provided either on the operator's basic tier or on an enhanced basic tier that contained no fewer than 10 other first-quality cable programming networks. Another sports network required that its programming be distributed as part of basic service, enhanced basic service, or a third-tier service. If the programming was offered on the third tier, the network required that the tier be received by at least 30 percent of the operator's subscribers and that it contain at least four other cable programming networks. However, the network also allowed the cable operator to distribute the network on an a la carte basis[22] so long as the system also offered the network as part of a third tier in which each other programming network was also offered on an a la carte basis. Yet another network that offers general entertainment and major sporting events required that its programming be received by an aggregate of at least 90 percent of the total subscribers throughout all the MSO's systems and that it not be offered solely as an a la carte service on any system.[23]

In addition to having specific bundling requirements, sports networks and networks that offer general entertainment and major sporting events also frequently employ fee structures whereby the amount cable operators pay for programming decreases as the percentage of subscribers who receive the service increases, according to information we received. For example, one network's fees were broken into three price levels. The lowest fee was charged to a cable operator that provided the network's programming as part of its service to 95 percent or more of the operator's subscribers. The level increased by about 11 percent per subscriber if more than 85 percent but less than 95 percent of subscribers received the network and by an additional 18 percent if less than 85 percent of the operator's subscribers received the network. Another network provided a discount if the total

[22]Programming offered on an a la carte basis allows cable subscribers to purchase channels individually.

[23]Information we obtained from cable operators also indicates that some sports networks that previously were available on an a la carte basis have tried to convince operators to move the networks to the enhanced basic tier. A 1998 study conducted by Economists Incorporated also found that there has been a migration of regional sports networks from a la carte programming to cable operators' enhanced service tiers. How Bundling Cable Networks Benefits Consumers (Washington, D.C.: Economists Incorporated, Feb. 28, 1998), p. 6.

number of cable system subscribers receiving the network was above 80 percent. The discount increased for each percentage point that the number of subscribers exceeded the 80-percent level.

Differing Views Exist on the Effect That the Bundling of Cable Programming Networks Has on Cable Rates

Views on the effect of bundling vary. According to many cable industry officials, the bundling of cable television programming is economically efficient. For example, an official representing a large MSO commented that the bundling of cable networks is the most efficient means of providing cable programming for cable customers. Having numerous tiers of service or a la carte programming would increase costs and, therefore, increase cable rates, the official stated. A 1998 industry-sponsored study by Economists Incorporated reported that without bundling, all subscribers would have to pay the additional costs of adding and deleting channels since the cable operator would likely have to add additional customer support and technical staff to deal with the increased number of calls. The study also reported that many cable subscribers would have to purchase or rent additional pieces of equipment, like converter boxes, since cable operators would probably scramble unbundled channels to prevent unauthorized subscribers from viewing them. The study cited a National Cable Television Association estimate that the rental rate of a converter box is about $3.20 per month. A panel of experts we commissioned agreed that the bundling of cable programming, to at least some extent, results in economic efficiencies and thereby helps in minimizing cable rate increases.[24]

The Economists Incorporated study, as well as some industry officials we contacted, stated that unbundling cable programming would not be in the best interest of cable subscribers. For example, one sports network official indicated that unbundling would lead to fewer subscribers receiving the network, which would result in decreased advertising sales because a smaller audience share would be viewing the programming. The loss in advertising sales could then lead to cable operators' raising cable rates to make up the loss in revenue from advertising. An official of a major broadcast network also indicated his concern by stating, "If forced in an a la carte direction, the cost to the consumer of each individual channel will necessarily go up, and the number of people subscribing to various services will accordingly shrink."

Other officials believe that bundling limits the choices of cable customers and that cable operators should seriously consider a la carte programming.

[24]For a list of the expert panel members, see app. III.

For example, one of the experts on the panel we commissioned commented that even if economic modeling indicates that bundling is more efficient for cable operators and consumers, consumers do not feel they are benefiting. The panelist commented that, after complaints about rates, the lack of choice in the number and types of networks they receive is consumers' second most frequent complaint about cable television.

