THE NEED FOR A REGULATORY SAFETY NET

Broadcasting Policy and Canadian Television Drama in English Canada in the Next Five Years

A Report by
The Coalition of Canadian Audio-visual Unions

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CCAU
Coalition of Canadian Audio-visual Unions

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Introduction and Executive Summary

1. Introduction

This report was prepared by the Coalition of Canadian Audio-visual Unions ("CCAU"), and focuses on the production of Canadian English-language television drama productions over the next five years. The report addresses the current state of play, and provides projections for the advertising revenue of conventional television broadcasters over the next few years. After reviewing the capacity of the broadcasting sector to support new Canadian drama, and the problems that need to be addressed, the report concludes with recommendations for broadcasting policy.

The CCAU is a coalition of ten Canadian audio-visual unions. The members of the CCAU include the following organizations that financed the preparation of this report: the Alliance of Canadian Cinema Television and Radio Artists ("ACTRA"), the Directors Guild of Canada ("DGC"), the National Association of Broadcast Employees and Technicians Local 700-CEP ("NABET"), and the Writers Guild of Canada ("WGC"). The other members of the CCAU are the American Federation of Musicians – Canada ("AFM-Canada"), Union des artistes ("UdA"), the Communications, Energy and Paperworkers Union of Canada ("CEP"), Association des réalisateurs et réalisatrices du Québec ("ARRQ"), Association Québécoise des techniciens de l'image et du son ("AQTIS"), and Société des auteurs de radio, télévision et cinéma ("SARTeC").

This report focuses only on English-language Canadian drama. We do not comment here on issues relating to French-language drama, other than to note that the environment for French-language drama in Canada is entirely different and calls for different approaches. In particular, French-language programs are more insulated from direct competition with U.S. programs; by contrast, English-language Canadian drama competes directly with U.S. programs that are effectively dumped into Canada at a fraction of their production cost.

Accordingly, references to "Canadian drama" in this submission relate only to English-language Canadian dramatic programs (including both drama and comedy) unless otherwise specified.

2. Executive Summary

This report contains revealing new information on the ability of Canada's conventional private broadcasters to produce and air original Canadian dramatic programming.

Spending on Canadian drama by the private broadcast sector hit a seven-year low in 2004, dipping to only $53.6 million from a high of $73.0 million in 1998.

During that time, the percentage of advertising revenue the broadcasters spent on eligible Canadian programming stayed the same from year to year – at around 27% – but spending on American programming rose from 27% of revenue to an all-time high of 34%. Over the past five years, broadcasters have increased the amount of money they have spent on Canadian programming by only 8.5% – which doesn't even match the 12.8% rate of inflation over the same period. By contrast, their spending on U.S. programming rose by 54% in the same five years.

And although this year the CTF announced it would provide almost $100 million in funding for 36 English-language drama productions, this will only generate three more hours of drama programming than the year before.

This on-going decline in the development, production and broadcast of original Canadian drama is a serious problem that must be addressed.

Drama is expensive to produce. Support from the public and private broadcast sectors is essential for its survival; therefore the CCAU retained Nordicity Group Ltd. to validate projections for the advertising revenue likely to be generated by the private broadcast sector. Working with estimates from PricewaterhouseCoopers LLP, Nordicity concluded that ad revenue for the private conventional TV station groups is likely to increase over the next four years to between $1.8 and $1.9 billion in 2008 – an increase of over $200 million from 2004.

In other words, conventional television will continue to be a lucrative business, despite the broadcasters' fears that audience fragmentation caused by pay and specialty services would hurt revenues.

Although fragmentation did erode audience share, the audience share of the conventional TV broadcasters has stabilized at 40% over the last four years. And instead of declining, the broadcasters' ad revenue rose by almost 35% in that time.

We also found that the introduction of borderless technologies like satellites and the Internet will have little effect.

