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# NETWORK TELEVISION AND THE DIGITAL THREAT

Lisa Lapan\*

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## I. INTRODUCTION

The network television industry, centered in Hollywood, California, has long had two major components to its business model: content and distribution.<sup>1</sup> The content business involves the development, production and exploitation of entertainment product; distribution is the dissemination of that entertainment product across proprietary and non-proprietary television stations.

Recent innovations in digital technologies have threatened to destroy much of network television's distribution business, and, as a result, the industry has shifted its focus to content. Hence, the much repeated Hollywood mantra "content is king."

But digital technologies also threaten television's content business. Digital technologies have democratized content creation, leading to an explosion in the content supply. With audiences fragmenting and looming TV/internet convergence, the networks have seen their profit margins grow thin. In the face of these challenges, can network television survive?

This article will examine the threat digital technologies pose to the television industry, specifically the "Big Four" broadcast networks: ABC, CBS, Fox and NBC. First, this article will examine the impact that digital technologies have had on the networks' distribution and content businesses. Secondly, the article considers how TV/internet convergence may be the tipping point in network television's decline.

<sup>1</sup> Bureau of Labor and Statistics, Broadcasting, <http://www.bls.gov/oco/cg/cgs017.htm> (last visited Dec. 9, 2008).

Thirdly, the article will discuss the networks' response to the digital threat and additional strategies they may pursue. Finally, the article will consider the future of network television and consequences for television audiences.

## II. THE IMPACT OF DIGITAL TECHNOLOGY ON TELEVISION DISTRIBUTION AND CONTENT

### A. *Television Distribution and the Loss of Network Control*

Throughout the history of television, what we watch and when we watch it has been controlled by a handful of entertainment companies. Distribution is the mechanism by which these companies control *when* we watch our entertainment. Today, the most important players in the television distribution game are the Big Four broadcast networks – ABC, CBS, Fox and NBC – which collectively reach the largest percentage of television audiences.<sup>2</sup>

Traditional television is distributed in a constant stream.<sup>3</sup> When you turn on your television, you can watch only what each network streams into your living room at that particular moment. If you want to watch a specific program, you may watch it (along with the inter-spliced commercial advertisements) only when the network puts it on air – what the networks have coined “appointment viewing.” By dictating when we watch our entertainment, the Big Four networks are able to reap profit through a model that combines advertising revenue earned when a show first airs and lucrative syndication deals, which allow distribution partners to subsequently air reruns in a specific geographic territory.<sup>4</sup> The distribution partners, in turn, earn advertising revenue when the show reruns through their own distribution outlets.

Technology began to erode the appointment viewing model, and the Big Four networks' control of distribution, as early as the 1970s with the advent of mass-market videocassette recorders (VCRs).<sup>5</sup> More recently, “time-shifting” devices like TiVo and other digital video recorders (DVRs) allow viewers to record a television program and

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<sup>2</sup> In any given week the Big Four broadcast networks reach between 29% and 34% of U.S. television households, compared with 9% to 15% for cable networks. See Diane Mermigas, *Do The Math: Broadcast, Cable Network Parity Play*, MEDIA POST, Sep. 28, 2004, [http://www.mediapost.com/publications/?fa=Articles.showArticle&art\\_aid=91293](http://www.mediapost.com/publications/?fa=Articles.showArticle&art_aid=91293).

<sup>3</sup> Wikipedia, Streaming Media, [http://en.wikipedia.org/wiki/Streaming\\_media](http://en.wikipedia.org/wiki/Streaming_media) (last visited Dec. 9, 2008).

<sup>4</sup> Amy Schatz & Brooks Barnes, *TV Stations Build Online Fences to Blunt Web's Effect*, PITTSBURGH POST GAZETTE, Mar. 16, 2006, available at <http://www.post-gazette.com/pg/06075/671516-237.stm>.

<sup>5</sup> Wikipedia, Videocassette Recorder, <http://en.wikipedia.org/wiki/VCR>, (last visited Dec. 7, 2008).

replay it at their convenience (with the ability to skip past commercials). There are also now “place-shifting” devices such as the SlingBox which allow viewers to “sling” whatever is playing on their television to a laptop computer anywhere in the world. Time-shifting decreases the value of advertisements both in first run and in syndication, while place-shifting decreases the value of syndicated programming because the distribution partner no longer has exclusivity within its geographic territory.

But the real story is the internet. The internet allows for the worldwide, instantaneous distribution of content with zero marginal cost. Something that is downloaded and made available to view online is accessible to anyone, anytime and anywhere there is a computer and an internet connection. Technology companies like YouTube created a centralized platform for users to upload and find video, while BitTorrent peer-to-peer (P2P) file sharing protocol allowed the easy viral spread of pirated premium content.<sup>6</sup> As one entertainment attorney writes, “Distribution used to be the exclusive province of Hollywood . . . but no longer.”<sup>7</sup>

The immediacy of the internet has thus forever changed consumer demand. Knowing we can have the entertainment we want, when we want it means we aren’t willing to settle for appointment viewing. We are the “on-demand” generation.<sup>8</sup> Because our preferred entertainment is now available at the click of a mouse, we don’t wait for the networks – we simply find the content online, often illegally. Facilitated by technology companies, the consumer increasingly dictates distribution; the networks have lost control. As Jeff Zucker, CEO of NBC Universal stated, “today the consumer wears the crown.”<sup>9</sup>

## B. *Content is King: Focus on Content Creation*

Without control of distribution outlets and the power to dictate when we watch our entertainment, both advertising space and syndication rights have become far less valuable to the networks. Faced with declining profits on the distribution side, the television industry has fo-

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<sup>6</sup> “Premium” refers to content produced by Hollywood professionals. BitTorrent is a P2P file-sharing protocol that enables the transfer of large amounts of data using minimum bandwidth. See Wikipedia.org, BitTorrent (protocol), [http://en.wikipedia.org/wiki/BitTorrent\\_\(protocol\)](http://en.wikipedia.org/wiki/BitTorrent_(protocol)) (last visited Dec. 9, 2008).

<sup>7</sup> Jonathan Handel, *Hollywood Under Siege*, ENT. AND SPORTS LAWYER, Fall, 2008 at 10.

<sup>8</sup> *Listen to the Music*, ECONOMIST, Nov. 28, 2008, available at [http://www.economist.com/people/displaystory.cfm?story\\_id=12633125](http://www.economist.com/people/displaystory.cfm?story_id=12633125).

<sup>9</sup> Jeff Zucker, Keynote Address at the National Association of Television Program Executives: A Time For Change (Jan. 29, 2008), available at [http://www.graphicartsonline.com/contents/pdf/ZUCKER\\_NATPE.pdf](http://www.graphicartsonline.com/contents/pdf/ZUCKER_NATPE.pdf).

cused on the surviving half of its business model: *what* we watch, or “content.” Content is the catchall phrase for entertainment products – movies, television shows and music – and “content is king” has become an oft-repeated mantra around Hollywood representing the belief that those entertainment products are more profitable than the conduits used to distribute them.<sup>10</sup>

In keeping with this mantra, many companies have begun ramping up their content businesses. In 2005, CBS Entertainment President Leslie Moonves began licensing the network’s content to every imaginable distributor, stating that CBS’s “future success will depend on maximizing the use of our great entertainment . . . content.”<sup>11</sup> Since that time, each of the Big Four networks has boosted content production within their own ranks, while buying less content from independent producers. In 2008, a remarkable 79% of network shows were produced internally, compared to only 58% of shows in 2006.<sup>12</sup> Further, the networks have begun selling many of their local affiliate stations, a further indication the networks are realigning themselves as pure content companies.<sup>13</sup> One ABC executive has gone so far as to adjust the nomenclature, stating, “I don’t think of [ABC, CBS, Fox and NBC] as networks. I think of them as content engines.”<sup>14</sup>

Other television companies have followed the networks’ lead. Time Warner CEO Jeff Bewkes announced a new business strategy as recently as August 2008, wagering that “the media pendulum will swing away from distribution and back toward content.”<sup>15</sup> The company announced plans to spin off its cable operations, find a partner to take over AOL, and shrink down Time Inc.’s publishing business to a handful of profitable titles. The remaining Time Warner business will be comprised primarily of content producers, including Warner Brothers television (producers of such shows as *Friends*, *ER* and *Gossip Girl*), TNT and HBO. Since 2002, when F/X’s *The Shield* became the number one series on basic cable, cable companies have also increasingly ramped up content production by adding original programming to their

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<sup>10</sup> Handel, *supra* note 7.

<sup>11</sup> Diane Mermigas, *New CBS Banks on Content*, HOLLYWOOD REPORTER, Dec. 16, 2005, available at [http://www.hollywoodreporter.com/hr/search/article\\_display.jsp?vnu\\_content\\_id=1001699724](http://www.hollywoodreporter.com/hr/search/article_display.jsp?vnu_content_id=1001699724).

<sup>12</sup> Tim Arango, *Holy Cash Cow, Batman! Content Is Back*, N.Y. TIMES, Aug. 10, 2008, available at <http://www.nytimes.com/2008/08/10/business/media/10warner.html>.

<sup>13</sup> See J.P. Hannan, *TV Networks Reach a Fork in the Digital Road*, SEEKING ALPHA, Aug. 21, 2008, <http://seekingalpha.com/article/91972-tv-networks-reach-a-fork-in-the-digital-road>.

<sup>14</sup> Staci Kramer, *Disney’s Anne Sweeney Talks Hulu: It’s All About Casual Viewers*, PAID CONTENT, Apr. 30, 2009, <http://www.paidcontent.org/entry/419-disneys-anne-sweeney-talks-hulu/>.

<sup>15</sup> Arango, *supra* note 12.

schedules.<sup>16</sup> During the 2008 development season, Time Warner companies HBO and TNT had a whopping twenty<sup>17</sup> and fourteen<sup>18</sup> new series in development, respectively. AMC, who only entered the original programming business in 2007, already has two Emmy winners – *Mad Men* and *Breaking Bad* – and was developing at least six new shows in 2008.<sup>19</sup> Moreover, new cable companies are continually entering the content business; most recently, TV Land<sup>20</sup> and Starz movie channel<sup>21</sup> have begun to develop original series. As Viacom's CEO Philippe Dauman expressed, "[T]here has never been a better time to be in the content business."<sup>22</sup>

However, this strategy is problematic for two reasons. First, content has never really been king. Content may have glamour, but, as we will see, the economics of distribution are fundamentally superior to those of pure content play.<sup>23</sup> Secondly, Hollywood's content business is likely no safer from the threat of digital technology than its distribution business. As Warner Brothers chairman Barry Meyers states, Hollywood has shifted towards content because in "the last number of years, [with] new and better ways to distribute content . . . distribution [has been] commoditized, leaving content as the more valuable component."<sup>24</sup> But the digital technologies that have commoditized distribution also threaten to commoditize content, making content "more a commoner than a king."<sup>25</sup>

### C. Democratization of Content Creation

In the past, Hollywood companies have controlled content by overseeing the means of production and the barriers to entry into entertainment. By owning the very expensive cameras, massive sound boards and elaborate editing equipment necessary to create a television

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<sup>16</sup> Brian Stetler, *The Blossoming of Original Shows on Cable*, TV DECODER, N.Y. TIMES, July 16, 2008, <http://tvdecoder.blogs.nytimes.com/2008/07/16/the-blossoming-of-original-shows-on-cable/>.

<sup>17</sup> Daniel Frankel, *Cable Builds a Bigger Stable*, VARIETY, Nov. 26, 2008, available at <http://www.variety.com/article/VR1117996524.html?categoryid=2522&cs=1>.

<sup>18</sup> John Dempsey, *TNT Primes Primetime Originals Push*, VARIETY, Mar. 3, 2008, available at <http://www.variety.com/article/VR1117981770.html?categoryid=10&cs=1>.

<sup>19</sup> Frankel, *supra* note 17.

<sup>20</sup> *TV Land to Launch Scripted Series*, TELEVISION BUS. INT'L, Aug. 12, 2008, <http://tbivision.com/article.php?category=9&article=682>.

<sup>21</sup> Frankel, *supra* note 17.

<sup>22</sup> Arango, *supra* note 12.

<sup>23</sup> See Andrew Odlyzko, *Content is Not King*, ATT LABS RESEARCH, Jan. 03, 2001, available at <http://www.dtc.umn.edu/~odlyzko/doc/history.communications2.pdf>

<sup>24</sup> Arango, *supra* note 12.

<sup>25</sup> Handel, *supra* note 7.

show, the networks could dictate which shows (created by which writers, directors and producers, and starring which actors) were produced and eventually broadcast to the public.<sup>26</sup> Talent was not enough to get work in television; only those deemed worthy by Hollywood could gain exposure to a television audience.

However, with the advent of digital technologies, content creation no longer requires expensive equipment owned only by large media companies. Home computers, digital video cameras and editing software can be readily purchased for a relatively small price, and the aspiring auteur can use those simple tools to create content as easily as anyone in Hollywood. What was once rare and expensive is now pervasive and incredibly affordable. Further, content created by the digital masses need not suffer in quality. Video cameras have gone high definition (HD) and joint ventures like the one between Move Networks and Permission TV provide HD video streaming alongside an interactive video application platform that allows small online publishers to easily upload high quality video content onto their sites.<sup>27</sup> The collective result of these digital technologies is that Hollywood no longer has a monopoly on the means of media production.

Technology has made content creation cheap for the digital masses. While some of the costs of physical production have similarly fallen for Hollywood, Hollywood is encumbered with precedents and relationships that buoy the costs of creating a show and prevent Hollywood from capturing a significant benefit from declining costs.<sup>28</sup>

For example, Hollywood pays its star actors incredible salaries. These salaries, now established and precedential, are difficult to change. Consider a network that approaches a famous actor to star in a television series. The actor has a quote which she has been previously paid, and she knows what the network has paid other stars in the past, so she is willing to take no less. The network – needing the star to sell advertising and garner audiences, and afraid of offending her representatives who supply the network with talent – has little choice but to agree. The networks are thus burdened by salary expenses that, over time, have become progressively inflated, each time setting a new and higher benchmark.<sup>29</sup>

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<sup>26</sup> Mark Tratos, *Entertainment on the Internet: The Evolution of Entertainment Production, Distribution, Ownership and Control in the Digital Age*, PRACTISING L. INST., PATENT, COPYRIGHTS, TRADEMARKS, AND LITERARY PROPERTY COURSE HANDBOOK SERIES, Mar., 2007.

<sup>27</sup> Meghan Keane, *Permission TV and Move Networks Bring High Quality Video to the Masses*, WIRED, Nov. 19, 2008, <http://blog.wired.com/business/2008/11/permissiontv-an.html>.

<sup>28</sup> Handel, *supra* note 7.

<sup>29</sup> See Scott Collins, *Analysis: Paying Price for Star Salaries Means Fewer Hollywood Jobs*, PITTSBURGH POST-GAZETTE, May 19, 2008, available at <http://www.post-gazette.com/pg/>



Hollywood is similarly burdened on the revenue side by complex union rules, including residual formulas. The entertainment guilds have long fought for residual formulas based on the notion that their members own an exclusive copyright and should therefore be compensated for every copy of their work.<sup>30</sup> However, in today's digital world this is an obviously outdated notion. Value in a networked environment rests at the point of access, not from the exchange of copies. The more viewers a site achieves, the more valuable the advertising space. Yet Hollywood is required to pay residuals based on previously negotiated per-copy formulas, regardless of the fact that the model is antiquated and largely unworkable in a digital age.<sup>31</sup>

While Hollywood has relationships and precedents that hamper its ability to adapt in a changing world, new producers, unburdened by the high overheads and obsolete habits of established players, can interact more nimbly with talent and consumers alike. Digital technologies have thus democratized content creation, stripping Hollywood of its monopoly in the content arena.

#### D. *Proliferation of Content and Loss of Network Control*

With the ability to create video content at low cost and the means to distribute that video for the price of an internet connection, it is no surprise that content of all kinds has proliferated on the web. Today, there are generally three types of entertainment content available online: 1) user-generated content (UGC), 2) professional content developed for distribution in other media (typically film and television), and 3) professional content developed for mobile device or online distribution (so called "new media"<sup>32</sup>). As we will see, new media threatens to wrest control of content away from Hollywood, just as digital technologies destroyed its control over distribution.

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08140/882963-42.stm. This is an obviously simplified version of the problem, and may be changing as a result of the economic recession. See Kim Masters, *Haggling with the Stars*, DAILY BEAST, Apr. 2, 2009, <http://www.thedailybeast.com/blogs-and-stories/2009-04-02/haggling-with-the-stars/>.