An official of one large MSO indicated that the cable industry should take a serious look at offering a la carte programming because "choice" is a good marketing banner. Another official representing a large MSO commented that his company would like to offer sports networks on an a la carte basis because it could provide a more economical package of other kinds of programming to non-sports fans. The official continued by saying that the MSO might be able to add more subscribers if it could better package its programming.

Differing Views Are Held on the Future of Bundling

Some cable industry officials we talked with indicated that the implementation of new technologies, such as digital cable, and the increasing number of programming networks that a cable operator can carry will lead to more tiers of service but not necessarily to a transition to a la carte programming whereby subscribers can choose each channel they want. For example, an official representing a large MSO commented that as cable moves to a digital format, programming provided on smaller tiers or a la carte will be easier for cable operators to offer because of the new technology. However, another MSO official pointed out that even if a la carte programming eventually becomes a reality, there would still be a need for a basic tier of service; placing new programming networks on a basic tier gives them an opportunity to attract an audience. According to the panel of experts we commissioned, there is at least a moderate likelihood that system upgrades and new technology will result in cable operators' offering programming on an increased number of tiers within the next few years. But even if additional tiering occurs because of digital technology, it may not necessarily mean that existing networks, including sports networks, will move into the new tiers—only that new programming networks will be added to the additional service tiers.

Players' Salaries Have Increased, but Views Differ on the Extent to Which Salary Increases Have Contributed to Rises in Cable Rates

Players' salaries in four major sports leagues—the NFL, MLB, NBA, and NHL—have increased during the last 4 years as have the amounts that cable system operators have paid to acquire the rights to air the leagues' games. Cable subscribers' rates have also increased during this period. However, views differ on the extent to which players' salary increases have contributed to rises in cable rates.

Players' Salaries and Team Payrolls Have Increased During the Last 4 Years

Data we obtained from the sports leagues indicate that average player salaries in each league increased between the 1994-95 and the 1997-98 seasons. However, as shown in table 1, the percentage of these increases varied widely from league to league. While average salaries for NHL players increased by 64 percent, average salaries for MLB players increased by only 14 percent.

Table 1: Average Player Salaries in Four Major Professional Sports Leagues

Season	National Football League[a]	Major League Baseball[a]	National Basketball Association	National Hockey League
1994-95	$588,000	$1.154 million	$1.8 million	$733,000
1997-98	$720,000	$1.314 million	$2.6 million	$1.2 million
Percentage increase	22%	14%	44%	64%

Note: Average player salaries are in nominal dollars.

[a]The average salaries shown for the NFL and MLB are for the 1994 and 1997 seasons, which, with the exception of the NFL playoffs, extend through a single calendar year. The NHL and NBA seasons begin in the fall of one year and end during the late spring of the following year.

As shown in table 2, average team payrolls for the three leagues for which information was available also increased during the same period. The increases ranged from 19 percent for NFL teams to 47 percent for NBA teams. We were not able to obtain team payroll information from the NHL.

Table 2: Average Team Payrolls of Major Professional Sports Leagues

Season	National Football League[a]	Major League Baseball[a,b]	National Basketball Association
1994-95	$34.1 million	$31.377 million	$22.7 million
1997-98	$40.7 million	$38.775 million	$33.3 million
Percentage increase	19%	24%	47%

Note: Average team payrolls are in nominal dollars. Payroll figures for the NFL include salaries, bonuses, and some standard league benefits. Figures for MLB and the NBA include salaries and bonuses only.

[a]The average payrolls shown for the NFL and MLB are for the 1994 and 1997 seasons, which, with the exception of the NFL playoffs, extend through a single calendar year. The NBA season begins in the fall of one year and ends during the late spring of the following year.

[b]In 1997, there were 826 players on MLB's active roster, compared with 761 players on the active roster in 1994. Additional players were also on the disabled list in 1997.

Much of the attention that has been given to increases in players' salaries may, however, stem from the increases in salaries received by the leagues' star players. The salaries for such players have, in some cases, increased at a much higher rate than average player salaries. For example, available data indicate that the average salaries received by the five highest-paid NBA and MLB players have more than doubled since 1994. According to one of the expert panelists, unlike in most markets, there are a limited number of top sports stars, which gives them an increased ability to raise the prices paid for their services.