But despite increasing revenues, we have grave concerns about long-term support by the private broadcasters for Canadian drama. The track record of Canadian broadcasters has amply shown that unless there is a regulatory requirement -- or the imminent threat of one – broadcasters will do what is in their best financial interest. That means broadcasting the cheapest form of priority programming they can produce or acquire in order to meet their priority program scheduling requirement.

That means that even if there is an increase in Canadian drama spending in the next two years, it will not be a reliable indicator of increased future spending. CCAU research indicates that the broadcasters are required to spend almost as much on Canadian drama in 2005 as they did in 2004 <u>just by virtue of transfer and new licence benefits alone</u>.

Broadcasters will also have a powerful regulatory incentive to spend more on drama in 2005 and 2006 since their licences come up for review or renewal in the next two years, and they will want to put the best face on their performance.

Once renewal licences are issued, and the transfer and new licence benefits come to an end, the fate of Canadian drama will hang in the balance.

Therefore, <u>we believe that it is crucial that the CRTC put a long-term regulatory "safety net" in place to ensure that Canadian drama levels do not fall below an acceptable level in English Canada</u>.

That safety net should contain two components.

The first component would be a requirement that private conventional TV broadcasters spend a minimum percentage of their gross ad revenue on Canadian drama. Based on our research, the CCAU believes that the requirement should be at least 7%, and that this should be a minimum level, complemented by incentives that will reward broadcasters that meet or exceed that level.

The second component relates to the amount of new, original Canadian drama production being commissioned by the conventional broadcasters. The CCAU believes that each private station group should be required to commission at least two hours of original 10-point Canadian drama per week.

This 7% minimum level of support, and the weekly two-hour requirement would finally ensure that Canada's private conventional broadcasters play a role in curtailing the current drama decline. Spending on Canadian drama would increase from $53.6 million in 2004 to $129-131 million in 2008.

Over the next few years, pay and specialty revenues are expected to increase faster than that for conventional television. Therefore, it will be also important to ensure that their contributions to Canadian drama increase as well. In that regard, this report has a number of recommendations to increase the transparency and integrity of their support.

But as this report indicates, the CCAU strongly believes that conventional television – CBC and the three private TV station groups in English Canada -- must continue to be the principal mainstay for high-ticket popular Canadian drama. The broadcasters must remain the economic drivers for quality, popular Canadian drama.

We feel our proposed regulations are realistic given the fact that the advertising revenues of conventional broadcasters are forecast to increase over the next five years.

Canadian drama is critically important to the future of Canadian television. Drama is not only the most popular genre of TV programming – Canadian dramatic programs allow us to celebrate our experiences, share our stories and identify with other Canadians. The production of Canadian drama is central to our cultural sovereignty.

3. Recommendations

Based on the foregoing, the CCAU has made the following recommendations:

Recommendation 1

The CRTC should develop and implement a two-part regulatory "safety net," applicable to each of the private TV station groups, comprised of the following obligations:

(1) a minimum of 7% of the previous year's ad revenue to be expended on Canadian drama, and

(2) at least 2 hours per week of new original 10-point Canadian drama to be commissioned.

Recommendation 2

Station groups should be required to allocate a reasonable proportion of their Canadian drama budget for script and concept development.

Recommendation 3

Station groups should be required to allocate a reasonable proportion of their Canadian drama budget to the licensing of Canadian feature films.

Recommendation 4

The CBC should be supported in its efforts to broadcast more original Canadian drama, with more public funding provided for this purpose. The CBC should be given increased access to the CTF only to the extent that private broadcasters are able to replace their dependence on the CTF with non-CTF production funded through the incentive plan or equity participation.

Recommendation 5

Canadian pay and specialty services should be required to make enhanced Canadian content programming expenditures, commensurate with their increased financial resources. Those that include drama in their mandate should be subject to reporting on their contribution to Canadian drama.

Recommendation 6

The CRTC should review its incentive plan so as to make it complementary with the regulatory safety net.

Recommendation 7

The CRTC should provide enhanced annual reporting on the performance of the TV station groups and the pay and specialty television services, with revenues and drama hours and dollars identified.