<sup>30</sup> Paul Sweeting, *Writers Strike an Issue for Future of Television*, CONTENT AGENDA, Nov. 9, 2007, <http://www.contentagenda.com/article/CA6499374.html?q-future+of+television>.

<sup>31</sup> *Id.*

<sup>32</sup> New media is defined by the WGA as any program produced for "the internet, a mobile device, or any other platform thought of as 'new media' by the industry." See Writers Guild of America, *Original Programs Made for New Media Fact Sheet*, <http://www.wga.org/uploadedfiles/contracts/NewMediaOriginal.pdf>.

UGC is content requiring a “creative effort” by non-media professionals (i.e. ordinary people) and published online.<sup>33</sup> YouTube is the premiere site for UGC, with an average of ten hours of video uploaded to the site every minute<sup>34</sup> and up to 344 million unique visitors per month.<sup>35</sup> For the internet-savvy set, the term “UGC” generally conjures notions of home video with low production quality (i.e. the skateboarding bulldog) or video blog series broadcast from a teenager’s bedroom (such as *LonelyGirl15*).

Professional content developed for distribution in other media such as film or television ends up online legally through venues such as Apple’s iTunes or Hulu, or illegally as pirated material aggregated by BitTorrent sites, traded on P2P systems, or posted in whole or in part by the same end-users generating UGC on sites like YouTube.

Professional content developed for distribution online, so called “new media,” is created either by established players in Hollywood or other professionals. New media has been the subject of much controversy recently, and was one of the major points of contention during the 2007-2008 Writers Guild of America (WGA) strike.

The Alliance of Motion Picture and Television Producers (AMPTP) represents 350 entertainment companies that employ WGA members, dominated by the major studios and networks.<sup>36</sup> In negotiating the WGA’s minimum basic agreement (MBA), it was assumed that AMPTP members would be the producers of new media, or that any producer not under the jurisdiction of the MBA would pay WGA members on equal or better terms. During the strike, the fight over new media focused on whether the WGA had jurisdiction over new media at all,<sup>37</sup> and, if so, the amount WGA members would be paid for services in the new media sector. The writers wanted to preserve traditional media residual formulas while the AMPTP wanted to break free of those antiquated formulas and create new business models. AMPTP’s goal was to avoid “union-imposed pay structures and restrictions that . . . would keep their companies from operating effectively in

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<sup>33</sup> Organization for Economic Cooperation and Development, *Participative Web: User Created Content*, Apr. 12, 2007, at 4, available at <http://www.oecd.org/dataoecd/57/14/38393115.pdf>.

<sup>34</sup> YouTube Fact Sheet, [http://www.youtube.com/t/fact\\_sheet](http://www.youtube.com/t/fact_sheet) (last visited Mar. 17, 2009).

<sup>35</sup> Liz Gannes, *Just Wow: YouTube Had 344M Global Uniques in Oct.*, NEWTEEVEE, Dec. 1, 2008, <http://newteevee.com/2008/12/01/just-wow-youtube-had-344m-global-uniques-in-oct/>.

<sup>36</sup> Alliance of Motion Picture and Television Producers About Us, <http://www.amptp.org/aboutus.html> (last visited Dec. 9, 2008).

<sup>37</sup> They do.

a rowdy internet world that has already badly damaged the music and news industries.”<sup>38</sup>

But while Hollywood was busy at the negotiating table, many well-known, extremely talented writers (and directors and actors) were out of work. And they all finally took notice of what was right in front of them: they no longer needed Hollywood. Content creation was cheap, the distribution mechanisms were in place and entrepreneurs were ready to make it all happen.<sup>39</sup> Kevin Morris predicted in the *Wall Street Journal* months prior to the strike that this might occur: “if you kick artists off a playground,” he wrote, “don’t be surprised if they make sandcastles at a new sandbox.”<sup>40</sup>

Consider the website Strike TV. Strike TV was originally created to promote videos about the writers’ strike,<sup>41</sup> but soon CEO Peter Hyoguchi determined this would be “a great opportunity for a great section of Hollywood to take control of their own careers, create their own stories, own their content and have complete freedom for the first time.”<sup>42</sup> Today, Strike TV is an online network featuring HD web videos from well-known Hollywood creators.<sup>43</sup> The talent behind its more than 40 web series come from popular shows including *The Office*, *The Daily Show with John Stewart*, *Saturday Night Live*, *Friends*, *Malcolm in the Middle*, *Star Trek* and *The Wire*, just to name a few.<sup>44</sup> The talent has complete creative freedom and takes home 60% of revenues<sup>45</sup> (compare to the 2008 WGA MBA which guarantees writers 1.2% of distributor’s new media gross receipts<sup>46</sup>).

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<sup>38</sup> Michael Cieply, *Both Sides in Writers’ Strike See New-Media Future at Stake*, N.Y. TIMES, Dec. 1, 2007, available at <http://www.nytimes.com/2007/12/01/business/media/01strike.html>.

<sup>39</sup> Kevin Morris, *Hollywood Showdown*, WALL ST. J., May 16, 2007 at A20, available at <http://online.wsj.com/article/SB117928334751004441.html>.

<sup>40</sup> *Id.*

<sup>41</sup> Mark Madler, *New Media Ventures Not Making Piles of Money, Yet*, SAN FERN. V.L. BUS. J., Vol. 13, Issue 18, Sept. 1, 2008.

<sup>42</sup> *Id.*

<sup>43</sup> Press Release, Market Watch, *Strike.TV Launches Largest Web Network of Original Hollywood Shows*, Oct. 28, 2008, available at <http://www.marketwatch.com/news/story/Strike-TV-Launches-Largest-Web-Network/story.aspx?guid={2909C8C4-1CA4-4860-8BA4-06D1A88E2BDF}>.

<sup>44</sup> *Id.*; see also Madler, *supra* note 41.

<sup>45</sup> Jamison Tilsner, *Strike.TV Launches with Thunder*, TILZY.TV, Oct. 28, 2008, <http://www.tilzy.tv/striketv-launches-with-thunder.htm>.

<sup>46</sup> Writers Guild of America, *Original Programs Made for New Media Fact Sheet*, <http://www.wga.org/uploadedfiles/contracts/NewMediaOriginal.pdf>. It should be noted that AMPTP contracts generally involve substantial upfront fees, while Strike TV and other online distribution sites generally do not.

Plenty of other professionals have followed suit, seeking to bypass the Hollywood system and directly distribute their content online (so called “super-distribution”<sup>47</sup>). Their initiatives include sites backed by well-known talent, such as Funny or Die (actor Will Ferrell and director Judd Apatow), Jackson Bites (director Doug Liman) and South Park Studios (creators Matt Stone and Trey Parker),<sup>48</sup> and aggregated online network sites like Revision3, College Humor, Indie Flix, My Damn Channel or Next New Networks. All this indicates that not only is there a massive amount of content available on the web, but a lot of that content is good. Hollywood faces competition not just from amateurs armed with an HD home video camera, but, more alarmingly, from the very talent they employ.<sup>49</sup>

Strike TV’s Hyoguchi describes the loss of network control on his blog:

“Working as a [creative in the entertainment] industry is much like the game of musical chairs. There are only a handful of scripted TV shows in production at any one time, and the same goes for feature films. In fact, only 5% of Hollywood professionals are working at any one time. Most of the time, we are going round in circles trying to find a chair before the music stops. Movies and TV shows cost millions of dollars and there are only so many slots. Until now.”<sup>50</sup>

Now there are an unlimited number of “slots,” so the remaining 95% of Hollywood professionals can work almost as often as they would like. For the first time, the creators, rather than Hollywood, are beginning to dictate what content gets made and who makes it. Just as digital technologies once placed control of distribution in the hands of the consumer, digital technologies are now placing control of content in the hands of the creator. Hollywood thus foresees its control of content waning as independent professional content flourishes on the web.

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<sup>47</sup> “Super-distribution” or “super-syndication” is when the creator of media content becomes her own distributor, either because the content resides on a P2P system or is distributed by some other viral mechanism, thus bypassing traditional distribution and syndication channels.

<sup>48</sup> Matt Stone and Trey Parker’s site SouthParkStudios.com is a joint venture with Comedy Central in which revenues are split 50/50.

<sup>49</sup> Additionally, Hollywood faces competition from independent digital studios, some backed by Hollywood insiders like Agility (Fremantle), Vuguru (former Disney CEO Michael Eisner) and Media Rights Capital (Endeavor Talent Agency, employing talents like *Family Guy* creator Seth MacFarlane).

<sup>50</sup> Peter Hyoguchi, *Hollywood Renaissance*, STRIKE TV, Oct. 27, 2008, <http://www.strike.tv/blogs/peterh>.

### E. *Fragmented Audiences and Declining Revenues*

Thanks to digital technologies, there is a vast amount of content available for consumers on multiple distribution platforms. With more choices than ever before, audiences are fragmenting. Consumers once watched all of their home entertainment on television, but now they have a choice of three separate screens: the television screen, the computer screen and the mobile phone screen. Fragmented audiences mean advertisers have to spread their advertising dollars across all three of those screens to reach the same people they used to reach on one. Thus, fewer advertising dollars are now being spent on television, and decreasing advertising revenue spells trouble for the networks.

We have seen there is now a vast amount of content available for audiences, but what about demand? Time is a valuable commodity, and most of us spend a set number of hours each week engaging in leisure activity. Logic tells us, then, that demand should remain relatively constant. However, there is strong evidence that as the supply of entertainment increases, demand increases as well. A Nielsen Media study published in November 2008 found that television use is at an all-time high, while internet use also continues to increase (in fact, the study found 31% of television and internet use happens simultaneously).<sup>51</sup> So rather than cannibalizing television, online content may be additive, which is good news for the networks.

Unfortunately, while overall TV viewership is up, the networks are capturing a shrinking percentage of viewers, who increasingly spread their attention over hundreds of available cable channels. Primetime network viewership has declined by 49% in the past twenty years,<sup>52</sup> and the networks lost 7% of their audience in the fourth quarter of 2008 alone.<sup>53</sup>

Decreased viewership has been accompanied by decreased advertising revenues. Network television ad spending decreased 3.5% in

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<sup>51</sup> Press Release, Nielsen Media Research, Americans Can't Get Enough of their Screen Time (Nov. 24, 2008), available at <http://www.nielsenmedia.com/nc/portal/site/Public/menu.item.55dc65b4a7d5.adff3f65936147a062a0/?vgnnextoid=e6db9c9ba2ecd110VgnVCM100000ac0a260aRCRD>.

<sup>52</sup> Bill Gorman, *Updated: Where Did the Primetime Broadcast Audience Go?*, TV BY THE NUMBERS, NIELSEN MEDIA, Dec. 3, 2008, <http://tvbythenumbers.com/2008/12/03/updated-where-did-the-primetime-broadcast-audience-go/9079>.

<sup>53</sup> Tim Arango, *Broadcast TV Faces Struggle to Stay Viable*, N.Y. TIMES, Feb. 27, 2009, available at [http://www.nytimes.com/2009/02/28/business/media/28network.html?pagewanted=1&\\_r=1](http://www.nytimes.com/2009/02/28/business/media/28network.html?pagewanted=1&_r=1).

2008<sup>54</sup> and forecasts indicate a 10% decrease in 2009.<sup>55</sup> In the third quarter of 2008, Fox's ad revenues were down 22%, and CBS and ABC were both down 12%, even with political advertising.<sup>56</sup> These numbers will only get worse in the near future: the troubled auto industry represents the largest advertising category for network television<sup>57</sup> and the economic recession has brought about dramatic declines in the value of primetime spots.<sup>58</sup>

Interestingly, while overall television viewership is up, total advertising revenues for television are falling. According to the Television Bureau of Advertising, total spot TV revenues were expected to decline 7.1% in 2008 and are expected to fall an additional 7-11% in 2009.<sup>59</sup> This amounts to a three to five billion dollar loss for the industry. As Diane Mermigas of MediaPost writes, "non-digital advertising is plummeting."<sup>60</sup> This is due in part to commercial-skipping through time-shifting devices (29% of homes now have DVR and time-shifted TV viewing is up 33% from the previous year<sup>61</sup>) and in part to the three-screen phenomenon.<sup>62</sup>

Television viewership may be up slightly, but it is the other two screens – internet and mobile – where viewership is surging. A worldwide study by IBM showed that 76% of consumers watch video on their personal computer, up 27% from last year, and that 32% watch video on a mobile device, up a remarkable 45%.<sup>63</sup> A significant por-

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<sup>54</sup> News Release, The Nielsen Company, U.S. Ad Spending Fell 2.6% in 2008, Nielsen Reports, (Mar. 13, 2009), available at <http://blog.nielsen.com/nielsenwire/wp-content/uploads/2009/03/nielsen2008adspend-release.pdf>.

<sup>55</sup> Diane Mermigas, *Reality Check for Sustainable Business Models*, MEDIA POST, Feb. 16, 2009, [http://www.mediapost.com/publications/?fa=Articles.showArticle&art\\_aid=100328](http://www.mediapost.com/publications/?fa=Articles.showArticle&art_aid=100328).

<sup>56</sup> Diane Mermigas, *Great (Media) Depression Looms*, MEDIA POST, Nov. 10, 2008, [http://www.mediapost.com/publications/?fa=Articles.showArticle&art\\_aid=94411&art\\_type=3](http://www.mediapost.com/publications/?fa=Articles.showArticle&art_aid=94411&art_type=3).

<sup>57</sup> Brian Stetler, *Low Ratings End Show and a Product Placement*, N.Y. TIMES, Nov. 14, 2008, available at <http://www.nytimes.com/2008/11/14/business/media/14adco.html?ref=business>.

<sup>58</sup> The average cost of a thirty-second primetime fell by 15% to approximately \$122,000 in the fourth quarter of 2008. See Arango, *supra* note 52.

<sup>59</sup> Press Release, Television Bureau of Advertising, TVB Revises 2009 Forecast (Nov. 11, 2008), available at [http://www.tvb.org/about/revised\\_forecast.aspx](http://www.tvb.org/about/revised_forecast.aspx). These numbers were adjusted to account for the weakening economy. Prior to the downturn total spot TV revenues were forecasted at 2.5% in 2008 and 8% in 2009.

<sup>60</sup> Mermigas, *Great (Media) Depression Looms*, *supra* note 55.

<sup>61</sup> Nielsen, *A2/M2 Three Screen Report (Fourth Quarter 2008)*, available at [http://www.nielsen-online.com/downloads/3\\_Screens\\_4Q08\\_final.pdf](http://www.nielsen-online.com/downloads/3_Screens_4Q08_final.pdf).

<sup>62</sup> The significant drop in ad revenue is also related to the economic downturn, but figures show TV ad revenues were already in steady decline. See Press Release, Television Bureau of Advertising, *supra* note 59.

<sup>63</sup> Press Release, IBM, *IBM Study Shows Consumers Will Accept New Forms of Advertising If Companies Follow Their Rules* (Nov. 17, 2008), available at <http://www-03.ibm.com/press/us/en/pressrelease/26077.wss>.

tion of those videos are full-length television episodes. A Nielsen study for the Cable & Telecommunications Association for Marketing (CTAM) found that 35% of all broadband users in the U.S. have watched at least one television program originally broadcast on TV via the internet.<sup>64</sup> An Integrated Media Measurement Inc. (IMMI) study found that 20% of TV viewers watch some amount of primetime programming online regularly, 50% as a substitute for television and 50% to watch past television programming they had missed.<sup>65</sup>

What about the networks' hope that online content is additive, rather than cannibalizing? According to a study by Magid Advisors, of the 92% of internet users who engage in some form of online entertainment, 35% claim they are watching less television as a result.<sup>66</sup> The IBM and IMMI studies support these results. As further evidence viewers are moving to the web, consider NBC's comedy *The Office*. When the fifth season premiered in September 2008, 15.4 million viewers watched the broadcast, while a remarkable 6.9 million streamed the show online.<sup>67</sup> So many *Gossip Girl* fans showed up online to watch the last season they almost crashed the CWTV website.<sup>68</sup> On top of all this, cyberspace abounds with anecdotal reports of cable-cancellers, such as when Digg CEO Kevin Rose announced via Twitter he was cancelling his cable and TiVo services in favor of web-based TV platforms.<sup>69</sup> There are even websites such as CancelCable.com and NoMoreTV.com dedicated to the cause, and research indicates that young cable subscribers may pinch pennies during the economic downturn by cancelling their cable service, since TV shows and other en-

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<sup>64</sup> Press Release, Nielsen Media, TV Websites Grow More Popular, but Viewers Still Prefer Their TV Sets, According to Nielsen and CTAM (June 30, 2008), available at [http://www.nielsen.com/media/2008/pr\\_080630.html](http://www.nielsen.com/media/2008/pr_080630.html).