Prices Paid by Cable Networks to Carry the Major Sports Leagues' Games Have Increased

Since 1996, each of the four major sports leagues has signed new agreements with cable and broadcast networks for the rights to its games. It is difficult to compare precisely the amounts cable networks paid under the new and old agreements because the specific terms of the agreements are proprietary and the rights acquired may vary. However, the available information indicates that the amounts that cable networks paid under the new agreements are substantially higher than what they paid under the previous contracts.[25]

In August 1998, the NHL approved Disney's 5-year $600 million offer for the television rights to air NHL games on ABC and ESPN. It is expected that ESPN will pay approximately $70 million per season for this package. Under the prior agreement, ESPN is reported to have paid $100 million for seven seasons (about $14 million per season). According to an NHL

[25]Teams also obtain revenues from cable networks and broadcast stations under other agreements for the local and regional rights to their games.

representative, under the new agreement, ABC and ESPN have exclusive rights to televise twice as many games as ESPN did under the previous agreement.

In January 1998, ABC and ESPN, CBS, and Fox signed 8-year broadcast and cable rights agreements totaling about $18.3 billion to air NFL games. ABC and ESPN made a combined bid of $9.4 billion to air games from 1998 to 2005. Of this figure, $4.8 billion ($600 million per season) is allocated to ESPN for the Sunday Night Football cable package, the NFL Prime Time highlights show, and other related programming. Under the prior agreement, which covered the 1994 through 1997 seasons, the rights to televise NFL programming on broadcast and cable television sold for about $4.4 billion.

In November 1997, the NBA entered into a 4-year broadcast rights agreement with NBC Sports, Inc., and a 4-year cable rights agreement with Turner Broadcasting System (TBS), Inc. Combined, these contracts totaled $2.6 billion. This includes the cost paid by TBS—$890 million—an increase of about 153 percent over the company's previous 4-year contract of $352 million, which expired after the 1997-98 season.

In 1996, MLB signed 5-year agreements totaling about $1.7 billion with Fox, NBC, and ESPN for the broadcast and cable rights to MLB games. Fox and NBC collectively paid about $1.1 billion for the broadcast rights, and Fox and ESPN collectively paid about $600 million for the cable rights. The information needed to compare these amounts with the amounts that TBS and ESPN paid for rights under the previous agreements with MLB was not available.

Views Differ on the Effect of Players' Salaries on Cable Rates

The views of the cable industry and sports league officials we talked with differed on whether increases in players' salaries have contributed to rises in cable rates. Some cable industry officials said they believed that the salary increases have contributed to higher cable rates. While most stated that they were not experts in this area, their observations of the sports and cable television industries led them to believe that salaries have driven up fees charged to televise sports, which in turn have driven up cable rates. For example, one representative of a major MSO and programmer noted that while sports stars' rising salaries were not the only cause of cable rate increases, they were surely one of the causes.

On the other hand, most members of our expert panel, as well as some cable industry officials, said that players' salaries should not be viewed as a cause of increases in cable rates. More specifically, five of the seven panel members believed that increases in players' salaries had caused increases in cable rates to little or no extent, while one panelist believed that they had caused increases to a moderate extent. In addition, according to the NFL, players' salaries do not cause the NFL to charge higher fees for televising professional football games because, under the league's "salary cap" system, what teams spend on players is a direct function of leaguewide revenues.[26] For example, if television revenues increase in any year, the salary cap increases and teams are able to spend more on players' salaries. If television revenues remain constant, however, the teams' spending on players is unchanged.

Several panelists pointed to the increases in broadcast and cable rights fees and players' salaries as a reflection of increased consumer demand for major professional sports. In this regard, one of our experts stated that cable operators and programmers recognize the demand and try to satisfy it, thereby bidding up the prices in the market, including players' salaries. Another panelist agreed that increases were related to demand but said that additional factors also come into play. For example, he said that while movies and other types of programming are available on more outlets, the major sports leagues have one product that can be broadcast one time, thus giving them market power. In addition, he noted that with the plethora of new cable channels, it has become more important for individual networks to form distinct identities, such as being identified as the carrier of a major sports league like the NFL. This, he believed, had fueled competition among networks for the leagues' rights and had led to the high prices paid. Thus, increases in players' salaries may be viewed as an effect rather than a cause of cable rate increases.