Recommendation 8

The CRTC should improve the integrity of the financial reporting process by removing or limiting its licence fee top-up policy.

Recommendation 9

The CRTC should improve the integrity of the financial reporting process by imposing more stringent rules on what qualifies as an "equity investment" entitled to be counted as a Canadian expenditure.

Recommendation 10

The CRTC should schedule broadcast licence review hearings for CTV, CanWest Global and CHUM within the next two years so as to be able to review their Canadian drama expenditures and performance on a coherent and consistent basis.

Recommendation 11

The CRTC should ensure that contributions from BDUs to the CTF are maintained and enhanced.

Recommendation 12

The CRTC should ensure that in any digital migration, Canadian analog programming services that include Canadian drama in their mandate are protected from unfair packaging and/or dislocation by BDUs.

Recommendation 13

To qualify as priority programs, all Canadian entertainment magazine shows should be subject to the rule that 2/3rds of the content relate to Canadian entertainment, not just shows produced from Toronto or Vancouver.

Recommendation 14

Private station groups with Canadian entertainment magazine shows should be required to report regularly on their compliance with the 2/3rds rule, and how they have supported a Canadian star system.

B. Canadian Dramatic Productions: The Story So Far

1. Why Drama is Important

Canadian dramatic programs – including both drama and comedy programs -- are the cornerstone of our broadcasting system. For decades, these Canadian programs have brought a wide range of ideas, historical events and voices to life. Canadian dramatic programs have allowed us to celebrate our experiences, share our stories, and identify with other Canadians. Drama continues to be the most popular genre of TV programming, and the production of Canadian drama is central to our cultural sovereignty.

As stated by the Chair of the CRTC, Charles Dalfen, during his address at the Canadian Association of Broadcasters' Annual Conference in October 2002, "Drama is storytelling – and storytelling is close to the heart of human culture." To this, the Chair added: "I believe we need to tell our stories, in all their diversity, through strong Canadian dramatic series." The CCAU strongly agrees with these statements by Mr. Dalfen.

Dramatic programs are indeed the manner in which Canadians tell and share their stories with one another. (In this report, as noted earlier, we use the term "drama" to include both drama and comedy.) In *Degrassi: The Next Generation*, winner of the 2005 Shaw Rocket Prize, we learn about the ups and down of teenage life in multicultural Toronto. In *This is Wonderland*, we see the world of criminal courts and the challenges faced by both lawyers and the accused. In *Corner Gas,* CTV's top-rated Canadian drama program, we enjoy the gentle humour of rural Saskatchewan. And, *The Shields Stories*, a six part series, brought together some of Canada's finest artists to showcase a collection of stories by one of Canada's leading authors, Carol Shields.

These dramatic programs – particularly original "10-point drama," which involves the fullest Canadian creative contribution – serve to strengthen and enrich our broadcasting system. They allow our outstanding screenwriters and other talent to bring Canadian stories to the screen, where they can be shared with viewers from coast to coast. Canadian dramas also provide the production community with an opportunity to share their vision of our experiences, and to archive our Canadian stories for the future. Additionally, Canadian dramas provide Canadians with the pleasure of seeing themselves on TV, an experience that countries the world-over enjoy and go to great lengths to achieve. As Trina McQueen stated at the CTV licence renewal hearings:

> "[M]ost of the viewing to television is in the dramatic genre. That is what people love to see on television. I'm talking overall, not necessarily Canadian or American, but in general folks love a good story, they love an imaginary story and that is what they want from television."

In addition to helping define our Canadian identity, indigenous 10-point drama also helps bind new Canadians to our culture. Shows like *Godivas* and *Metropia,* with diverse leads, and *This is Wonderland*, showing the immigrant experience, help advance Canada's multicultural objectives.

The CCAU is of the view that both drama series and miniseries or movies of the week (MOWs) are important to our broadcasting system. Both of these genres of dramatic programs should be given priority in the television schedules of private broadcasters. Dramatic series bring the continued, familiar and powerful storylines and characters that Canadians love to watch. Movies of the week and miniseries allow Canadian television viewers to explore a broad range of programming genres, ideas, and concepts.