<sup>65</sup> *TV Viewers Migrating to Web for Primetime Programming*, SEEKING ALPHA, July 29, 2008, <http://seekingalpha.com/article/87696-tv-viewers-migrating-to-web-for-primetime-programming>.

<sup>66</sup> Jacqueline Emigh, *Analysts: Consumers Drop TV, Turn to Internet for Entertainment*, BETA NEWS, Nov. 25, 2008, [http://www.betanews.com/article/Analysts\\_Consumers\\_drop\\_TV\\_turn\\_to\\_Internet\\_for\\_entertainment/1227631850](http://www.betanews.com/article/Analysts_Consumers_drop_TV_turn_to_Internet_for_entertainment/1227631850).

<sup>67</sup> Streams are not counted equally because NBC.com counts each segment as a separate stream. However, even if half the streams came from NBC.com, the full episode was viewed an impressive 4 million times online. See Brian Stetler, *Serving Up Television Without the TV Set*, N.Y. TIMES, Mar. 10, 2008, available at <http://www.nytimes.com/2008/03/10/technology/10online.html>.

<sup>68</sup> Laura Holson, *Who Needs a TV? I'm Watching on a Laptop*, N.Y. TIMES, Dec. 3, 2008, [http://www.nytimes.com/2008/12/04/technology/personaltech/04basics.html?\\_r=2&scp=2&sq=television&st=cse](http://www.nytimes.com/2008/12/04/technology/personaltech/04basics.html?_r=2&scp=2&sq=television&st=cse).

<sup>69</sup> Betsy Schiffman, *The Revolution Will Not Be Televised – But It Will Be Streamed Online*, EPICENTER, WIRED, Nov. 03, 2008, <http://blog.wired.com/business/2008/11/the-revolution.html>.

tertainment are available online.<sup>70</sup> So much for online content being additive – it is clearly cannibalizing TV viewership.

Needless to say, the inroads have been most remarkable among younger generations. A study by LiveRail reports that 18-24 year olds now spend more time watching internet-distributed video than broadcast television,<sup>71</sup> while a study released by Magna Global shows the average live median age (i.e. not including DVR viewership) of network programming viewers is now 50 years old, a number outside the networks' target 18-49 demographic.<sup>72</sup> This is the oldest average live median age in the decade Magna Global has been conducting the study, a clear indication that "traditional television is no longer necessarily the first screen for the younger set."<sup>73</sup>

But demographics for internet-TV viewing are broader than one might think. An October 2008 Nielsen study found that 23% of viewers ages 34-54 watched a television episode online in the first three months of 2008.<sup>74</sup> In the Magid Advisors report mentioned above, both males and females between 55 and 64 – the oldest age bracket studied – preferred TV to the internet for entertainment, but only by 4%.<sup>75</sup>

So where has the dwindling television advertising revenue gone? To the internet, of course. Internet video advertising is growing rapidly. Online video ad spending totaled \$734 million in 2008, and analysts expect it to reach \$1 billion in 2009.<sup>76</sup> With a slowing economy, overall ad spending in the U.S. is expected to decline in 2009,<sup>77</sup> while online video advertising is expected to grow by 45%.<sup>78</sup> Unsurprisingly, advertising dollars are following consumers, who have fragmented across the three screens and the infinity of the web.

The networks capture a significant portion of the online video ad revenue when they place their content online. Advertisers clearly pre-

<sup>70</sup> Solutions Research Group, Consumer View: Impact of a Downturn on the Entertainment & Communications Sector (Oct. 24, 2008), available at [http://blog.wired.com/business/files/impact\\_of\\_downturn\\_on\\_ec\\_srgus\\_f1.pdf](http://blog.wired.com/business/files/impact_of_downturn_on_ec_srgus_f1.pdf).

<sup>71</sup> LiveRail, State of the Industry, Q4 2008 Report, available at [http://www.liverail.com/Downloads/Q4\\_2008\\_State\\_of\\_the\\_Industry.pdf](http://www.liverail.com/Downloads/Q4_2008_State_of_the_Industry.pdf).

<sup>72</sup> Michael Schneider, *TV Viewers' Average Age Hits 50*, VARIETY, June 29, 2008, available at <http://www.variety.com/article/VR1117988273.html?categoryid=14&cs=1>.

<sup>73</sup> *Id.*

<sup>74</sup> Stetler, *Serving Up Television*, *supra* note 66.

<sup>75</sup> Emigh, *supra* note 66.

<sup>76</sup> Brian Stetler, *Hulu Questions Count of its Audience*, N.Y. TIMES, May 15, 2009, available at [http://www.nytimes.com/2009/05/15/business/media/15nielsen.html?\\_r=1](http://www.nytimes.com/2009/05/15/business/media/15nielsen.html?_r=1).

<sup>77</sup> See Toni Fitzgerald, *Latest Ad Forecast: From Bad to Worse*, MEDIA LIFE MAG., Mar. 31, 2009, available at [http://www.medialifemagazine.com/artman2/publish/Media\\_economy\\_57/Latest\\_ad\\_forecast\\_From\\_bad\\_to\\_worse.asp](http://www.medialifemagazine.com/artman2/publish/Media_economy_57/Latest_ad_forecast_From_bad_to_worse.asp).

<sup>78</sup> Press Release, eMarketer, Numbers Show Decline in TV Ad Spending (Jan. 27, 2009), <http://www.emarketer.com/Article.aspx?id=1006900>.



fer placement beside premium content over UGC. A study by The Diffusion Group found that UGC generated 42% of streams but only 4% of online video revenue while professional online video accounted for 58% of streams and 96% of revenue.<sup>79</sup> 41.6% of total streams were long-form content, Hollywood's primary domain.<sup>80</sup>

But many people question whether revenues from online advertising can ever match television numbers. Few media companies publish statistics about digital advertising revenues, which leads some analysts to believe that the numbers must be embarrassingly low.<sup>81</sup> U.S. broadcast television advertising was worth \$46.6 billion in 2007, while online video ad revenue was just \$471 million.<sup>82</sup> There is serious concern in the industry that internet viewers will never be worth more than a fraction of their television counterparts. As Quincy Smith, president of CBS Interactive, has said, "The four and a half billion we make on broadcast is never going to equate to four and a half billion online."<sup>83</sup> For NBC Universal CEO Jeff Zucker, the fear is that the networks are trading "analog dollars for digital pennies."<sup>84</sup>

John Malone, chairman of Liberty Media and DirectTV, warned television networks in an interview with the *Financial Times* that ad-supported online models were "doomed to fail."<sup>85</sup> Ad-supported models pay no upfront fees and preclude the networks from experimenting with more lucrative subscription or pay-per-view models.<sup>86</sup> But the networks have little choice. Consumers are in control. They want what they want, when they want it, and they will find a way to get it online, legally or otherwise. The only way the networks can curb piracy is by

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<sup>79</sup> Liz Gannes, *Report: User-Gen to Only Ever Account for 4% of Video Revenue*, NEWTEEEVEE, July 10, 2008, <http://newteevee.com/2008/07/10/report-user-gen-to-only-ever-account-for-4-of-video-revenue/>.

<sup>80</sup> *Id.*

<sup>81</sup> Liz Gannes, *Will Digital Revenue Ever Replace What It's Displacing?*, NEWTEEEVEE, July 8, 2008, <http://newteevee.com/2008/07/08/will-digital-revenue-ever-replace-what-its-displacing/>.

<sup>82</sup> *Id.*

<sup>83</sup> Stetler, *Serving Up Television*, *supra* note 66.

<sup>84</sup> *Id.* Zucker recently amended this quote at the 2009 Media Summit when he announced "I think we're at digital dimes now. We've made some progress, but there's still a long way to go from those dimes to dollars." See Lacey Rose, *Zucker on the Media*, FORBES.COM, Mar. 18, 2009, <http://www.forbes.com/2009/03/18/jeff-zucker-nbc-cnbc-jon-stewart-business-media-zucker.html>.

<sup>85</sup> Jonathan Soble, *Malone Gives Poor Reception to Free Online TV*, FIN. TIMES, June 20, 2008, [http://www.ft.com/cms/s/0/67e0a1e2-3eed-11dd-8fd9-0000779fd2ac.html?nclick\\_check=1](http://www.ft.com/cms/s/0/67e0a1e2-3eed-11dd-8fd9-0000779fd2ac.html?nclick_check=1).

<sup>86</sup> *Id.*

luring users to watch the content legally in a venue where, at the very least, the rightful owner can sell advertising space.<sup>87</sup>

Subscription or pay-per-view services are unlikely to work in any case. Content has been so devalued in the marketplace that consumers are no longer willing to pay. In his article, *Hollywood Under Siege*, entertainment attorney Jonathan Handel gives six reasons, in addition to piracy, why content has lost its value, including: the vast supply available, the loss of physical form, declining transaction costs, ad-supported models, market forces in the technology industry (traditional media companies adapt slower than others, leading to a reduced market share), and a generation of users hostile to copyright law.<sup>88</sup> Indeed, IBM's study found that 70% of consumers prefer their entertainment free.<sup>89</sup>

#### F. *Ugly Town*

Network television's problems have not gone unnoticed in the business community. TiVo CEO Tom Rogers recently predicted the demise of the television network in a letter to shareholders when he wrote, "easy commercial avoidance in the next two to three years will create such an overwhelming challenge to the economics of television that it will rock the very foundation of the industry. It may well make what the newspaper industry is going through today seem like a minor tremor by comparison."<sup>90</sup> With similar sentiment, financial analysts downgraded the entertainment industry as a whole and slashed forecasts for major companies based on the digital threat to traditional profit models. As Barclay Capital's Anthony DiClemente explained, "[The shift] from physical to digital will disrupt the marginal economics of the TV and movie businesses, just as it did for music."<sup>91</sup> Network television is already underperforming GDP at the highest rate in five decades,<sup>92</sup> and, based on DiClemente's predictions, Hollywood will be making far less in the future. He predicts sales from movies and TV shows will hit \$5.8 billion by 2015, down from \$17.5 billion in 2007.<sup>93</sup>

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<sup>87</sup> *Id.*

<sup>88</sup> Handel, *supra* note 7.

<sup>89</sup> Press Release, IBM, *supra* note 63.

<sup>90</sup> Betsy Schiffman, *TiVo CEO Sees the Demise of Network TV*, EPICENTER, WIRED, July 01, 2008, <http://blog.wired.com/business/2008/07/tivo-warns-of-d.html>.

<sup>91</sup> Ryan Nakashima, *Digital Threat Prompts Movie Industry Downgrade*, ASSOCIATED PRESS, July 9, 2008.

<sup>92</sup> Betsy Schiffman, *And Another Reason TV Networks Are Screwed: The Credit Crisis*, EPICENTER, WIRED, Oct. 14, 2008, <http://blog.wired.com/business/2008/10/yet-another-rea.html>.

<sup>93</sup> Gannes, *Will Digital Revenue*, *supra* note 81.

Bernstein Research recently created profit and loss statements for a mythical television company based on 40% margins (which the networks are nowhere near). Assuming a 10% decline in revenues and a 3% decline in costs over the next two years, earnings would plummet 39% and margins would collapse.<sup>94</sup>

This all spells bad news for network television. With intense competition from distributors and content creators, as well as fragmented audiences and rapidly declining revenues, it is questionable whether the economics of the television industry are sustainable. Betsy Schiffman of *Wired* says it best: “the networks are entering Ugly Town.”<sup>95</sup>

### III. TV/INTERNET CONVERGENCE

#### A. *TV/Internet Convergence: What it is and Why it Matters*

TV/Internet convergence is the technological convergence of television and computer capability into one device. With convergence technology, we will be able surf the web and stream internet video on our TV screens. When convergence technology reaches a tipping point – when there is adoption of the technology by a significant portion of entertainment consumers – it will mark a watershed moment for the television business.

No one questions that revolutions in digital technology have placed network television in a precarious position. But for all the media rhetoric harkening the end of television as we know it, the networks are still in control. Nielsen studies show that 94% of adult cable or satellite subscribers prefer to watch home entertainment on a proper television set rather than on their computer screen.<sup>96</sup> Cable subscriptions grew by 441,000 in the fourth quarter of 2008, even in the face of an economic recession.<sup>97</sup> Even though networks have seen their revenues slipping and their sources of income changing form, for the most part, consumers are still watching television.

The reason consumers are still watching television is because television is comfortable. When we come home from a long day sitting upright at a desk, staring at a computer screen in the office, we don't want to come home and do that again. We prefer sprawling out on our comfortable couches, passively flipping through channels on our giant

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<sup>94</sup> Diane Mermigas, *Downturn is Time to Revamp Traditional Business Models*, MEDIA POST, Nov. 14, 2008, [http://www.mediapost.com/publications/?fa=Articles.showArticle&art\\_aid=94761](http://www.mediapost.com/publications/?fa=Articles.showArticle&art_aid=94761).

<sup>95</sup> Schiffman, *And Another Reason*, *supra* note 92.

<sup>96</sup> Press Release, Nielsen Media, *supra* note 64.

<sup>97</sup> Carol Wilson, *Video Cord-Cutting? Not So Much*, TELEPHONY ONLINE, Feb. 20, 2009, <http://telephonyonline.com/video/news/pay-tv-service-sales-0220/>.

plasma HD screens. This is why the average length of the nearly 12 billion videos we watched online in the U.S. during November 2008 was only 3.1 minutes long.<sup>98</sup> Hence, we're still watching television.

TV/Internet convergence will change that.

Once convergence occurs, the distinction between television and "new media" will be obsolete – it will all simply be video.<sup>99</sup> There will be no distinction for consumers between the television screen or the computer screen, the couch or the desk chair, channel surfing or web surfing. If there is nothing we want to watch on the networks or cable, we will have infinitely more choices to browse online. We will be able to watch the Superbowl on our fifty inch plasma TVs and screen YouTube videos at halftime. At some point a web series, created independent of the networks, will become a huge hit and advertisers will flock. Online content will finally be successfully monetized.<sup>100</sup> As Strike TV's Hyoguchi says, "Right now, the internet is where television was before its first hit. Cynics were saying TV is a fad. A gimmick. There's no money to be made in TV. Then *Howdy Doody* became the first smash hit and a whole economy was created around TV."<sup>101</sup> When this happens in web video the networks will find themselves in something far more perilous than the "Ugly Town" where they now reside.

## B. *On the Verge*

TV/Internet convergence has not yet caught on in the general consumer marketplace, but there are scores of varying convergence technologies being developed, branded and sold as of this writing. Simply log on to any tech blog and it becomes clear that convergence is on the verge of mass adoption. The following is a sampling of some of the convergence technologies currently available.

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<sup>98</sup> Press Release, comScore, Americans View 34 Percent More Online Videos in November 2008 Compared to Year Ago, Jan. 5, 2009, available at <http://www.comscore.com/press/release.asp?press=2660>.

<sup>99</sup> For the digerati, this distinction no longer exists. Both UGC, content developed for film and television, and new media are all considered "electronically transmitted content" or "ETC." See Bruce Rosenblum, President, Warner Brothers Television Group, Keynote Address at the Future of Television Conference (Feb. 26, 2008), available at <http://www.web2point0.tv/video.php?id=57>.

<sup>100</sup> There have already been internet "hits" such as Joss Whedon's *Dr. Horrible's Sing Along Blog* starring Neil Patrick Harris. This indicates the content is already in place and the technology must achieve more widespread adoption in order for the content to be successfully monetized. On the other hand, critics argue the web has failed to generate hits with any consistency. See Dan Frommer, *Original Web Video Still a Bust*, SILICON ALLEY INSIDER, May 11, 2009, <http://www.businessinsider.com/original-web-video-still-a-bust-2009-5>.

<sup>101</sup> Hyoguchi, *supra* note 50.

## 1. Set-Top-Box Technology

A set-top box (STB) is a device that connects to an external signal and converts the signal into content that can be displayed on the television screen.<sup>102</sup> One of the first TV/internet convergence STBs was a product called WebTV that went on the market in 1996.<sup>103</sup> The company had 150,000 subscribers before being bought out by Microsoft in 1997 and rebranded as MSN TV, a product which, while not very popular, can still be purchased today.<sup>104</sup>

Other currently available STBs, which allow varying amounts of internet connectivity, include Roku's Netflix Player, Microsoft's Xbox 360, the AppleTV, Sony's PlayStation 3, Blockbuster's MediaPoint Box, the LG BD300 Blu-Ray Player, Nintendo Wii's BBC iPlayer, the VUDU Box, Digeo, Moxi, the Sage TV HD Theatre, TiVo and the Hollywood-financed ZillionTV.<sup>105</sup> There are so many similar STB options on the market that, as one blogger aptly quipped, "Choice will soon be the new black."<sup>106</sup> Most of these are closed systems that do not have web browsing capabilities and only allow streaming from partner sites, such as YouTube, Netflix's media server or Amazon's Unbox Video on Demand (VoD) service. In addition to limited streaming services, some STBs will play any media stored in a local media server (e.g., iTunes).<sup>107</sup> Another drawback is that many STBs lack the capability to play HD content and/or do not support surround sound.