Agency Comments

We provided the FCC with a draft of this report for its review and comment. The FCC stated that our report was not inconsistent with the FCC's own research on the subject. The FCC also provided some technical comments, which we incorporated into the report as appropriate. The FCC's comments appear in appendix IV.

[26]The NFL receives leaguewide revenues from a variety of sources, including the sale of broadcast and cable rights for league games. These revenues are divided among the teams in the league. According to the NFL, each year, each NFL team knows the amount of the salary cap available to it before it begins to sign free agents or to draft players.

We performed our work from July 1998 through June 1999 in accordance with generally accepted government auditing standards.

As arranged with your office, unless you publicly release its contents earlier, we plan no further distribution of this report until 14 days after the date of this letter. At that time, we will provide copies to William E. Kennard, Chairman, Federal Communications Commission, and other interested parties. We will also make copies available to others on request.

Please call me at (202) 512-7631 if you or your staff have any questions. Major contributors to this report are listed in appendix VI.

Sincerely yours,

Judy A. England-Joseph
Director, Telecommunications Issues

Contents

Figures

Abbreviations

ACA	American Cable Association
FCC	Federal Communications Commission
GAO	General Accounting Office
MLB	Major League Baseball
MSO	multiple system operator
NBA	National Basketball Association
NCTC	National Cable Television Cooperative
NFL	National Football League
NHL	National Hockey League
TBS	Turner Broadcasting System

Scope and Methodology

To determine the extent to which sports programming costs are contributing to higher cable television rates, we reviewed reports from the Federal Communications Commission (FCC) on cable industry prices covering the years 1995 through 1998, reviewed its 1998 inquiry into cable rate increases for six multiple system operators (MSO), and analyzed information we obtained on 15 cable systems.

The FCC's Report on Cable Industry Prices collects data from a statistical sample of cable operators on a variety of fees and revenues associated with the provision of cable television programming services. While the FCC has issued the report since 1993, the 1999 report is the first one in which the Commission included questions about the cost of cable programming and associated advertising revenues by type (i.e., sports, news, children's, general entertainment). The FCC included questions about the cost of programming by type because of concerns about the impact of sports programming, in particular, on increases in cable rates. The 1999 Report on Cable Industry Prices covers the periods July 1, 1996, to July 1, 1997, and July 1, 1997, to July 1, 1998. The 1997 report covers the periods July 1, 1995, to July 1, 1996, and July 1, 1996, to July 1, 1997. Because the FCC's reports on cable industry prices are based on a sample of cable operators, rather than all operators, statistics in the report are subject to sampling error. The sampling errors for the statistics we used from the FCC's reports are provided in appendix V. We did not independently verify the FCC's estimates.

The FCC's 1998 inquiry into cable rate increases provided information on recent cost increases for cable television programming that the FCC collected from the nation's six largest MSOs. Collectively, the MSOs serve about 67 percent of all cable subscribers. With the inquiry, the FCC sought to build on information that was gathered in the 1997 Report on Cable Industry Prices. While all six MSOs responded, not all respondents provided complete information on every question. The participants provided several reasons for not responding fully, including the unavailability of the requested data, the inability of the MSOs to compile the data in the requested format, and the MSOs' unwillingness to share the requested data because of their proprietary or competitively sensitive nature. However, at least four respondents provided consistent information for most of the questions. The results of the inquiry, therefore, are largely based on four responses.

From FCC public files and from public files at the state regulatory office in Massachusetts, we obtained data on the licensing fees that 15 cable systems incurred for cable programming. The cable systems were part of three large MSOs and one medium-sized MSO, which, combined, represented about 28 percent of cable subscribers nationwide. The systems served subscribers in six states. According to available data, the number of subscribers for the 15 systems ranged from about 400 to over 90,000. The information we obtained primarily covered the programming costs for the basic tier and the cable programming service tier. The data reflect the cable operators' programming costs for each of their channels on a per subscriber, per month basis.