The Commission has consistently affirmed the importance of Canadian dramatic productions as a crucial component of our broadcasting landscape. Notably, in Public Notice CRTC 2003-54, the Commission stated that:

> "Canadian drama should be a cornerstone of the Canadian broadcasting system. Drama can, and should, reflect Canadians of every background and culture to each other…The Commission considers that a healthy and successful Canadian broadcasting system must include popular drama programs that reflect Canadian society and project Canada's stories onto the world stage."

. In the same Public Notice at paragraphs 14 and 18, the Commission added the following observation:

> "As noted in Public Notice CRTC 2003-54, drama is the most popular programming on television. English-language drama programs receive more than twice the number of viewing hours received by any other type of programming...
>
> It is the Commission's preliminary view that effective measures to increase the availability of, and viewing to, Canadian drama programs are needed at this time and that such measures would further the objectives of the *Broadcasting Act* (the Act)."

Additionally, the importance of drama within our broadcasting system was reiterated by most interveners who responded to Public Notice CRTC 2003-54. At paragraph 6 of the Public Notice, the Commission stated that it "received a total of 301 submissions in response to Public Notice 2003-54. A large majority of these were in agreement with the importance the Commission places on Canadian drama…"

The 2003 Report by the Standing Committee on Canadian Heritage (the Lincoln Report), emphasized the importance of Canadian dramatic programming. It determined that the "goal [for English-language drama] must be to create more opportunities and more spaces, to strive for programs that are not only made-in-Canada but also made-for-Canada." (p.8). The Standing Committee on Canadian Heritage also expressed its concern with particular elements of television policy, and recommended that the CRTC be directed to review its 1999 policy for the exhibition of priority programming in prime time.

The Department of Canadian Heritage has also recently recognized the importance of Canadian programs, including dramatic programs, within our broadcasting system. In this regard, it stated the following in its summary of its second response to the Lincoln Report, issued in March 2005:

> "Canadians are best served by a broadcasting system that offers an ample supply of high quality, distinctively Canadian content that enlightens, entertains and informs citizens. To achieve this, the Government will actively encourage the development of compelling programming – particularly drama, children's and cultural programming and documentaries – that reflects that Canadian experience and reaches out to large numbers of Canadians."

The Heritage response also included the following statement:

> "In an environment where funding the economic model for broadcasting is under stress, the Government will…put more emphasis on high-quality Canadian content that reaches wide audiences in the Francophone or Anglophone markets, and that tells Canadian stories and reflects Canada in all its diversity. It is this type of programming that brings us together through common experiences."

2. Why Drama is Hard to Do

It may be appropriate to begin with an important observation. Producing popular television drama, particularly series drama, is not easy! Drama is far more difficult than any other form of television to master. It is a truly collaborative form of art, combining the art of story-telling with sophisticated production skills in screenwriting, composing, performing, directing, and editing, as well as many other talents.

Many look with envy at the success of U.S. television drama. Of course, that drama typically costs well over $3 million (Can.) an hour to produce, three or more times the cost of a Canadian drama per hour. Costs rise even higher for U.S. dramatic series that succeed and are renewed.

But what many forget is that most U.S. television drama series do not succeed. Most drama series in the U.S. fail in terms of hoped-for ratings and are not renewed. And this is so even though millions of dollars are spent in the U.S. in the selection of ideas, commissioning of scripts, filming of pilots, and the use of focus groups. Despite all this effort, the bottom line is that the success or failure of television drama is inherently unpredictable. However, the U.S. networks employ two strategies to minimize risk.

The first strategy is to pour money into script and concept development – where screenwriters write a range of scripts, which are then tested to see which appeals to audiences. This is one of the most important factors in creating a successful drama. This process makes a huge difference to whether a script will work as a production, and is standard practice in Hollywood. As a rule of thumb, Hollywood develops about ten scripts for each show that is produced. Most studios do even twice that to increase the likelihood of making a hit.