The SlingCatcher is a different kind of STB developed by Sling Media, creator of the place-shifting SlingBox.<sup>108</sup> While the SlingBox receives content from a television and displays it on a computer, the SlingCatcher captures whatever is being shown on a network PC and slings it to the television set.<sup>109</sup>

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<sup>102</sup> Wikipedia.org, Set-top Box, [http://en.wikipedia.org/wiki/Set\\_top\\_box](http://en.wikipedia.org/wiki/Set_top_box) (last visited Nov. 24).

<sup>103</sup> Wikipedia.org, MSN TV, [http://en.wikipedia.org/wiki/MSN\\_TV](http://en.wikipedia.org/wiki/MSN_TV) (last visited Dec. 5, 2008).

<sup>104</sup> *Id.*

<sup>105</sup> Disney, NBC Universal, Sony Pictures Television and Warner Brothers Digital Distribution are equity partners in ZillionTV. See ZillionTV, About ZillionTV, <http://www.zilliontv.tv/about-zilliontv/> (last visited Mar. 17, 2009).

<sup>106</sup> Dave Parrack, *Blockbuster MediaPoint Joins Crowded Set-Top Box Market – Blu-Ray Should Just Give Up Now*, WEB TV WIRE, Nov., 29, 2008, <http://www.webtvwire.com/blockbuster-mediapoint-joins-crowded-set-top-box-market-blu-ray-should-just-give-up-now/>.

<sup>107</sup> Randall Bennett, *Ditch Your Cable Box: Stream Internet Video to the Living Room*, OBSESSABLE, <http://www.observable.com/feature/ditch-your-cable-box-stream-internet-video-to-the-living-room/>.

<sup>108</sup> *Id.*

<sup>109</sup> *Id.*

Perhaps the most exciting brand in the STB category is Boxee. Boxee is a third-party software solution based on the XBMC open-source project, currently in alpha testing.<sup>110</sup> This software connects internet-connected devices to television sets, allowing users to watch and share media stored on the computer, and to share stored media via P2P networks. The alpha version already allows streaming from sites like Netflix, YouTube, MTV Music, CNN, CBS and Comedy Central, to name a few. As of this writing Boxee can be hacked onto Mac and Linux processors and AppleTV, and the company plans to release a Microsoft Windows version as well as their own STB in 2009.<sup>111</sup> The software is popular among the digerati and has received significant venture capital.<sup>112</sup> However, questions have arisen about the service's long-term viability since content providers required Boxee to remove Hulu from its service.<sup>113</sup>

## 2. STB Bypass Technology

STB Bypass technologies aim to bring the computer to television without the need for a set-top box.<sup>114</sup> GridNetwork's GridCastTV is one such service that allows content owners to deliver video directly to the TV set without a user STB or a portal like YouTube or Hulu.<sup>115</sup> A user can install the GridCastTV plug-in on her computer, which connects to the television's universal plug and play device, available either through an STB or an internet-enabled television. GridCastTV has already made deals with content providers such as Revision3, IndieFlix and havocTV, all of which can now directly distribute their content to

<sup>110</sup> Wikipedia.org, Boxee, <http://en.wikipedia.org/wiki/Boxee> (as of Mar. 17, 2009).

<sup>111</sup> *Id.*

<sup>112</sup> Kathleen Flynn, *Union Square, Spark Capital Back Media Center Software Maker Boxee*, THE DEAL, Nov. 18, 2008, <http://www.thedeal.com/techconfidential/behind-the-money/blog/behind-the-money/union-square-spark-capital-bac.php>.

<sup>113</sup> See Elizabeth Holmes, *Hulu Withdraws its Content from TV.com, Boxee*, DIGITS, WALL ST. J., Feb. 19, 2009, <http://blogs.wsj.com/digits/2009/02/19/hulu-withdraws-its-content-from-tvcom-boxee/>. Both Hulu and YouTube have launched web-based applications for enhanced web viewing, theoretically to compete with Boxee. However, it is unlikely either application will accelerate TV/internet convergence directly. Hulu expressly prohibits use of its desktop application on a television screen, and YouTube's web browser has not been developed for TV-specific implementation. See Om Malik, *So That's Why Hulu Hates Boxee*, GIGAOM, May 28, 2009, <http://gigaom.com/2009/05/28/so-thats-why-hulu-hates-boxee/>; Liz Gannes, *YouTube XL: The Living Room Model Gets Delayed*, NEWTEEVEE, June 2, 2009, <http://newteevee.com/2009/06/02/youtube-xl-the-living-room-remodel-gets-delayed/>.

<sup>114</sup> Richard Siklos, *Apple TV and the Death of the Cable Set-top Box*, FORTUNE MAG., May 30, 2008, available at [http://money.cnn.com/2008/05/30/technology/siklos\\_appletv.fortune/index.htm](http://money.cnn.com/2008/05/30/technology/siklos_appletv.fortune/index.htm).

<sup>115</sup> Paul Sweeting, *GridNetworks Goes Over the Top of Everyone*, CONTENT AGENDA, Nov. 17, 2008, <http://www.contentagenda.com/article/CA6615364.html?industryid=45173>.

consumers without a single product-specific vendor or distribution deal in place.<sup>116</sup> According to GridNetworks CEO Tony Naughton, there are already 35 million television sets in homes ready to use this technology.<sup>117</sup> Interestingly, because the content owner does not have to secure a distribution deal, she retains complete control over revenue streams.<sup>118</sup>

### 3. Internet Enabled Television Sets

Internet-enabled television sets have networking connections built directly into the set, requiring no additional STB for online access.<sup>119</sup> Most major electronics manufacturers, including Sony, Panasonic, Philips, Vizio and LG, plan to release an internet-enabled television set in 2009. Although manufacturers have deals in place with services like YouTube and Netflix, like STBs, the systems are closed. Despite this fact, internet-enabled televisions are expected to make a huge impact in the consumer market. One estimate shows that 14% of televisions sold will be internet-enabled by 2012,<sup>120</sup> increasing to 100% by 2015.<sup>121</sup>

### 4. Home Theatre PC

A home theater PC is a single convergence device which plugs into a television set and serves as an all-in-one media player, DVR, cable box and web browser.<sup>122</sup> Examples include the MacMini, Microsoft's Media Center PC and the Intel Viiv. Due to mediocre technologies and the subsequent rise of STBs, the home theatre PC is largely considered a dead technology.<sup>123</sup> However, flat-panel wide-screen LCD computer monitors such as Apple's 24-inch Cinema Display, which are now making their way into the consumer marketplace, may indicate a second coming.<sup>124</sup>

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<sup>116</sup> *Id.*

<sup>117</sup> *Id.*

<sup>118</sup> *Id.*

<sup>119</sup> Nick Wingfield, *Internet-Ready TVs Usher Web Into Living Room*, WALL ST. J., Jan. 5, 2009, available at <http://online.wsj.com/article/SB123111603391052641.html>.

<sup>120</sup> *Id.*

<sup>121</sup> Duncan Riley, *By 2015, Every New Television Will Be Internet Enabled*, THE INQUISITR, Sep. 1, 2008, <http://www.inquisitr.com/2799/by-2015-every-new-television-will-be-internet-enabled/>.

<sup>122</sup> See Nate Anderson, *Opinion: The HTPC is Dead, Long Live the HTPC*, ARS TECHNICA, July 27, 2008, <http://arstechnica.com/news.ars/post/20080727-opinion-the-htpc-is-dead-long-live-the-htpc.html>.

<sup>123</sup> *Id.*

<sup>124</sup> Sonia Zjawinski, *Using Your Computer Screen as a Television*, GADGETWISE, N.Y. TIMES, Apr. 30, 2009, <http://gadgetwise.blogs.nytimes.com/2009/04/30/using-your-computer-screen-as-a-television/>.

## 5. Internet Protocol Television

Internet Protocol Television (IPTV) is the transmission of video and audio over a combination of fiber and DSL lines using internet protocol.<sup>125</sup> While cable is a one-way broadcast system, IPTV is essentially a two-way system. Rather than receiving a constant stream sent by the broadcaster, each subscriber gets only the video/audio stream she specifically selects using her remote control. The companies offering this service, including Verizon's FiOS TV and AT&T's U-verse, hope that both advertisers and consumers find the service superior to cable. They believe advertisers may find the system superior because the individualized streams introduce an opportunity for targeted marketing not possible on a one-way system. They hope consumers find the system superior because they can enjoy a more interactive viewing experience with advanced search capabilities. Although IPTV is essentially a substitute for traditional cable, some analysts predict IPTV providers will be the first to open their STBs to internet video because their services use the same underlying communication technology.<sup>126</sup> Indeed, FiOS is expected to offer an Internet-on-TV feature in Summer 2009 that will give subscribers access to Veoh, Blip.TV, Facebook and Twitter.<sup>127</sup>

### C. *The Tipping Point*

Clearly there is a plethora of technologies on the verge of making TV/internet convergence a widespread reality. So why has it not happened yet? The first reason is precisely because there are so many competing technologies. No one brand is even close to winning the format war.<sup>128</sup> Another reason may be that there is no universal remote for internet-on-TV viewing that can browse the TV like a mouse, although the Wii-like motion-sensing concept remote by Hillcrest Labs is a good start.<sup>129</sup> Finally, and perhaps most importantly, none of the

<sup>125</sup> Louis Frenzel, *IPTV Makes Channel Surfing More Like Web Surfing*, ELECTRONIC DESIGN, Oct. 9, 2008, <http://electronicdesign.com/Articles/Index.cfm?ArticleID=19833&pg=2>.

<sup>126</sup> Nick Wingfield, *The Internet. The TV.*, WALL ST. J., Dec. 11, 2007, available at <http://online.wsj.com/article/SB119706406734417529.html>.

<sup>127</sup> Todd Spangler, *Next on FiOS: Web Videos On Your Flat-Panel TV*, MULTICHANNEL NEWS, May 13, 2009, available at [http://www.multichannel.com/article/232423-Next\\_On\\_FiOS\\_Web\\_Videos\\_On\\_Your\\_Flat\\_Panel\\_TV.php](http://www.multichannel.com/article/232423-Next_On_FiOS_Web_Videos_On_Your_Flat_Panel_TV.php).

<sup>128</sup> Ross Dawson, *The Convergence of the Internet and TV: How Will it Happen?*, ROSS DAWSON, Dec. 11, 2007, [http://www.rossdawsonblog.com/weblog/archives/2007/12/the\\_convergence.html](http://www.rossdawsonblog.com/weblog/archives/2007/12/the_convergence.html).

<sup>129</sup> Hillcrest Labs has filed a lawsuit for patent infringement against Nintendo. See Priya Ganapati, *Motion Sensing Remote Makes It Easier For Couch Potatoes*, GADGETS, WIRED, Jan. 9, 2009, <http://blog.wired.com/gadgets/2009/01/motion-sensing.html>.



companies competing in the format war have gotten the technology quite right. In a *Wall Street Journal* article entitled “The Internet. The TV.” Nick Wingfield describes set-top boxes as “too complicated, too expensive and too limited in what they can do.”<sup>130</sup> He lists five major reasons the current convergence options haven’t caught on, most notably because the STB’s available are closed systems, offering only a limited selection of internet video options.<sup>131</sup> This is something the on-demand generation just will not accept.

Whichever devices do eventually win out with consumers, TV/internet convergence is a fait accompli. We will soon be converged – it is not a question of if, but when. A tipping point in adoption of this new technology will come, and in the not too distant future. The question is whether network television can find a way to survive long past that seminal moment in entertainment history.

#### IV. HOLLYWOOD’S RESPONSE TO THE DIGITAL THREAT

Hollywood is well aware of the problems it faces. The television industry witnessed the devastating effect digital technologies had on the music industry and is taking many important steps to protect itself from a similar fate. As we have seen, digital technologies have presented five major challenges for the television industry: 1) piracy, 2) loss of distribution control, 3) loss of content control, 4) fragmented audiences, and 5) declining advertising revenue. This section considers the various defensive strategies the networks are pursuing to meet these challenges and prevent their ultimate demise.

##### A. *The Music Industry and the Piracy Problem*

The music industry was essentially dismantled by the rise of digital music files, the advent of the iPod and illegal file-sharing sites like Napster in the late 1990s.<sup>132</sup> Ten years later, the television industry is similarly threatened by BitTorrent technologies that allow the transfer of large video files (i.e. full TV episodes or films) over P2P networks. As noted previously, financial analysts recently downgraded the entertainment industry because they believe the “shift from physical to digital will disrupt the marginal economics of the TV and movie businesses, just as it did for music.”<sup>133</sup>

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<sup>130</sup> Wingfield, *supra* note 127.

<sup>131</sup> *Id.*

<sup>132</sup> Seth Gilbert, *Will the Internet Harm Media’s Major Players?*, SEEKING ALPHA, July 10, 2008, <http://seekingalpha.com/article/84371-will-the-internet-harm-media-s-major-players>.

<sup>133</sup> Nakashima, *supra* note 91.

However, this comparison may be unfair for several reasons. First, music and television are fundamentally different media. Music – dating back to portable radios and walkmans – has always been something people carried with them.<sup>134</sup> Television, by contrast, has long been consumed in a fixed setting, such as the living room or the background of a bar.<sup>135</sup> Secondly, the two industries are built on distinctly different business models. The music industry was primarily a pay-per-copy model that required consumers to purchase an entire album, even when the consumer only wanted one or two songs. This made the industry especially susceptible to the changes brought about by consumer-driven digital technologies. Conversely, television is built on a combination of advertising revenue and syndication deals. Unlike music, network television has long been free for the consumer. Lastly, the television industry has learned from at least some of its sister industry's mistakes. While the music industry largely stuck its head in the sand when confronted with digital file sharing, television companies are actively involved in the evolution of digital entertainment.<sup>136</sup>

Still, piracy does exist in television. There are hundreds of torrent download sites, each offering a healthy sampling of pirated television shows. For example, the notorious Pirate Bay is one of the world's largest facilitators of illegal downloading with a database of over 500,000 movies, TV shows, songs, games and software titles<sup>137</sup> and 25 million unique users.<sup>138</sup> Indeed, an Accenture study of more than 100 entertainment executives showed that 46% believe piracy to be the biggest issue facing their industry.<sup>139</sup>

Fortunately, television has the ability to combat piracy far more effectively than the music industry ever could. Because television is largely ad-supported, television does not have to transform its business model that dramatically; it just has to move online. Television can effectively beat the pirates simply by placing its content online, for free, worldwide, as soon as it becomes available, on a high quality video/audio platform, without overly intrusive commercial interruption.

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<sup>134</sup> Gilbert, *supra* note 133.

<sup>135</sup> *Id.*

<sup>136</sup> *Id.*

<sup>137</sup> David Sarno, *The Internet Sure Loves Its Outlaws*, L. A. TIMES, APR. 29, 2007, available at <http://www.latimes.com/business/la-ca-webscout29apr29,1,4094353.story>.

<sup>138</sup> The Pirate Bay, Wikipedia.org, [http://en.wikipedia.org/wiki/The\\_Pirate\\_Bay](http://en.wikipedia.org/wiki/The_Pirate_Bay) (last visited Mar. 24, 2009).

<sup>139</sup> Accenture, *Beyond the Hype: How New Content and Technology are Redefining the Future of Media* (Dec. 2007), available at [http://www.accenture.com/Global/Research\\_and\\_Insights/By\\_Industry/Media\\_and\\_Entertainment/Entertainment/2007ContentStudy.htm](http://www.accenture.com/Global/Research_and_Insights/By_Industry/Media_and_Entertainment/Entertainment/2007ContentStudy.htm).

This, of course, is no easy task. There are rights issues to overcome, distribution partners to appease, guild resistance to quell and, as always, the perpetual struggle to monetize content in the digital space. However, as consumers move online, the television industry has little choice but to follow suit. And, as the networks wisely pursue this path, placing more and more content in cyberspace, piracy will become an increasingly marginal problem for the television industry.

### B. *Reclaiming Control of Distribution*

In addition to the piracy problem, digital technologies have deprived the networks control over their television distribution business. In response, the networks have focused their business on the catchall “content.” But for all the proselytizing that “content is king,” the network’s primary order of business in defending itself against the internet revolution has been to reclaim control of distribution, either by building or partnering with online distribution outlets.