To determine the percentage of programming costs that were attributable to sports programming for the 15 cable systems, we compared the systems' monthly cost (on a per subscriber basis) for carrying the sports networks included in their basic or enhanced basic tiers to the systems' total cost of programming included in their basic and enhanced basic tiers. The total programming costs that we used included both costs for cable networks and for copyright fees. To compare sports programming costs to subscribers' monthly bills, we compared the monthly cost (on a per subscriber basis) that the cable systems incurred for carrying sports networks included in their basic or enhanced basic tiers to the monthly amount that the systems charged customers for subscribing to basic and enhanced basic service. We used data from January 1997 for these analyses. We obtained information on the rates paid by subscribers from the FCC's public files, from one state regulatory agency's public files, and directly from cable operators and MSOs. As discussed in the report, we recognize that this analysis tends to understate the impact of sports programming on programming costs and cable rates because sports are also carried on other cable channels. To calculate the increases in programming costs that are attributable to sports programming, we compared the increases in the costs that cable systems incurred for carrying sports networks to the total increases in costs for programming that they included in their basic and enhanced tiers. We used data from 1997 and 1998 for this analysis.

To provide information on differences in what sports programmers charge small and large cable operators for programming, we interviewed representatives of large and small cable companies, cable programming networks, state and federal regulatory agencies, cable trade associations, and a cable program buying cooperative and reviewed information they provided. We also obtained information from a panel of seven experts we convened on subscription television issues and analyzed data from the

1999 Report on Cable Industry Prices on the impact of sports programming costs on small, medium, and large cable operators.

To determine the extent to which sports programmers require cable operators to bundle sports programming with other cable programming and the effects that the bundling of cable programming has on cable rates, we interviewed and reviewed information provided by officials representing cable companies, sports programming networks, over-the-air broadcast networks, a cable association, and a cable program buying cooperative. In addition, we reviewed documents of three cable companies containing specific bundling requirements that cable programming networks set forth in their agreements with these companies. We also obtained information from the panel of seven experts on the effects of bundling and obtained information from a study conducted by Economists Incorporated that discusses how bundling benefits cable subscribers.

To provide information on trends in players' salaries and their relationship to cable rate increases, we interviewed cable industry officials and obtained information from public sources, professional sports leagues, and our expert panel. To obtain information on increases in average players' salaries and team payrolls (1994-95 through 1997-98) for four major sports leagues—the National Football League, Major League Baseball, the National Basketball Association, and the National Hockey League—and, recent prices cable networks paid for the rights to air games, we used data from cable and broadcast industry trade periodicals and sports Web sites. The leagues confirmed data we had obtained and supplied correct or missing information.[27] Also, during our expert panel, we asked the seven participants to address the question of whether salaries of players in professional sports had risen over the last 4 years and, if so, whether this contributed to increases in cable rates. At the conclusion of the panel, we administered a survey instrument that allowed the participants to indicate the extent to which they believed players' salaries contribute to increases in cable rates.

To accomplish our assignment, we also received assistance from Professor Douglas Gomery of the College of Journalism, University of Maryland, College Park, who specializes in media studies. Professor Gomery reviewed and commented on our overall methodology. In addition, he conducted research on sources of information on sports programming

[27]We were unable to obtain confirmation from Major League Baseball on prices cable networks paid for the rights to air professional baseball games.

costs; differences in the prices small and large cable operators pay for sports programming; cable programming bundling practices; players' salaries and leagues' payrolls; and the impact of players' salaries on cable rates. Professor Gomery also reviewed and commented on our final report.

Cable Sports Programming Services

American Sports Classics
BAY TV
Classic Sports Network
CNN/SI
Comcast SportsNet
Empire Sports Network
ESPN
ESPN2
ESPNews
Football Channel
Fox Sports Americas
Fox Sports Arizona
Fox Sports Bay Area
Fox Sports Northwest
Fox Sports Pittsburgh
Fox Sports Rocky Mountain
Fox Sports South
Fox Sports Southwest
Fox Sports West
Fox Sports West 2
Golf Channel
Home Team Sports
Jock Talk TV
Little Leaguers Sports/News Network
Madison Square Garden Network
Midwest Sports Channel
New England Sports Network
NewSport
NTN Entertainment Network
PASS Sports
Prime Network
Speedvision Network
SportsChannel Chicago
SportsChannel Florida
SportsChannel New England
Sports Channel New York
SportsChannel Ohio
SportsChannel Pacific
SportsChannel Philadelphia
Sunshine Network

Source: The Federal Communications Commission.