In the U.S., a pilot program is usually developed to gauge audience interest before investing millions of dollars to make a full episode run of a series. These pilots are expensive, but studios know the chance of making one monster hit will help cover the development costs of all the other pilots combined. For example, studios are willing to spend as much as $12 million on a pilot, as they did with the two-hour pilot episode of *Lost*. On average, however, a one-hour drama pilot costs $4 million (U.S.), while a half-hour comedy costs about $2 million (U.S.).

The L.A. based Entertainment Industry Development Corporation (EIDC) recently reported that some 131 TV pilots were produced in Hollywood and New York for the 2005 production season, generating about 90 hours of programming and costing $364 million (U.S.) to make.

No wonder Canadians like to watch American programs – these programs have been thoroughly tested before they ever reach the airwaves.

The second strategy of the U.S. networks to minimize risk is to focus on the volume of original production. Every year they commission dozens of new drama programs, in the full knowledge that most of them will not succeed, but with the hope that at least a few will prove to be winners. The economics of the business are such that a winning U.S. drama series can be extraordinarily lucrative for everyone concerned.

In competing with the U.S. juggernaut in television drama, Canada has a few advantages. First, we have an extraordinary talent pool, developed over the last several decades, with a notable track record of past successes. These include screenwriters and show runners like Chris Haddock (*DaVinci's Inquest*), Pete Mitchell (*Cold Squad*), Wayne Grigsby (*Trudeau, Snakes and Ladders*), James Hurst (*Degrassi, Instant Star*), Mark Farrell (*Made in Canada, Corner Gas, This Hour has 22 Minutes*), Brad Wright (*Stargate)*, and Brent Butt (*Corner Gas)*.

Second, our costs for drama are less than a third of those in the U.S. And third, we also have the benefit of a major subsidy program from the Canadian Television Fund, triggered by commitment letters from broadcasters.

However, Canadian drama also faces some extraordinary challenges in order to grow its audience. Here are the main ones.

First, as noted above, our limited budgets mean that we cannot begin to match the U.S. networks in terms of script and concept development, focus group testing and the like. Canada does not have the luxury of shooting a number of pilots which are then never aired. To carry out a process of winnowing at the front end, like the U.S. networks, would require far more investment than has been the case in the past. In our much smaller Canadian English-language market, development costs are seen as too expensive – therefore everything that is written is produced. That means productions are made without knowing if the script will actually work well on the screen. The program quality also suffers because there is no room to commission extra scripts and then select the best to be produced.

In some cases screenwriters fund a large portion, if not all, of the development process themselves, or work without pay to develop part of the project. An example of this is *Blue Murder*, which began as *Major Crime*, a CBC mini-series aired in 1997. Based on the mini-series success, the screenwriter who created it invested his own money to develop it into a drama series. The developed script and concept went to two production companies before it was finally green-lit by CanWest Global in 1999 and aired two years later in 2001. *This is Wonderland* is another example. The creators of that series negotiated a six-script development deal, but also had to personally fund eighteen months of research to develop the project.

A second challenge facing Canadian drama is that we cannot match the huge promotional machine that washes over Canadian households from the U.S. media. Whether it is on *Entertainment Tonight*, Viacom's nightly entertainment magazine show, on *People Magazine*, Time Warner's monthly celebrity magazine, on the *Tonight Show with Jay Leno*, NBC's late-night talk show, or on many other U.S. outlets, the stars of U.S. television drama are constantly being promoted, cross-promoted, and talked about. The resulting "blowback" to Canada uniquely benefits acquired U.S. shows.

Canada has begun to respond, with programs like *Star TV* on CHUM*, etalkDAILY* on CTV, *Inside Entertainment* on Global and *A-List* on Toronto 1. But these provide only a fraction of the "star system" support that comes with the relentless and omnipresent U.S promotional juggernaut. Moreover, as noted further in this report, most of these programs have been recently criticized for focusing mostly on non-Canadian celebrities, not on Canadian entertainment stories. So their contribution has been disappointing.