The most noteworthy story is Hulu.com, an NBC Universal/News Corp (Fox) joint venture founded in March 2007.<sup>140</sup> Hulu is an online video service that allows users to stream current and classic television shows and movies from over 130 content providers for free on an HD video platform.<sup>141</sup> Their mission is to serve the on-demand generation by helping “people find and enjoy the world’s premium video content when, where and how they want it.”<sup>142</sup> By offering popular, current content in the highest quality format, the site has successfully driven remarkable traffic to its site, becoming the second most visited online video site<sup>143</sup> and the third fastest growing site on the web.<sup>144</sup>

More remarkable than the traffic, however, are the company’s advertising revenues. Hulu was on track to earn \$65 million in 2008 and the site is expected to earn \$120 million in 2009.<sup>145</sup> While these ad revenues come nowhere near television numbers, the site is quickly catching up with YouTube, widely considered to be the biggest competitor for any online video site. However, YouTube has had trouble monetiz-

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<sup>140</sup> Hulu.com, About Hulu, <http://www.hulu.com/about> (last visited Mar. 29, 2009).

<sup>141</sup> *Id.*

<sup>142</sup> *Id.*

<sup>143</sup> Nielsen Online, Nielsen Online Provides Topline U.S. Online Video Data for March 2009 (Apr. 13, 2009), available at <http://www.nielsen-online.com/pr/090413.pdf>.

<sup>144</sup> Measured by percentage increase in unique users from September to October 2008. See Press Release, comScore, comScore Media Metrix Ranks Top 50 US Web Properties for October 2008, Nov. 20, 2008, available at <http://www.comscore.com/press/release.asp?press=2593>.

<sup>145</sup> Liz Gannes, *Analyst Hulu to Bring in \$120 Million in '09*, NEWTEEVEE, Mar. 31, 2009, <http://newteevee.com/2009/03/31/analyst-hulu-to-bring-in-120-million-in-09/>.

ing its vast amounts of uncontrolled content (much to the chagrin of Google, who purchased the site for \$1.65 billion in 2006).<sup>146</sup> Hulu's premium content – thought to be a safer vehicle for advertisers – is expected to match YouTube in revenue in 2009, in only its second year of existence.<sup>147</sup>

ABC initially had no equity dealings in the online distribution world (perhaps because Apple iTunes CEO Steve Jobs sits on the board of Disney, ABC's parent company). Its strategy was to lock ABC content exclusively within the “garden walls” of its proprietary distribution platform, ABC.com.<sup>148</sup> However, the network soon rethought this strategy, and in May 2009 became a 27% equity partner in Hulu.<sup>149</sup>

CBS, rather than build its own distribution site, first invested in a Hulu competitor, Joost.com.<sup>150</sup> When Joost failed to take off, CBS purchased TV.com, announcing plans to turn the site into a better-than-Hulu “real video destination.”<sup>151</sup> Since that time, ABC joined Hulu, leaving CBS as the only Big Four network without a stake in the fast-growing site. It remains to be seen how CBS will adjust its strategy.

As Hulu quickly becomes a favorite destination for premium online content viewing, ABC, Fox and NBC are well positioned to capitalize on network effects and reclaim control of distribution mechanisms within the digital space. TV.com and other content aggregators such as Joost, Veoh, Fancast and MySpaceTV will have a difficult time matching Hulu's momentum or popularity. This strategy of building or partnering with distribution outlets belies the proclaimed notion that “content is king.” For content to be of any value, it must be exploited for profit. When content is given away to the consumer free online, the only way a content producer can secure a significant portion of advertising revenues is by controlling the distribution outlet. Content may have glamour, but the economics of distribution are fundamentally superior to those of pure content play.<sup>152</sup>

<sup>146</sup> Diane Garnett, *Growth of Hulu: Who Knew?*, VARIETY, Nov. 14, 2008, available at <http://www.variety.com/article/VR1117995900.html?categoryid=20&cs=1>.

<sup>147</sup> Gannes, *Analyst: Hulu*, *supra* note 146.

<sup>148</sup> Liz Gannes, *Streaming TV on ABC and MTV is Profitable*, NEWTEEVIE, Mar. 18, 2009, <http://newteevee.com/2009/03/18/streaming-tv-on-abc-and-mtv-is-profitable/>.

<sup>149</sup> Staci Kramer, *It's Official: Disney Joins News Corp., NBCU in Hulu; Deal Includes Some Cable*, PAID CONTENT, Apr. 30, 2009, <http://www.paidcontent.org/entry/419-its-official-disney-joins-news-corp-nbcu-in-hulu/>.

<sup>150</sup> Joost, *Joost Closes \$45 Million in Financing*, May 10, 2007, <http://press.joost.com/2007/05/>.

<sup>151</sup> Dan Frommer, *CBS Going After Hulu With TV.com*, BUS. INSIDER, Dec. 15, 2008, available at <http://www.businessinsider.com/2008/12/cbs-going-after-hulu-with-tvcom>.

<sup>152</sup> See Odlyzko, *supra* note 23.

### C. *Fighting Content with Content*

Digital technologies have commoditized the networks' distribution business and their content business, through the democratization of content creation. The networks now face intense competition from a multitude of content creators. Cable channels are successfully creating premium content en masse, and there has been a proliferation of content on the web, in the form of user-generated content and "new media" content developed by Hollywood and other professionals.

With so many distribution platforms available, networks have endeavored to fight content with more content. This means owning as much content as feasible, and placing it ubiquitously online. This also has the added benefit of combating piracy.

When it comes to owning content, the networks are both buying and creating content for multi-platform exploitation. They are creating derivative versions of popular shows (for example, *The Office's* web series *The Accountants*, featuring three characters from the television show), and developing new content for mobile and internet platforms. The networks are also buying independently-created web series to develop into television shows, or acquiring or partnering with web content producers. NBC was the first to place a web series on television with the ill-fated *Quarterlife*.<sup>153</sup> Although the series was a dismal flop, rarely a day goes by without a story in the entertainment trade papers announcing the acquisition by a network or production company of web content for TV development.

The networks are also opening up their vast libraries of classic content for online distribution. In putting old episodes of off-air shows online, broadcasters are able to exploit the "long tail" economics made possible by the internet.<sup>154</sup> Essentially the "long tail" is the economic phenomenon by which a digital product's useful life is extended infinitely further than a physical product, which requires manufacture, packaging, shipping and shelf-space to reach the end-consumer.<sup>155</sup> With no marginal cost involved in duplicating the digital product, even niche shows with limited appeal – for example, old episodes of *Twin Peaks* – can find and reach an interested audience as far into the future as that audience exists. This creates new revenue streams for networks

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<sup>153</sup> Steve Gorman, *Web-Based Quarterlife Canceled by NBC After Flop*, REUTERS, Feb. 28, 2008, available at <http://www.reuters.com/article/entertainmentNews/idUSN2748604320080228>.

<sup>154</sup> Brian Stetler, *Golden Years of Television Find New Life on Web*, N.Y. TIMES, Apr. 28, 2008, available at <http://www.nytimes.com/2008/04/28/business/media/28tube.html>.

<sup>155</sup> Wikipedia.com, *The Long Tail*, [http://en.wikipedia.org/wiki/The\\_Long\\_Tail](http://en.wikipedia.org/wiki/The_Long_Tail) (last visited Dec. 7, 2008).

now able to exploit libraries that were previously unprofitable to distribute. As NBC Universal's Jeff Zucker explains, "Frankly if there is one person interested in it [and we can cover our streaming costs], we've found it's a new opportunity for content."<sup>156</sup>

In addition to owning as much content as feasible, the networks have sought to place their content ubiquitously online. In an already noisy market, it seems the goal is to make their content loudest by placing it in as many legitimate, ad-supported venues as possible. CBS, without a stake in a successful distribution platform, has been at the forefront of this strategy, partnering with a wide net of distribution partners in what it dubs its "Audience Network," which includes Joost, YouTube, Veoh, AOL, Yahoo! and almost three hundred others.<sup>157</sup> CBS is banking on the fact that users are largely platform agnostic, and will consume content wherever they can find it.

This "who-cares-where-they-see-it-as-long-as-they-watch-our-ads" approach has caught on quickly among the networks.<sup>158</sup> For example, NBC placed all of its Fall 2008 shows online one week prior to their television premieres, not only on NBC.com but on Hulu, iTunes, Amazon's UnBox, Microsoft's Xbox Live, Zune, and On Demand with Comcast, Cox, Charter, Dish and Verizon Fios.<sup>159</sup> Even ABC, which was once the most frugal network in placing its content on sites other than ABC.com or iTunes, began signing content distribution deals with websites like AOL, Veoh<sup>160</sup> and YouTube<sup>161</sup> before joining Hulu. Accenture advised this strategy to the entertainment industry in their report: "To put [it] bluntly," they wrote, "don't be prissy about where people consume your content."<sup>162</sup>

The networks are smart to embrace this strategy, but it is not without problems. Rights and clearance issues in prior dealings are major stumbling blocks in the transfer of shows from traditional formats to the web. Entertainment contracts with various actors that predate in-

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<sup>156</sup> Stetler, *Golden Years*, *supra* note 155.

<sup>157</sup> CBS Audience Network, About CBS Audience Network, [http://www.cbs.com/can\\_player/about.php](http://www.cbs.com/can_player/about.php) (last visited Dec. 6, 2008).

<sup>158</sup> Hugh Hart, *TV Networks Discover Life Without iTunes*, WIRED, Oct. 17, 2008, [http://www.wired.com/techbiz/media/news/2007/10/nbc\\_itunes](http://www.wired.com/techbiz/media/news/2007/10/nbc_itunes).

<sup>159</sup> Gary Levin, *NBC Puts It All Out There Early Online*, USA TODAY, Sept. 17, 2008, available at [http://www.usatoday.com/life/television/news/2008-09-16-premier-es-online\\_N.htm](http://www.usatoday.com/life/television/news/2008-09-16-premier-es-online_N.htm).

<sup>160</sup> Brad Stone, *ABC Moves to Expand Its Reach On Video Websites*, N.Y. TIMES, June 23, 2008, available at <http://www.nytimes.com/2008/06/23/business/media/23veoh.html?partner=rssnyt>.

<sup>161</sup> Staci Kramer, *Disney Finalizing Deal For Clips On YouTube*, PAID CONTENT, Mar. 29, 2009, <http://www.paidcontent.org/entry/419-disney-you-tube-clips-deal-in-final-stages/>.

<sup>162</sup> Accenture, *supra* note 140.

ternet technology frequently failed to acquire rights broad enough to encompass web exploitation, resulting in rights of publicity lawsuits when Hollywood tried to take advantage of the long tail.<sup>163</sup> Moreover, this problem has not disappeared in contemporary contracts. The television shows *Project Runway* (2005) and *Mad Men* (2007) are not legally available for streaming online because the producers' contracts with the cable operators limit their right to display clips longer than three minutes.<sup>164</sup> In addition, many shows cannot be placed on the web because the producer cannot obtain the internet rights to the soundtrack music.<sup>165</sup> For example, a *Saturday Night Live* video featuring Beyonce and Justin Timberlake in leotards cannot be found legally online due to music rights issues (although it can be found on YouTube).<sup>166</sup> Additionally, any exclusivities granted in new contracts, such as exclusive online distribution deals, could lead to problems down the road, as both the popular platforms and technologies of distribution rapidly change.

Furthermore, although placing content ubiquitously online is the best way to fight piracy, it offends syndication and distribution partners. TV studios make a significant portion of their profits through syndication by selling reruns to local stations in the U.S. and abroad.<sup>167</sup> These deals are based on geographic boundaries, as each syndicate's reach is generally limited to a local market, and can be especially lucrative for television networks. For example, the Warner Brothers show *Friends*, originally broadcast on NBC, sold for \$4 million an episode in syndication markets, generating more than \$1 billion in syndication fees.<sup>168</sup> The exportation of television shows to syndicates internationally has been an \$8 billion annual business.<sup>169</sup>

However, as the networks place an increasing amount of content online, viewers do not need a local station to watch their shows. The shows, in turn, fetch a significantly lower syndication fee than they might have otherwise. As one network affiliate general manager expressed, "Nobody is going to pay a very high price for a show that is all

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<sup>163</sup> Tratos, *supra* note 26.

<sup>164</sup> *Id.*

<sup>165</sup> Stacy Higginbotham, *Managed vs. Unmanaged Content*, NEWTEEVEE, Nov. 13, 2008, <http://newteevee.com/2008/11/13/managed-vs-unmanaged-content/>.

<sup>166</sup> Elizabeth Snead, *Where's Justin Timberlake's SNL 'Single Ladies' Video?*, THE DISH RAG, L.A. TIMES, Nov. 20, 2008, <http://latimesblogs.latimes.com/thedishrag/2008/11/where-is-justin.html>.

<sup>167</sup> Schatz, *supra* note 4.

<sup>168</sup> *Id.*

<sup>169</sup> *Id.*

over cyberspace.”<sup>170</sup> Because syndication sales far outweigh sales from online distribution (at least in the near term), the networks must be careful not to offend distribution partners when placing content online.

Networks have attempted to placate affiliates primarily using a technology called geofiltering, which restricts internet viewing to certain geographical areas based on the user’s IP address. Hulu, for example, is currently only available in the US.<sup>171</sup> This, however, has the unintended consequence of encouraging foreign piracy. Moreover, while geofiltering is effective for average consumers, the more tech-savvy set can easily bypass the technology system using a remote server.

Finally, powerful distribution partners like Wal-Mart and Best Buy are also offended by online distribution deals, and have threatened to retaliate. Wal-Mart accounts for 40% of DVD sales (including TV DVDs).<sup>172</sup> If the mega-store cut shelf-space for DVDs, Hollywood (especially the film industry) could not afford the sales loss. Wal-Mart, with no stake in the internet game, is expected to take a hard line against any further efforts made in favor of online distribution.<sup>173</sup>

#### D. *Cultivating Audiences: Interactivity and the Social Media*

With so much content available, audiences have fragmented across the three screens. This has led to declining ratings for the networks as audiences spread across the infinity of the web. In an effort to recapture viewers’ attention, the networks have focused on two buzzwords: “interactivity” and “social media.” “Social media” is defined as the use of electronic and internet tools for the purpose of sharing and discussing information and experiences,<sup>174</sup> and the concept embodies what Tim O’Reilly meant when he called the new age of internet use “Web 2.0.”<sup>175</sup> The television industry’s belief is that the best way to keep an audience in a crowded content market is to create an interactive, personal experience for each consumer. This involves platforms that allow

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<sup>170</sup> *Id.*

<sup>171</sup> Hulu has plans to go global, and will likely be in at least the UK by the end of 2009. See Robert Andrews, *Industry Moves: Hulu Adds New Exec Larcher For International Push*, PAID CONTENT, Mar. 24, 2009, <http://www.paidcontent.org/entry/419-industry-moves-hulu-adds-new-exec-for-international-push/>; see also Staci Kramer, *Hulu Plans For UK Presence Are Far From Set*, PAID CONTENT, May 21, 2009, <http://www.paidcontent.org/entry/419-hulu-plans-for-uk-presence-are-far-from-set/>.

<sup>172</sup> *Coming Soon – Hollywood and the Internet*, ECONOMIST, Feb. 21, 2008.

<sup>173</sup> *Id.*

<sup>174</sup> Wikipedia, Social Media, [http://en.wikipedia.org/wiki/Social\\_media](http://en.wikipedia.org/wiki/Social_media) (last visited Dec. 7, 2008).

<sup>175</sup> Wikipedia, Web 2.0, [http://en.wikipedia.org/wiki/Web\\_2.0](http://en.wikipedia.org/wiki/Web_2.0) (last visited Dec. 7, 2008).



consumers not only to watch a show, but to interact with other viewers, the talent and/or the show's characters, and to create and share derivative UGC.

Many players in the television industry are hotly pursuing this strategy. Companies have created chat rooms, casual games,<sup>176</sup> virtual worlds, contests, blogs, fan pages, Facebook applications and video-sharing sites. CBS has introduced "Social Viewing Rooms" – the virtual living rooms of the future – where friends can watch shows and chat virtually as if they were together.<sup>177</sup> Within the Social Viewing Room friends can also take polls, compete in quizzes and throw animated objects such as kisses or tomatoes at the screen. MTV has introduced Backchannel, a multiplayer online game based on *The Hills*. Players play the game online while the show airs, earning points for witty or cruel comments made about what's happening on screen.<sup>178</sup> Viewers have fickle habits, so the networks are racing to come up with the new killer app<sup>179</sup> that will drive users to their websites and keep them there.