Expert Panel Participants

Dale Hatfield, Chief, Office of Engineering and Technology, Federal Communications Commission

Thomas W. Hazlett, Professor and Director of Telecommunications Policy, University of California at Davis, and Resident Scholar, American Enterprise Institute

Gene Kimmelman, Co-Director, Washington Office, Consumers' Union

Robert Pepper, Chief, Office of Plans and Policy, Federal Communications Commission

Donald J. Russell, Chief, Telecommunications Task Force, Antitrust Division, U.S. Department of Justice

David Waterman, Associate Professor, Department of Telecommunications, Indiana University

Steven S. Wildman, Director, Telecommunications Science, Management and Policy Program, Northwestern University

Comments From the Federal Communications Commission

Federal Communications Commission
Washington, D.C. 20554

May 18, 1999

Judy A. England-Joseph
Director, Telecommunications Issues
General Accounting Office
Washington, DC 20548

Dear Ms. England-Joseph:

Your draft report entitled Telecommunications: Impact of Sports Programming Costs on Cable Television Rates (GAO/RCED-99-136, Code 385758) has been reviewed in the Cable Services Bureau. It is my understanding that staff comments on the draft report have been forwarded to you previously. We have no additional concerns with the report. Its conclusions are not inconsistent with those found in the Commission's own research. We appreciate very much the opportunity to review and comment on the draft report.

Sincerely,

Deborah A. Lathen, Chief
Cable Services Bureau

Sampling Error of Estimates From FCC's May 1999 Report on Cable Industry Prices

Because the FCC's price survey is based on a nationwide sample of cable systems, estimates from the survey are subject to sampling error. The following table contains the sampling errors for all the estimates we used from the FCC's 1998 price survey. Some of these estimates and sampling errors were contained in the May 1999 Report on Cable Industry Prices. The table does not include sampling errors for competitive cable systems because, in conducting the price survey, the FCC sampled all available competitive cable systems.

Description	Estimate	Sampling error of estimate[a]
Percentage increase in rates for noncompetitive cable systems from July 1, 1997, through July 1, 1998	6.9	0.5
Percentage increase in rates per channel for noncompetitive cable systems from July 1, 1997, through July 1, 1998	1.6	0.7
Average monthly cable rate for noncompetitive systems as of July 1, 1998	$30.53	$0.35
Average monthly programming services rate for noncompetitive systems as of July 1, 1998	$27.88	$0.33
Average monthly rate for equipment rentals for noncompetitive systems as of July 1, 1998	$2.65	$0.10
Percentage increase in rates attributable to programming costs for noncompetitive systems from July 1, 1997, to July 1, 1998	33.6	7.7
Percentage increase in rates attributable to programming costs for noncompetitive systems from July 1, 1996, to July 1, 1997	24.4	3.4
Percentage increase in programming costs attributable to sports programming costs for noncompetitive systems from July 1, 1997, to July 1, 1998	22.4	2.5
Percentage increase in rates attributable to sports programming costs for noncompetitive systems from July 1, 1997, to July 1, 1998	7.5	2.3
Percentage increase in programming costs attributable to sports programming costs for noncompetitive systems from July 1, 1996, to July 1, 1997	19.6	7.5
Percentage increase in rates attributable to sports programming costs for noncompetitive systems from July 1, 1996, to July 1, 1997	4.8	2.1

Note: Estimates from the May 1999 report.

[a]Sampling errors are stated at the 95-percent level of confidence based on standard errors provided by the FCC. They were computed as 1.96 times the standard errors provided by the FCC.

GAO Contacts and Staff Acknowledgements

GAO Contacts

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Acknowledgments

In addition to those named above, Charles E. Wilson, Jr., Karen E. Bracey, Richard C. LaMore, Andy C. Clinton, Michael R. Volpe, and Mindi G. Weisenbloom made key contributions to this report.