The third problem faced by Canadian drama is a problem of our own making. The prime-time schedule of the English-language private broadcasters continues to be built around the maximization of simulcast opportunities with U.S. network programs. As a result, much of the prime-time schedule for CTV, Global and CHUM is determined in L.A., not in Toronto. By virtue of this practice, Canadian private broadcasters are severely limited in where they can place Canadian drama series. Since they tend to schedule Canadian drama sporadically around the U.S. simulcast shows, time slots often change. Building audience requires a predictable time slot, and this cannot have helped develop an audience for that program. For example, the scheduled time for CTV's most popular Canadian drama, *Corner Gas*, was shifted three times to accommodate the simulcast of *American Idol*. Notwithstanding this, *Corner Gas* still garnered rating in excess of 1.5 million viewers across Canada. But those ratings would undoubtedly have been even higher if it had had a consistent slot on the schedule.

A fourth factor affecting the ratings of Canadian drama is the tendency by Canadian private broadcasters to schedule that drama in shoulder periods (7-8 p.m., 10-11 p.m.), on lower viewing nights (Friday and Saturday), in weeks other than BBM sweep weeks, and in the summer period.[1] Canadian dramas are virtually shut out of the best 9 or 10 p.m. slots on Monday or Tuesday nights. The number of persons watching television is significantly lower in shoulder periods. On Friday and Saturday evenings, households tuned to TV

[1] In that regard, BBM audience numbers inflate U.S. drama ratings compared to Canadian because they are based on sweep week comparisons. However, the CTF has recently led a project in collaboration with the CRTC to use year-round audience data. See Canadian Television Fund, Annual Report, 2003-2004, at pp.12-17.

declines by 10-15% compared with the audience on Sunday through Thursday evenings. The common practice of scheduling Canadian drama on Friday and Saturday evenings -- when fewer people are watching -- therefore contributes to the lower ratings achieved.

The same phenomenon occurs when Canadian programs are scheduled in the summer months. The number of persons watching TV declines significantly in the summer. Yet that is when a heavier than average number of Canadian shows are often scheduled. Again, with fewer households tuned to television, ratings for Canadian shows are inevitably lower.

A fifth problem for Canadian drama is that Canadian broadcasters do not order up enough episodes to build audience loyalty each season. U.S. networks typically order 22 episodes of a new series. In Canada, unless the series is an industrial drama pre-sold to a U.S. network, the Canadian stations only order up 13 episodes per season, and some Canadian series have only six episodes. (The CTV benefits package has recently allowed a number of series to be "topped up" to 22 episodes). With only 6 to 13 new episodes in the can each year, it is much harder to develop and maintain a loyal audience week after week.

A sixth problem relates to the nature of the Canadian drama. With some exceptions, ratings in Canada have been generally better for distinctive Canadian drama – typically qualifying as 10-point Canadian drama under CRTC rules -- than for so-called industrial drama, i.e. drama pre-sold to a U.S. specialty service without any obvious Canadian markers, and usually qualifying as only 6-point Canadian drama. The recent ratings success of series like *Corner Gas* and *Degrassi: The Next Generation* provide eloquent testimony to this. Yet Canadian broadcasters have an economic incentive to purchase 6-point Canadian industrials instead of 10-point Canadian distinctive drama, since the licence fees can be much cheaper if some of the costs are borne by a U.S. programming service. The heavy reliance in the past on 6-point generic industrials has also undoubtedly lowered the overall ratings performance of Canadian drama in the system.

A final problem relates to the number of repeats. Here we are not talking about the normal repeats that occur in the first cycle of a Canadian drama's conventional window. Rather, we are talking about the practice of filling part of the requisite 8-hours of priority programming with repeats of past years' episodes of Canadian drama, episodes that have been made in earlier years and that have already run at least 2 or 3 times on Canadian free-to-air television.