This strategy is so pervasive that 90% of executives in the Accenture study said their companies would become involved in social media over the next year.<sup>180</sup> The networks are right to pursue this course of action. Consumers, especially the younger set, want interactive content constructed uniquely for them. As Diane Mermigas of Media Post writes, "Television broadcasters will continue to fold, and on-line. . . networks will not be monetized, if media does not fully embrace the notion that personal relevance and social interactivity trumps all."<sup>181</sup>

However, here again there are legal stumbling blocks the networks must overcome. Hollywood must balance content protection with their desire to allow users to create mash-ups and other UGC involving copyrighted works. While this loosening of copyright may make some in the entertainment industry uncomfortable, the fact is that the line between professional content and UGC is quite blurry. Rather than

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<sup>176</sup> Casual games are games which do not require significant investment time, as opposed to the more subsuming games like *Doom* or *World of Warcraft*.

<sup>177</sup> Jenna Wortham, *TVs Killer App: Social Video Viewing?*, UNDERWIRE, WIRED, NOV. 12, 2008, <http://blog.wired.com/underwire/2008/11/tvs-killer-app.html>.

<sup>178</sup> *Id.*

<sup>179</sup> A "killer app" or "killer application" is an application so desired or valuable that it adds value to the larger technology on which its run. In this context, it refers to the website where the video content is displayed. See Wikipedia, *Killer Application*, [http://en.wikipedia.org/wiki/Killer\\_application](http://en.wikipedia.org/wiki/Killer_application) (last visited Dec. 9, 2008).

<sup>180</sup> Accenture, *supra* note 140.

<sup>181</sup> Diane Mermigas, *Media's Salvation: Interactive Consumers*, MEDIA POST, Dec. 3, 2008, [http://www.mediapost.com/publications/?fa=Articles.showArticle&art\\_aid=95875](http://www.mediapost.com/publications/?fa=Articles.showArticle&art_aid=95875).

pursuing copyright infringement claims, the industry should explore some type of licensing scheme, perhaps Creative Commons licensing, so that users can gain legal access to copyrighted material. This type of licensing scheme will allow professionals and amateurs to peacefully coexist in the new media ecosystem.

#### E. *Advertising Partnerships: Branded Entertainment*

As illustrated above, audiences have fragmented across the three screens and advertising revenues for the networks have been in steady decline. In an effort to secure more profitable advertising deals, the networks have focused on creating new forms of advertising that pack more qualitative punch.

The foremost strategy the networks are employing is “branded entertainment.” Branded entertainment is the reinvention of traditional product placement and early television sponsorship programs like the *Colgate Comedy Hour*. With the rising popularity of DVR and viewers increasingly likely to skip past commercials, branded entertainment places the advertiser directly inside programming content where it cannot be avoided. However, this is not simply placing a can of Coke on a character’s desk. In branded entertainment deals, the advertiser invests deeply in a show, underwriting some of the production costs. In exchange, the advertiser becomes a creative partner, helping shape story lines in order to integrate its company’s product and message.<sup>182</sup>

NBC has been a leader in promoting this type of advertiser-network partnership. For example, General Motors was heavily involved in the development of *My Own Worst Enemy*, creating commercials with the network and carefully adding in story lines involving a Camaro and a Traverse.<sup>183</sup> Similarly, Ford Motors took part in the network’s show *Knight Rider*. The main character drove a Ford Mustang Shelby GT500 KR and viewers could enter a contest to win a Ford vehicle on the NBC website.<sup>184</sup> The network aired a new series in 2009 called *Kings*, developed with Liberty Mutual Group. The insurance carrier’s slogan “Responsibility. What’s your policy?” was the inspiration for the show’s core themes – taking responsibility for one’s actions and deciding how to do the right thing.<sup>185</sup>

The problem with this strategy is aptly captured by Jimmy Kimmel who, speaking of the Liberty Mutual show, quipped, “I have to admit,

<sup>182</sup> Stetler, *Low Ratings*, *supra* note 57.

<sup>183</sup> *Id.*

<sup>184</sup> Stuart Elliott, *NBC to Revive a Mainstay of Early TV*, N.Y. TIMES, Apr. 2, 2008, available at <http://www.nytimes.com/2008/04/02/business/media/02adco.html>.

<sup>185</sup> *Id.*

America has been clamoring for more shows written by insurance agents.”<sup>186</sup> Branded entertainment has created serious discomfort among talent, who fear that such hands-on involvement by advertising executives may cost a show its integrity. As a result, deal negotiations between talent – especially writers and directors who want to retain creative control – and Hollywood have become more difficult and complex.<sup>187</sup> In addition, both the WGA and the Screen Actors Guild (SAG) are protesting the use of branded entertainment, describing it as a form of “forced endorsement” without compensation.<sup>188</sup> Writers feel they are not being compensated for the extra effort involved in meeting advertisers’ creative requests, while actors want compensation for appearing as a de facto-sponsor of an integrated product. This kind of product integration is a sticking point in the current round of negotiations between SAG and the AMPTP. Creative integrity and union issues aside, these kinds of partnership deals are still problematic in that they are only as successful as the show itself. Despite GM’s extensive investment in *My Own Worst Enemy*, the show was cancelled due to low ratings.<sup>189</sup> NBC aired five additional episodes of the show that it would have otherwise pulled, in part to satisfy its deal with GM. Clearly, branded entertainment deals can prove risky for networks and advertisers alike.

Still, for the time being, the strategy appears to be paying off. While NBC is fourth amongst the Big Four networks, down 13% in ratings, the company is up 50% in profitability.<sup>190</sup> That percentage increase is largely attributed to their use of branded entertainment.<sup>191</sup> Every other network seems to have caught on, and these types of deals have become prevalent in the entertainment community. Branded entertainment accounted for \$22.3 billion in ad spending in 2007, and was expected to reach \$25.4 billion in 2008.<sup>192</sup>

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<sup>186</sup> Bill Carter, *Networks Anticipate the Fall Cautiously*, N.Y. TIMES, May 17, 2008, available at <http://www.nytimes.com/2008/05/17/arts/television/17upfr.html>.

<sup>187</sup> Amanda Bronstad, *Branded Entertainment Deals Mean More Money For Companies – and More Complexity*, NAT’L L. J., May 3, 2006, available at <http://www.law.com/jsp/ihc/PubArticleIHC.jsp?id=1146560723702>.

<sup>188</sup> *Id.*

<sup>189</sup> Stetler, *Low Ratings*, *supra* note 57.

<sup>190</sup> Wayne Friedman, *TV’s New Metrics – Ben Silverman Knows the Score*, MEDIA POST, Nov. 17, 2008, [http://www.mediapost.com/publications/?fa=Articles.showArticle&art\\_aid=94887](http://www.mediapost.com/publications/?fa=Articles.showArticle&art_aid=94887).

<sup>191</sup> *Id.*

<sup>192</sup> Jack Loechner, *Elusive Consumers Create Marketers’ Needs For Branded Entertainment*, MEDIA POST, Mar. 7, 2008, [http://www.mediapost.com/publications/?fa=Articles.showArticle&art\\_aid=77639](http://www.mediapost.com/publications/?fa=Articles.showArticle&art_aid=77639).

In addition to branded entertainment, networks have explored other ways to make traditional advertising space more valuable. Fox has experimented with an initiative called “remote-free TV” in which the network shows only ten minutes of commercial interruption per hour of programming (as opposed to the average eighteen minutes of commercial interruption). This has resulted in 31% higher ad attention levels, and Fox has been able to charge a 40% premium for the space.<sup>193</sup>

#### F. *Pay-Per-Copy and Subscription Model Experimentation*

The television industry has experimented with pay-per-copy models, namely Apple’s iTunes, but this story could reasonably be left in a footnote. Most major entertainment companies have deals to distribute their content through iTunes, and there has been headline-worthy quibbling over the pricing of television episodes. But it has become apparent that the networks are placing their content with iTunes as an offshoot of the strategy to place content ubiquitously online as described above, rather than as good-faith experimentation in pay-per-copy regimes. iTunes, it turns out, is just another outlet where their content can be seen.

The television networks are not likely to experiment any further with pay-per-copy models for three reasons. First, the iTunes’ pay-per-copy model hasn’t shown itself to be a significant source of revenue. iTunes recently announced it has sold 200 million TV shows in the last three years, but at \$1.99 per episode that works out to a \$93 million shared pot for the networks and producers.<sup>194</sup> Even if all 200 million episodes were sold at the new HD episode price of \$2.99 that only works out to \$598 million (or \$150 million per network).<sup>195</sup> A percentage of that revenue belongs to cable content providers and iTunes itself, so the networks’ actual take home is considerably less. While this works out to a nice bit of change, it is not enough to be taken too seriously. Secondly, iTunes established a price ceiling for what a television episode is worth. No consumer is willing to pay more than that now, so there’s little room to experiment with pricing. Lastly, iTunes represents a failed attempt to translate analog sources of revenue in a

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<sup>193</sup> Brian Stetler, *Fox Will Experiment With Fewer Commercials*, TV DECODER, N.Y. TIMES, Sept. 9, 2008, <http://tvdecoder.blogs.nytimes.com/2008/09/09/fox-will-experiment-with-fewer-commercials/>.

<sup>194</sup> Andrea Chalupa, *Apple’s iTunes Chump Change for Hollywood*, SEEKING ALPHA, Oct. 19, 2008, <http://seekingalpha.com/article/100566-apple-s-itunes-chump-change-for-hollywood>.

<sup>195</sup> *Id.*

digital world. Hollywood dealmakers equate the iTunes download to buying a physical copy, while streaming is likened to renting or catching the rerun. In truth, this is an untenable distinction. As the networks promiscuously place their content around the web, the consumer has little reason to purchase something she can legally see for free.<sup>196</sup> A consumer only needs to own the digital file when she desires to watch a show while in an unconnected location, such as while traveling. Even this is becoming less relevant as major airlines and entire cities go wireless. There is little incentive for the consumer to “own” when she can “rent” at the click of a mouse for free. In the long term, this market will be viable only for categories of viewers who watch the same video repeatedly, namely children and the occasional avid fan.

In addition to pay-per-copy models, the industry has begun touting subscription models in which anyone who subscribes to a multichannel cable provider can watch available cable television content online, free of charge.<sup>197</sup> Time Warner CEO Jeff Bewkes has been pushing an initiative called “TV Everywhere” in which he envisions consumers accessing content anywhere on the web – including sites like Hulu and YouTube – simply by entering an authentication code that confirms their cable subscription.<sup>198</sup> Comcast and AT&T are looking into building their own authentication programs,<sup>199</sup> and Disney CEO Robert Iger<sup>200</sup> and Viacom CEO Phillippe Dauman<sup>201</sup> have publicly contemplated a subscription model for their content as well. While these initiatives may be an earnest effort to reestablish content value, the hurdles to success are high. Initiatives like TV Everywhere must achieve widespread industry support to make the model viable.<sup>202</sup> Additionally, because these models create friction in the viewing experience, they could be an open invitation to piracy. Still, if Hollywood can pull it off, the subscription model is promising.

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<sup>196</sup> See Holson, *supra* note 68.

<sup>197</sup> See Michael Learmonth and Andrew Hampp, *TV Everywhere – As Long As You Pay For It*, ADVERTISING AGE, Mar. 2, 2009, [http://adage.com/mediaworks/article?article\\_id=134961](http://adage.com/mediaworks/article?article_id=134961).

<sup>198</sup> *Id.*

<sup>199</sup> Todd Spangler, *Satellite, Telcos in TV Everywhere Camp*, MULTICHANNELNEWS, May 21, 2009, [http://www.multichannel.com/article/262152-Satellite\\_Telcos\\_In\\_TV\\_Everywhere\\_Camp.php](http://www.multichannel.com/article/262152-Satellite_Telcos_In_TV_Everywhere_Camp.php).

<sup>200</sup> Andrew Morese, *Disney CEO Sees Possibility of Online Subscription Service*, SMART MONEY, Mar. 3, 2009, <http://www.smartmoney.com/news/ON/?story=ON-20090303-000789-2009>.

<sup>201</sup> David Goetzl, *Viacom May Charge To View Shows Online*, MEDIA POST, Mar. 5, 2009, [http://www.mediapost.com/publications/?fa=Articles.showArticle&art\\_aid=101469](http://www.mediapost.com/publications/?fa=Articles.showArticle&art_aid=101469)

<sup>202</sup> Learmonth, *supra* note 198.

### G. *Cost-Cutting*

In the face of declining advertising revenues and shrinking margins, the networks have naturally taken a hard look at the expense-side of their spreadsheets and made important cost-cutting measures. As demonstrated above, the networks have little room to pushback against star salaries and union-imposed pay structures, so the most relevant cost-cutting schemes involve programming.

One strategy involves cutting the hours of original programming, which has traditionally been twenty-two hours per week. NBC, having had an especially tough Fall, gave away five hours of primetime programming to Jay Leno.<sup>203</sup> Fox too has dropped an hour of programming per night and returned that time to affiliates.<sup>204</sup> In Fall 2008, the CW network allowed an independent production company, Media Rights Capital, to program its Sunday night.<sup>205</sup> Fox closed down its Saturday morning block of cartoons and became the first major network to sell part of its programming to infomercials. Executives defended the move, stating, "Children's programming was simply no longer viable on network television."<sup>206</sup>

Another strategy has been to program "for margins and not for ratings," according to NBC Entertainment co-chair Ben Silverman.<sup>207</sup> To this end, the networks are running fewer movies, while increasing their reliance on reruns, live sports and other event programming.<sup>208</sup> Additionally, when the networks license original shows, they are opting for product with cheaper price tags.<sup>209</sup> Since the WGA strike, the networks also cut down the number of television pilots they made. However, fewer pilots imply less opportunity to experiment, so the networks have generally played it safe with revivals or adaptations of overseas

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<sup>203</sup> Gary Levin, *Jay Leno, NBC Make a Prime-Time Deal*, USA TODAY, Dec. 9, 2008, available at [http://www.usatoday.com/life/television/news/2008-12-08-jay-leno-deal\\_N.htm](http://www.usatoday.com/life/television/news/2008-12-08-jay-leno-deal_N.htm).

<sup>204</sup> Michael Schneider, *Needed: Network Bailout*, VARIETY, Nov. 23, 2008, available at <http://www.variety.com/article/VR1117996347.html?categoryid=14&cs=1>.

<sup>205</sup> See Scott Collins, *The Farming Out Of CW's Sunday Nights*, L.A. TIMES, June 9, 2008, available at [http://www.latimes.com/entertainment/news/tv/la-et-channel9-2008jun09\\_0,1307435.story](http://www.latimes.com/entertainment/news/tv/la-et-channel9-2008jun09_0,1307435.story).

<sup>206</sup> *Fox Ends Saturday Morning Cartoons*, N.Y. TIMES, Nov. 25, 2008, available at <http://www.nytimes.com/2008/11/25/business/media/25kidstv.html>.

<sup>207</sup> Shelly Palmer, *The End of Broadcast TV Nears*, SEEKING ALPHA, July 20, 2008, <http://seekingalpha.com/article/85828-the-end-of-broadcast-tv-nears>.

<sup>208</sup> Mermigas, *Broadcast, Cable Network Parity Play*, *supra* note 2.

<sup>209</sup> Peter Lauria, *Silverman Channeling Jack Welch*, N.Y. POST, July 17, 2008, available at [http://www.nypost.com/seven/07172008/business/silverman\\_channeling\\_jack\\_welch\\_120303.htm](http://www.nypost.com/seven/07172008/business/silverman_channeling_jack_welch_120303.htm).

hits.<sup>210</sup> Finally, in another effort to slash primetime programming costs, networks have been developing fewer expensive comedies and dramas in favor of cheaper reality television and game shows. On NBC, a show like *Heroes* costs \$2.7 million an episode, while *Deal or No Deal* costs just \$1.1 million.<sup>211</sup> As an added bonus, reality programming is more conducive to high-profile product placement.

Cutting costs is obviously a prudent strategy for any business seeking improved profit margins, but the networks should be careful not to cut costs at the expense of the quality of their programming. Reality shows may make a big splash for a smaller buck, and some of them may be very good storytelling, but they do not have the long tail value of quality scripted fare. David Carr of the *New York Times* questions the network move to reality programming:

“Confronted by an audience that is either on the web or a milk carton, and a writers’ strike that left the scripted cupboard a little bare, networks are opting in on all manner of contests and challenges, including human cockfighting. Randomly flip on a network broadcast and people are dancing, fighting, singing and conniving their way to the top. The sitcom laugh track is petering out, as are the kinds of tent-pole dramas and news coverage that gave networks their brand identity . . . [But if] networks are no longer in the business of coming up with must-see serials that mature over time — we all know that ‘M\*A\*S\*H,’ ‘Cheers,’ ‘Seinfeld,’ you-name-it took a long time to turn into hits — what business are they in?”<sup>212</sup>

#### H. *Legal and Legislative Responses*

Because the industry has no viable legal or legislative response to the threat posed by digital technologies or to increased competition from independent content creators, the industry’s efforts have largely been aimed at the piracy problem.