If we want to increase the ratings for Canadian drama, our first task must be to constantly prime the pump with new original episodes. Viewers want new, original programs rather than repeats. If we run repeats after repeats, we are simply living off capital and not investing in the future.

Drama continues to be the most popular genre on television, outlasting and now far surpassing reality programming. U.S. dramas like *Desperate Housewives, Lost* and *CSI* currently dominate the top 20 lists. The appetite for drama is there. Recent experience has shown that if a sufficient volume of adequately financed Canadian drama is produced and given pride of place in the schedule, Canadian viewers will respond positively. But we need more choice of Canadian drama in the schedule. It is essential to Canadian sovereignty that we have a significant representation of Canadian drama on our airwaves.

3. The Evolution of CRTC Policies to Support Canadian Drama

As noted above, Canadian dramatic productions are the life-blood of the Canadian broadcasting system, and the Canadian independent production sector. However, due to the size and the economic realities of the Canadian marketplace, the Canadian market cannot be relied upon to sustain this sector. There are two economic realities to be confronted here:

- The Canadian television market, already small in comparison with the U.S. market, is further subdivided into English and French language markets.

- U.S. programs are sold to Canadian broadcasters at prices that are a fraction of their U.S. production cost, a practice that is the equivalent of dumping.

Therefore, in order to develop, thrive and to be successful, the Canadian dramatic production sector requires government support and regulatory measures.

The history of CRTC regulation to support Canadian drama is long and complex. A summary of this history is provided in Appendix 1 of this report.

Prior to 1999, the two largest private broadcasters in English Canada were the CTV Network and Global Ontario. In the period immediately up to 1999, both licensees were subject to licence conditions that required them to broadcast a certain number of hours of original Canadian drama each week, and to expend a certain dollar amount on "entertainment programming," defined to mean drama, music and dance. The hours and amounts are set out in Appendix 1.

However, these rules were all supplanted by the Commission's TV Policy in 1999, which eliminated the expenditures rules for conventional television, and changed the scheduling requirement to focus on a minimum number of so-called "priority programs," a category that was expanded to include documentaries and regional non-news programs. The 1999 TV Policy is described in detail in Appendix 1.

4. The Canadian Television Fund (CTF)

The production of Canadian drama has been supported by federal subsidy programs since 1984. Ten years later, in 1994, this program, administered by Telefilm Canada, was supplemented by the newly created Cable Production Fund. Since 1996, the two subsidy programs funds have been combined into a single integrated initiative, now called the Canadian Television Fund (CTF).

The CTF, as created in 1996, is a private-public initiative that saw the Department of Canadian Heritage, the Canadian cable industry, and Telefilm Canada join together to create a funding body for programming in Canada. This fund is a key contributor to the creation of Canadian programming. Its current budget is approximately $230 million per year. These funds are directed towards two initiatives that support the creation of Canadian programming. The Licence Fee Program has a budget of approximately $145 million composed of $37 million from the Department of Canadian Heritage and approximately $108 million from Canadian cable and satellite distributors. The Equity Investment Program, administered by Telefilm Canada, has a budget of $85 million made up of $40 million from the Department of Canadian Heritage and $45 million from Telefilm Canada.

Funding for the CTF depends on the CRTC and the government. The contribution from broadcast distribution undertakings (BDUs) has risen to about $125 million a year, but is vitally dependent on the continuance of the CRTC regulation requiring BDUs to contribute a percentage of their revenue from broadcast distribution activities to the CTF.

The contribution from the government is dependent on the continuance of annual federal budget commitments. In March 2004, the government announced that it would restore its traditional $100 million commitment to the CTF for 2004-05 and 2005-06.

The CTF plays an absolutely critical role in supporting English-language Canadian drama. In 2003, it contributed $85.1 million in funding to support such productions, and this increased to $96.1 million in 2004 and $99.2 million in 2005. CTF funding now typically accounts for upwards of 37% of the financing for English-language drama productions.