The music industry’s effort to litigate pirates out of existence proved to be a largely ineffective strategy. When litigation did succeed in shutting down an illegal-file sharing company like Napster, two more companies would pop up using a new technology not controlled by the court’s holding and often outside of the industry’s jurisdictional reach.<sup>213</sup> In television, popular illegal file-sharing websites like the Pirate Bay are located offshore. Even when the Stockholm-based com-

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<sup>210</sup> Julia Boorstin, *NBC’s New TV Strategy: Prime Time, All the Time*, CNBC, Apr. 2, 2008, <http://www.cnbc.com/id/23920289>.

<sup>211</sup> Eric Bangeman, *NBC Rethinks Network Strategy With NBCU 2.0*, ARS TECHNICA, Oct. 19, 2006, <http://arstechnica.com/news.ars/post/20061019-8031.html>.

<sup>212</sup> David Carr, *Golden Age for TV?, Yes, On Cable*, N.Y. TIMES, June 9, 2008, available at <http://www.nytimes.com/2008/06/09/business/media/09carr.html>.

<sup>213</sup> Tratos, *supra* note 26.

pany was raided and their servers seized by Swedish police, they were back online within three days.<sup>214</sup>

Lawsuits aimed at distribution sites, such as the \$1 billion copyright infringement suit between Viacom and YouTube, also now appear to be fruitless. YouTube now offers greater copyright protection to Hollywood content providers through a program called ContentID, which identifies unauthorized material for removal or ad placement, and has introduced a click-to-buy e-commerce program as well.<sup>215</sup> However, it was not the lawsuit that ultimately encouraged YouTube to respect copyright laws, but the realization that they needed to secure premium content from Hollywood, à la Hulu, in order to lure advertisers and more successfully monetize the site.<sup>216</sup> Efforts to sue individuals in the music industry were disastrous from a publicity standpoint, and the television industry has intelligently avoided this tactic.

Newer efforts aimed at aggregators like the Pirate Bay are likely to prove equally ineffectual. The Pirate Bay acts as a search engine and does not directly violate copyright laws, so they stood trial in Swedish criminal court for “complicity to make [copyrighted material] available.”<sup>217</sup> Although the defendants were found guilty at the district level, the website is still up and running as of this writing.<sup>218</sup> Further, the trial is far from over; the defendants plan to appeal and the district court judge faces conflict of interest accusations (he is a member of two copyright organizations).<sup>219</sup> Even if the prosecution ultimately prevails and the Pirate Bay goes permanently off-line, if history is any indication, the end result will be the development of superior pirating technology.<sup>220</sup> After all, the demise of Napster led to more mature platforms like KaZaa and Grokster, which, when shuttered by the U.S. Supreme Court, led to BitTorrent technology.<sup>221</sup>

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<sup>214</sup> Sarno, *supra* note 138.

<sup>215</sup> *Id.*

<sup>216</sup> See Brad Stone & Brooks Barnes, *MGM to Post Full Films on YouTube*, N.Y. TIMES, Nov. 10, 2008, available at <http://www.nytimes.com/2008/11/10/business/media/10mgm.html>. See also Diane Garnett, *YouTube Cozies Up to Hollywood*, VARIETY, Nov. 14, 2008, available at <http://www.variety.com/article/VR1117995894.html?categoryid=20&cs=1>.

<sup>217</sup> Nate Anderson, *Charges Dropped – “Making Available” Now Focus of Pirate Bay Trial*, ARS TECHNICA, Feb. 17, 2009, <http://arstechnica.com/tech-policy/news/2009/02/charges-dropped-making-available-now-focus-of-tpb-trial.ars>.

<sup>218</sup> Janko Roettgers, *Future of P2P: What Comes After the Pirate Bay*, NEWTEEVEE, Apr. 25, 2009, <http://newteevee.com/2009/04/25/future-of-p2p-what-comes-after-the-pirate-bay/>.

<sup>219</sup> Mats Lewan, *Pirate Bay Judge Accused of Conflict of Interest*, CNET, Apr. 23, 2009, available at [http://news.cnet.com/8301-1023\\_3-10226167-93.html](http://news.cnet.com/8301-1023_3-10226167-93.html).

<sup>220</sup> Roettgers, *supra* note 219.

<sup>221</sup> *Id.*



A further blow to content-owning plaintiffs seeking restitution was dealt in January 2009, when a U.S. District Court held a criminal copyright infringer was not required to pay damages because the entertainment companies whose rights were violated had not proven how much money they lost as a result of web piracy.<sup>222</sup> The defendant was asked to pay \$7.22 – the wholesale price of a CD – per illegal album transfer, totaling \$124,000.<sup>223</sup> In rejecting the formula, the judge wrote, “I am skeptical customers would pay \$7.22 . . . for something they got for free.”<sup>224</sup>

Legislative campaigns spearheaded by the entertainment industry at large have been slightly more successful. The 1998 Digital Millennium Copyright Act criminalized the circumvention of technological measures that limit access to copyrighted works (copy protection or Digital Rights Management “DRM” technology).<sup>225</sup> However, there are interoperability issues with DRM which may curb viewing, or, as a recent study shows, actually drive users to piracy.<sup>226</sup> Thus, DRM may be more of a nuisance than a successful anti-piracy tool.<sup>227</sup> Currently, the industry is lobbying Washington for legislation that allows internet service providers (ISPs) to monitor traffic in order to block the trading of copyrighted files.<sup>228</sup> However, such legislation implicates complicated privacy issues and is likely to find strong opposition in Congress.<sup>229</sup>

Copyright law may ultimately have little function in a digital world. When files can be transferred instantaneously and DRM code can be cracked overnight, fighting piracy with brute force litigation or protectionist legislation is a losing battle. Such efforts are antithetical to the purpose of copyright law – namely, to encourage innovation and promote the creation of new works. As one Google copyright lawyer expressed, “Copyright law has abandoned its reason for being . . . Instead,

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<sup>222</sup> Wendy Davis, *Ruling Could Boost Defendants in RIAA Lawsuits*, MEDIA POST, Jan. 20, 2009, [http://www.mediapost.com/publications/?fa=Articles.showArticle&art\\_aid=98596](http://www.mediapost.com/publications/?fa=Articles.showArticle&art_aid=98596).

<sup>223</sup> *Id.*

<sup>224</sup> *Id.*

<sup>225</sup> Handel, *supra* note 7.

<sup>226</sup> Nate Anderson, *Landmark Study: DRM Truly Does Make Pirates Out Of Us All*, ARS TECHNICA, May 27, 2009, <http://arstechnica.com/tech-policy/news/2009/05/landmark-study-drm-truly-does-make-pirates-out-of-us-all.ars>.

<sup>227</sup> Seth Metsch, *Setting the Stage: New Technologies and New Entertainment Challenges*, PRACTISING L. INST., PATENT, COPYRIGHTS, TRADEMARKS, AND LITERARY PROPERTY COURSE HANDBOOK SERIES, Sept. 2008.

<sup>228</sup> Saul Hansell, *Hollywood Wants Internet Providers to Block Copyrighted Files*, N.Y. TIMES, Sept. 25, 2008, <http://bits.blogs.nytimes.com/2008/09/25/hollywood-tries-to-get-support-for-having-isps-block-copyrighted-files/>.

<sup>229</sup> *Id.*

its principal functions now are to preserve existing failed business models [and] to suppress new business models and technologies.”<sup>230</sup> Indeed, the legal strategies entertainment has pursued may be one reason younger generations are hostile to copyright law. The Pirate Bay’s claim to fame is an online gallery of legal threats from big entertainment companies, with antagonistic retorts from the pirates.<sup>231</sup> The company is outspoken about its belief that the copyright system is outmoded in a world where the exchange of ideas, and the growth of our culture, occurs online via file sharing.<sup>232</sup>

Ultimately, the television industry will be better served by its current business strategy – competing directly with pirates by offering the same product at the same price point (zero) on a more reliable, higher quality platform – than through litigation or legislation.

## V. ADDITIONAL STRATEGIES HOLLYWOOD SHOULD PURSUE

In addition to the aforementioned strategies, the following are several additional strategies I believe Hollywood should pursue more aggressively in order to ensure their continued existence in the impending TV/internet converged world:

### A. *Become Aggregators of Information*

Although television and the internet are both platforms for video viewing, the two technologies have important differences. Television is largely a passive medium in which viewers “lean back” while flipping through channels; internet usage is largely an active medium in which users “lean forward” while clicking and searching across websites.<sup>233</sup> In television there is a limited volume of content to browse – live programming, recorded programming through DVR and on-call programming from VoD services. On the internet, the volume of content is limitless.

With infinite choice comes overwhelming confusion, and the explosion in content choice has created a need for context. As television and internet video converge onto the same screen, consumers will demand a one-stop search tool that aggregates and sorts online video content in a meaningful way – a TV Guide for the internet.

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<sup>230</sup> Handel, *supra* note 7.

<sup>231</sup> Sarno, *supra* note 138.

<sup>232</sup> *Id.*

<sup>233</sup> Chris Tew, *Internet TV and Regular TV Convergence*, WEB TV WIRE, Mar. 21, 2007, <http://www.webtvwire.com/internet-tv-and-regular-tv-convergence/>.

This guide will, of course, have to be fundamentally different than a TV Guide. It will have to account for not only what is on television, but also all the places on the internet those television shows can be viewed. It will have to link derivative programming, and it must have a software program that is able to suggest content based on previously viewed shows the user indicates she enjoyed. It will need a user-friendly interface and a sophisticated search engine that can find appropriate programming – including select UGC – without chaotic results. And it must allow the user to choose whether her entertainment experience is active or passive, and to move seamlessly between both experiences.

This sounds like a task for a company already in the search engine business such as Google, rather than a network television company. But some entertainment companies have already started to pursue this path. TV Guide has created an Online Video Guide and Hulu has launched a beta program that offers up to five video recommendations based on the video being viewed.<sup>234</sup> Indeed, many websites are investing in collaborative filtering technologies, but none have quite cracked the code.<sup>235</sup> There are also independent aggregators like Life-OnMars.com, digital curators like Nizmlab and Chunnel.TV, and tastemakers such as the newly founded International Academy of Web Television “Streamy” Awards for outstanding achievement in new media.<sup>236</sup> Still, none of these options are completely satisfactory. As one *PC World* writer bemoans, “In many ways, the mish-mosh of overlapping content online transforms finding the content you want into a confusing treasure hunt. There’s no single stop on the net where you can find everything you want without being referred somewhere else.”<sup>237</sup>

In this void lies opportunity. The networks should seize the chance to build, buy or partner with a company in the business of aggregation and contextualization of internet video content. In doing so, the networks can create for themselves an indispensable place in a TV/internet converged world.

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<sup>234</sup> Rebecca Harper, *New Site Features*, HULU, Dec. 2, 2008, <http://blog.hulu.com/2008/12/2/site-features>.

<sup>235</sup> See Daisy Whitney, *Web Video Hurdle: Good Recommendations*, TV WEEK, Dec. 21, 2008, [http://www.tvweek.com/news/2008/12/web\\_video\\_hurdle\\_good\\_recommen.php](http://www.tvweek.com/news/2008/12/web_video_hurdle_good_recommen.php).

<sup>236</sup> Streamy Awards, *About the Streamys*, <http://www.streamys.org/about.shtml> (last visited Mar. 18, 2009).

<sup>237</sup> Melissa Pernson, *The Best TV on the Web*, PC WORLD, July 28, 2008, [http://www.pcworld.com/article/148944-2/the\\_best\\_tv\\_on\\_the\\_web.html](http://www.pcworld.com/article/148944-2/the_best_tv_on_the_web.html).

## B. *Get Real About Ratings*

Advertisers follow audiences, and as consumers move from television to the internet, the networks are losing viewers and advertising revenue. The conventional wisdom has been that the lost value will never be replaced online – it’s either analog dollars or digital pennies.

Perhaps this is the case. But it is also possible that there is simply a lag between consumers and advertisers in the move online. If so, there is real value to be found in online advertising. Online advertising can be more efficient and more effective than its television counterpart. Because online ad tracking focuses on actual audiences, advertisers get to target their exact desired demographic and geographic consumer, and consumers primarily get to see ads they actually care about. Studies have shown that online video viewers are more likely to remember commercials they see while watching online video than on television, chiefly because they see far fewer ads.<sup>238</sup> Moreover, unlike television advertising, the interactive nature of web video creates a unique opportunity for immediate consumer action, as interested viewers are able to purchase advertised products with the simple click of a mouse. With so much additional value available online, content providers should be able to charge high prices for ad units that reach targeted end-users in more memorable ways.

However, Hollywood will only be able to monetize this value if it can show advertisers its internet advertising space is actually *more* valuable than television advertising space. There are simple ways to demonstrate this value without implicating too many privacy issues. One good example is Hulu’s interactive ad-viewing experience.<sup>239</sup> The site allows users to choose whether they watch their commercials pre- and post-roll or during regularly scheduled commercial breaks. The site also allows users to click a “thumbs up” or “thumbs down” icon during the ad, communicating to Hulu, and in turn the advertisers, whether or not they want to see this kind of commercial again. Such schemes empower users by making them feel as if they chose their ad-viewing experience, presumably making the ads more memorable and preference-tailored, and they also create metric indicators for advertising partners.<sup>240</sup> One study found that video viewers on Hulu were 22%

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<sup>238</sup> Brian Stetler, *Web Site’s Formula for Success: TV Content With Fewer Ads*, N.Y. TIMES, Oct. 29, 2008, available at <http://www.nytimes.com/2008/10/29/business/media/29adco.html>.

<sup>239</sup> Joshua Cohen, *Hulu is Cooler Than You Think*, TILZY.TV, Nov. 14, 2008, <http://www.tilzy.tv/hulu-is-cooler-than-you-think.htm>

<sup>240</sup> *Id.*

more likely to register an advertiser's message, and 28% more likely to want to purchase the product.<sup>241</sup>

This kind of two-way interactive advertising model should eventually prove even more lucrative than traditional television spot-sales. As Diane Mermigas writes, "The internet and digital options provide competitive alternative platforms that will prevail."<sup>242</sup> The question is whether the networks will help pioneer the move to web-first advertising and invent new advertiser-relevant metrics for their content, or lag behind and miss this real opportunity for value-added revenue.

On the TV front, the television industry needs to get real about ratings. Television relies heavily on Nielsen ratings, but these numbers have long been regarded as half-truths or outright lies. They're sample size is notoriously small and homogeneous. Until recently college students were not counted, which led one college journalist to opine that "[Nielsen's] method of ratings measurement makes the 2000 election fiasco seem fair and just."<sup>243</sup> Bart Feder, formerly of FeedRoom, has been openly disdainful of Nielsen numbers, grumbling that "[t]hey're lies, and what's more everyone knows they're lies."<sup>244</sup>

Nielsen has long had a monopoly on TV ratings, but it now faces competition from services like TiVo and TNS Media Intelligence. Hollywood should use this newfound leverage to make Nielsen more accountable for its sampling techniques. At the same time, Google's new TV Ads program, by utilizing the same technology as their web ad targeting, provides far more accountability than Nielsen.<sup>245</sup> Canoe, a venture between the six major cable providers, offers a similar service.<sup>246</sup> Using these types of programs, networks should be able to provide more specific viewer information, and, as a result, charge more for ads. The networks have shunned Google TV in favor of Madison Avenue relationships, but as long-term upfront sales slump and advertisers

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<sup>241</sup> *Id.*

<sup>242</sup> Diane Mermigas, *Job One: Advertisers' Survival Plan for 2009*, MEDIA POST, Jan. 5, 2009, [http://www.mediapost.com/publications/?fa=Articles.showArticle&art\\_aid=97684](http://www.mediapost.com/publications/?fa=Articles.showArticle&art_aid=97684).

<sup>243</sup> Andrea Segal, *Nielsen Ratings: An Inaccurate Truth*, CORNELL DAILY SUN, Apr. 26, 2007, <http://cornellsun.com/node/23180>.

<sup>244</sup> Erik Sass, *TV, Internet Convergence Yields Cultural Chasm*, MEDIA POST, Feb. 10, 2006, [http://www.mediapost.com/publications/index.cfm?fuseaction=Articles.showArticleHomePage&art\\_aid=39667](http://www.mediapost.com/publications/index.cfm?fuseaction=Articles.showArticleHomePage&art_aid=39667).

<sup>245</sup> Julia Boorstin, *NBC Universal Makes Big New Media Deals*, CNBC, Sep. 10, 2008, <http://www.cnbc.com/id/26628916>.

<sup>246</sup> See Canoe Ventures, About Canoe, <http://www.canoe-ventures.com/about.html> (last visited June 3, 2009).

increasingly prefer to make more efficient on-the-spot buys, the networks should consider these viable alternatives.<sup>247</sup>

### C. *Do Not Underestimate the Pirates*

While piracy is a problem for the television industry, the networks have a clear strategy to beat the pirates: offer the same product at the same price point (zero) on a more reliable, higher quality platform.

Before the economic recession hit and television ad spending was cut back, the networks followed this strategy almost without reservation, placing their content ubiquitously online. But in 2009, faced with overwhelming challenges to their business models and no promise of salvation on the web, there are signs of a backlash. Content owners now seem to doubt early initiatives to give content away for free online. A sampling of the evidence: Warner Brothers pulling shows like *The Mentalist* and *The Big Bang Theory* from CBS.com,<sup>248</sup> F/X removing *It's Always Sunny in Philadelphia* from Hulu,<sup>249</sup> content providers forcing Hulu to remove its content from Boxee and TV.com,<sup>250</sup> the Sci Fi Channel discontinuing *Battlestar Galactica* streams and expiration dates for *Friday Night Lights* episodes on Hulu and NBC.com.

Jealous hoarding of content may be understandable in tough economic times, but such actions are ill advised. Ultimately, what really matters to the on-demand generation is convenience. How or where we get our content is not nearly as important as when we get it, which is to say, instantaneously. If it's not on Hulu or TV.com *when* we want to watch it, it is on the Pirate Bay, or MiniNova, isoHunt, Torrentz, Elite Torrents, or another of the many pirate sites lurking in cyberspace. The end result of content hoarding is that legitimate ad-supported venues like Hulu cannot compete with the convenience of piracy. By doing so, the networks destroy their best shot at success in the digital space.

Television piracy is not a waning practice, and the networks should not underestimate the potential for harm. BitTorrent tracking used to be complicated, but, as a disgruntled consumer-turned-pirate in Australia writes, "you don't need to be a nerd to figure this stuff out anymore."<sup>251</sup> Many pirate sites now stream their content, and a simple

<sup>247</sup> Tom Lowry, *Google TV Ads: Still A Tough Sell*, BUS. WEEK, Feb. 13, 2009, available at [http://www.businessweek.com/technology/content/feb2009/tc20090213\\_506671.htm](http://www.businessweek.com/technology/content/feb2009/tc20090213_506671.htm).

<sup>248</sup> James McQuivey, Forrester Research, *Preparing For The Coming Online TV Backlash*, Mar. 13, 2009.

<sup>249</sup> Jason Kilar, *Customer Trust is Hard Won, Easily Lost*, Hulu, Jan. 13, 2009, <http://blog.hulu.com/2009/1/13/customer-trust-is-hard-won-easily-lost>.

<sup>250</sup> Holmes, *supra* note 113.

<sup>251</sup> Aturner, *Is The Way On Online Piracy Lost?*, DIGIHUB, SYDNEY MORNING HERALD, Feb. 1, 2009, available at <http://digihub.smh.com.au/node/249>.

search can result in free versions of just about any show.<sup>252</sup> For example, to watch one of the aforementioned “expired” episodes of *Friday Night Lights*, simply search for “Friday Night Lights Season 3 Full Episodes” and they are but a click away. Moreover, innovations in piracy technology are as exciting as any other in the digital world. Consider the Torrent Episode Downloader, which allows a user to subscribe to a full season of a show,<sup>253</sup> or Feed My Torrents, which allows a user to remotely add torrents to an RSS feed which then download automatically.<sup>254</sup> Nor will the piracy problem fade: generations of internet-savvy, copyright-ambivalent “youth” now bleed into adult demographics.

The networks will never overcome the piracy problem by hoarding content and fighting amongst themselves. Instead, they should work together to win the trust and loyalty of consumers by ensuring that content is easily accessible and that shows do not unexpectedly vanish from user-beloved sites like Hulu. To that end, the networks must make more deals with one another and other distributors, without timetables and unreasonable exclusivity provisions, and they must open their content to STBs and other TV/Internet convergence devices. As Forrester Research writes in a report subtitled “An Open Letter To An Industry On the Verge of A Big Mistake:” “[W]e recommend that content owners and online TV show aggregators aggressively work together to strengthen the model and integrate it into broader strategies that include the TV as well as connected devices in the living room and elsewhere. If not, somebody else will serve consumers, legally or not.”<sup>255</sup>

#### D. *Avoid Another Strike*

The agreement between the AMPTP and SAG has expired. The two parties were mired in negotiations for months, largely because they could not agree on terms for “new media.” The AMPTP claimed SAG was asking for a better deal than they granted to the WGA, the Directors Guild, and four other labor unions.<sup>256</sup> SAG claimed they were only asking for “fair and reasonable modifications” specific to the

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<sup>252</sup> Brian Stetler and Brad Stone, *Digital Pirates Winning Battle With Studios*, N.Y. TIMES, Feb. 4, 2009, available at <http://www.nytimes.com/2009/02/05/business/media/05piracy.html?pagewanted=1>.

<sup>253</sup> Torrent Episode Downloader, <http://www.ted.nu/> (last visited Mar. 30, 2009).

<sup>254</sup> FeedMyTorrents, <http://feedmytorrents.com/> (last visited Mar. 30, 2009).

<sup>255</sup> McQuivey, *supra* note 249.

<sup>256</sup> An Open Letter to the Entertainment Industry from the Alliance of Motion Picture and Television Producers, (Dec. 1, 2008), available at <http://www.amptp.org/proposals.html> (last visited Mar. 30, 2009).

needs of actors.<sup>257</sup> Regardless, a deal was finally reached and (narrowly) approved by the SAG board in May 2009, and ballots from SAG membership approving or killing the deal will be returned after this article goes to print.<sup>258</sup>

The WGA strike was devastating to California's economy, below-the-line workers who rely on production for employment and many others who earn a living via the industry, not to mention the strikers themselves. Considering the crippling economic environment, another work stoppage would be even more distressing. Further, SAG has imploded from within, a pro-strike faction is embroiled in a lawsuit with the rest of the union,<sup>259</sup> and most new television shows have moved forward under a ratified contract with the American Federation of Television and Radio Artists (AFTRA).<sup>260</sup> For these reasons, it is likely the SAG deal will be approved and the guilds will not strike during the next round of negotiations in 2011.

Nevertheless, the television industry should be urging the AMPTP to avoid a strike if at all possible. During the WGA strike, content creators awakened to the fact they no longer need Hollywood in order to produce and distribute their product, and many Hollywood professionals put their hat in the online video ring. As director Doug Liman expressed, the WGA strike will be "best remembered [as] the strike where the writers [showed] they can do it without the studios."<sup>261</sup> If there is another strike in Hollywood, and the work stoppage lasts for any substantial length of time, there is no question that the many out-of-work writers, directors, producers and actors will utilize their time off by working in the digital space.<sup>262</sup> The last thing the television industry needs is for professional talent – especially celebrities with large audience pull – to get more deeply involved in independent, online content creation. During the WGA strike, the networks saw double digit declines as their audiences moved to cable and the internet.<sup>263</sup> Another strike would surely accelerate this trend.

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<sup>257</sup> Screen Actors Guild, Fact Checking the AMPTP (Dec. 1, 2008), available at [http://www.sag.org/files/documents/Fact\\_Checking\\_the\\_AMPTP\\_December\\_1.pdf](http://www.sag.org/files/documents/Fact_Checking_the_AMPTP_December_1.pdf).

<sup>258</sup> Jonathan Handel, *SAG Board Approves Studio Deal*, DIGITAL MEDIA LAW, Apr. 20, 2009, <http://digitalmedialaw.blogspot.com/2009/04/sag-board-approves-studio-deal.html>.

<sup>259</sup> Jonathan Handel, *Lawsuit Blocks SAG Negotiations*, DIGITAL MEDIA LAW, Feb. 3, 2009, <http://digitalmedialaw.blogspot.com/2009/02/lawsuit-blocks-sag-negotiations.html>.

<sup>260</sup> Jonathan Handel, *Pilot Season 94% AFTRA*, DIGITAL MEDIA LAW, Mar. 11, 2009, <http://digitalmedialaw.blogspot.com/2009/03/pilot-season-94-aftra.html>.

<sup>261</sup> Mike Bruno, *Doug Liman Forms WGA-Approved New Media Company*, HOLLYWOOD INSIDER, ENT. WEEKLY, Jan. 17, 2008, <http://hollywoodinsider.ew.com/2008/01/doug-limon-form.html>.

<sup>262</sup> Morris, *supra* note 39.

<sup>263</sup> Carr, *supra* note 213.



It would have been wiser for the unions to wait until the 2011 contract negotiations to wage the “new media” war. This go-around the unions have been clamoring for a piece of revenue pie that does not yet exist in any substantial way, and the AMPTP is understandably scared to bind itself to a pay structure that may not make economic sense in the digital world, especially when it sees its current business models crumbling so rapidly. Besides, once TV/internet convergence occurs, traditional and new media will both be simply “video,” and many of the deal points negotiated based on this distinction will cease to be meaningful. All the same, the unions chose this round of negotiations to take up the fight. In light of this fact, the television industry would be wise to avoid another labor walkout, which would surely hasten its demise.

At the same time, union and talent representatives need to recognize this new “Golden Age” of television<sup>264</sup> does not necessarily translate to healthy balance sheets. Saving traditional media (along with substantial upfront artist fees) will require cooperation between the AMPTP and guilds. The Hollywood crew union (the International Alliance of Theatrical Stage Employees) contract, ratified in early 2009, may be a sign the unions are ready to make reasonable concessions. In response to member complaints over deal terms, President Matthew Loeb gave a telling and promising response: “We feel we have given our members the best protection we can at a time when the bottom is falling out of a lot of traditional business models.”<sup>265</sup>

### E. *Invest in Good Programming*

At a 2007 Wharton School of Business Summit entitled “Hollywood Meets Wall Street,” Jeffery Berg, chairman and CEO of the talent agency International Creative Management, conveyed the state of the industry in his keynote address. In a post-speech interview, he noted that “[i]t’s an industry in severe transition to alternative technologies and delivery systems which are altering the ways in which consumers access programming and content. [However,] ultimately, our business is driven by the quality of ideas, and it favors those with a high level of artistic expression.”<sup>266</sup>

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<sup>264</sup> *Id.*

<sup>265</sup> Jonathan Handel, *Hollywood Crew Deal Ratified*, DIGITAL MEDIA LAW, Mar. 21, 2009, <http://digitalmedialaw.blogspot.com/2009/03/hollywood-crew-deal-ratified.html>.

<sup>266</sup> *Investing in the Fragmented Entertainment Industry: Is Safe Better than Sexy?*, KNOWLEDGE AT WHARTON, May 02, 2007, <http://knowledge.wharton.upenn.edu/article.cfm?articleid=1726>.

If the networks are going to shine through an overcrowded content market, it will be because they have good shows with a high level of artistic expression. Digital technologies have placed the consumer in the driver's seat, and network programming will be our destination only if it is a product worthy of our time. We have seen the rise of interesting, quality, award-winning shows on cable, while the networks have increasingly relied on reality gimmicks, recycled formats and low-concept fare. But if the networks truly believe "content is king," they cannot clothe their king in pauper's robes. If content really is the key to their survival, they must do better by the crown.

## VI. CONCLUSION

The Big Four networks have long been in the business of producing and distributing entertainment content. However, as illustrated above, digital technologies have undermined the networks' distribution business and democratized content creation. Content has proliferated on the web, and the television networks now face intense competition from cable and independent online video producers. As a result, audiences have fragmented and the networks have seen their advertising revenues decline. These challenges facing the networks will only worsen when TV/internet convergence technology reaches a tipping point and we have the ability to watch web video on our HD plasma television sets. The networks are taking important steps to preserve their business model by building distribution platforms and ubiquitously placing their content online. They are investing in social media, forming branded entertainment partnerships and cutting their programming costs.

Yet, despite these efforts, the question remains: can network television survive?

The entertainment industry has faced challenges brought on by new technology in the past – from radio, to television and the VCR – and it has survived them all. Television too will survive. It is likely there will always be a demand for network television, especially as a platform for sports, live events, news and other local programming. Yet the internet is a disruptive technology.<sup>267</sup> We have seen its devastating impact on both music and newspapers, which does not bode well for network television. It is likely that competition for audiences will be fierce in the future, and the Big Four networks will continue to lose market share. With the economics of the industry continually shrinking, the networks' current business model is simply not sustainable.

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<sup>267</sup> Odlyzko, *supra* note 23.

In the short term, there is likely to be industry consolidation. One possibility is that one or more networks will exit the industry altogether and become cable. The networks are averaging a 5% to 6% loss in viewership per year while the top five cable networks are growing by those same numbers.<sup>268</sup> Networks have traditionally been more far-reaching than cable, but if this trend continues, the audience gap will evaporate within four years.<sup>269</sup> Without a ratings advantage, a network would have little to lose by becoming cable and could benefit from the cable model. Cable has a shorter, more flexible programming schedule and pays lower production-related compensation rates.<sup>270</sup> The move would not be entirely unprecedented – before the WB and UPN became the CW network, Warner Brothers executives considered launching WB Cable.<sup>271</sup>

Another possibility is consolidation through merger and acquisition. As an independent network with 70% of its revenues tied to advertising,<sup>272</sup> CBS is a prime candidate for acquisition. There are rumors that CBS Chairman Sumner Redstone, struggling with mounting debt, may seek to sell all or part of the network.<sup>273</sup> There are also rumors floating around cyberspace that General Electric, parent of NBC Universal, is seeking to spin off its media assets.<sup>274</sup> Other rumors suggest Time Warner is an interested buyer; as is News Corp., parent of Fox, who has a “war chest” of cash on hand.<sup>275</sup>

In any case, in the near term there is likely to be a major change in the television landscape. When this change will occur, however, is still unclear. The global economic crisis may take its toll on network balance sheets and accelerate the process; on the other hand, a lack of funding for technology upstarts may buy the networks a little more time. Certainly limitations in our nation’s infrastructure will play a part, unless effectively countered by the Obama Administration’s Next-Generation broadband policies.<sup>276</sup>

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<sup>268</sup> Mermigas, *Broadcast, Cable Network Parity Play*, *supra* note 2.

<sup>269</sup> *Id.*

<sup>270</sup> *Id.*

<sup>271</sup> Schneider, *Needed: Network Bailout*, *supra* note 205.

<sup>272</sup> Diane Mermigas, *Big Media Coming Apart at the Seams*, MEDIA POST, Oct. 30, 2008, [http://www.mediapost.com/publications/?fa=Articles.showArticle&art\\_aid=93753](http://www.mediapost.com/publications/?fa=Articles.showArticle&art_aid=93753).

<sup>273</sup> Julia Boorstin, *Predictions: 9 For '09 in Media*, CNBC, Dec. 1, 2009, <http://www.cnbc.com/id/27907245>.

<sup>274</sup> Julia Boorstin, *Time Warner Cable Spinoff and NBC Universal Rumors*, SEEKING ALPHA, May 22, 2008, <http://seekingalpha.com/article/78379-time-warner-cable-spinoff-and-nbc-universal-rumors>.

<sup>275</sup> Boorstin, *Predictions*, *supra* note 274.

<sup>276</sup> The Obama Administration seeks to “drive economic growth and solve national problems by deploying a 21st century information infrastructure” including a “comprehen-

The long-term future of network television is less certain. It seems likely that some form of network television will survive in a TV/internet converged world, but it is another question whether it will prosper. We are only beginning to see the impact digital technologies can have on our society and the challenges they present for traditional business. The networks – and television providers in general – will have to adapt and transform to thrive in the changing media ecosystem, perhaps radically. Only time will tell, but however the story unfolds, it is sure to be captivating.

In the end, the demise of any or all of the television networks should not affect consumers too adversely. Digital technology has given viewers power, and the entertainment industry is heeding consumer demands. We are getting what we want, when we want it and how we want it. Our choices are growing exponentially by the minute, and the technologies in our gadgets are improving at breakneck speeds. In addition to quality television content, we have a new genre of short-form webisodic content flourishing online. More content creators vying for our attention will surely lead to more experimentation and innovation in storytelling, and the long tail assures that even the most niche content can find its audience. Content may or may not be king, but one thing is more certain than ever: the customer is always right.

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sive national broadband plan.” See The White House, Technology, <http://www.whitehouse.gov/issues/technology/> (last visited June 4, 2009). This policy is revised from the Obama-Biden transition team policy which stated the goal of “[getting] true broadband to every community in America.” See Change, Technology Agenda, [http://change.gov/agenda/technology\\_agenda/](http://change.gov/agenda/technology_agenda/) (last visited June 4, 2009).