The 2003 Lincoln Report recognized the importance of the CTF to the development and production of Canadian programming. In this regard, it stated at page 169 of the report that:

> "The Committee also notes that the Canadian Television Fund (CTF)…has become a key element in the financing of many Canadian productions. Indeed, Professor Catherine Murray's examination of the Fund concluded that: "Among all financing instruments to promote Canadian production, the CTF is the…most cultural in its objectives." Witnesses often noted, however, that uncertainty over the government's intentions for the CTF discourages planning and investment.
>
> <u>The Committee sees it as imperative that support targeting the funds…be stable…The Committee is also of the view that a refocused CTF should receive increased and stable funding</u>." [Emphasis added]

In its first response to the Lincoln Report, the Department of Canadian Heritage also supported the CTF and stated that this fund can play an integral role in the creation of Canadian programming. It, however, also found that the CTF must prove its worth and should support productions that attract growing Canadian audiences.

In its second response to the Lincoln Report, issued in March 2005, the Department recognized the CTF as an essential component of the Canadian broadcasting system and the most appropriate tool to support the development of Canadian television programming. The government undertook in this second response to take four steps to improve the CTF, which are:

- the government will work with Telefilm Canada and the CTF to investigate the efficiency and impact of the EIP for television;
- the evaluation of the CTF will give particular attention to assessing the efficiency of the fund;
- the government is working with stakeholders to bring changes to the governance and administration of the CTF by June 2005;
- the government expects that the CRTC to review its approach to handling benefits with respect to television ownership transactions with a view to channelling some of those benefits to the CTF. (p.10 DCH Second Response).

Thus, the Canadian government clearly supports the continued existence of the CTF. However, no new funding commitments have been made beyond the 2005/2006 year.

5. Tax Credits

Tax credits have been essential to the production of many Canadian productions over the past 30 years. As stated in the CFTPA's *Profile 2005*, "tax credits are clearly a win-win proposition – producers come to the table with capital while government gains economic stimulus."[2] The following is an overview of the tax credit regime in Canada.

The Canadian Audio-Visual Certification Office (CAVCO) was created in 1974 and co-administers two federal production tax credits with the Canada Revenue Agency (CRA): the Canadian Film or Video Production Tax Credit (CPTC) and Film or Video Production Services Tax Credit (PSTC). The objective of the CPTC is to encourage the creation of Canadian programming and to help develop a domestic production sector. It is a refundable tax credit that is available at a rate of 25% of eligible salaries and wages incurred after 1994. Under the CPTC program, eligible salaries and wages cannot exceed 60% of the cost of a production.

The purpose of the PSTC is to encourage production of film and video productions in Canada without regard to Canadian content and ownership. The goal of this tax credit is economic; it seeks to attract foreign productions to Canada and to employ Canadian residents. The PSTC is equal to 16% of salary and wages that are paid to Canadian residents or taxable Canadian corporations. There is no cap on the amount of labour that can be claimed under the PSTC.

[2] CFTPA Profile 2005, p.7.

All provinces in Canada, including Ontario, Quebec, B.C., Manitoba, Nova Scotia and Saskatchewan, provide tax credits for film and television productions. The level of the tax credit provided at the provincial level can vary from province to province. With the rise in the Canadian dollar, the SARS epidemic, and the rise in film incentive packages in other Canadian provinces as well as various places around the world (such as New York, South Carolina, Iceland, and South Carolina), the film sector in Ontario took a heavy beating.

Following months of industry pressure, several provinces raised their domestic and foreign service tax credits in late 2004 and early 2005. Ontario led the way with December tax changes raising the foreign production tax credit from 11% to 18% and the Canadian production credit from 20% to 30%. Quebec followed by increasing its foreign credit to 20% with no increase to the domestic credit. In January 2005 British Columbia bowed to threats from its producers to move work east by matching the Ontario rates, while Manitoba increased its rates to 40% for all productions. By March, Nova Scotia raised its film and TV tax credits from 30% to 35% for Halifax shoots and from 35% to 40% for productions shot outside of the capital.

Both the federal and provincial tax credit programs provide significant support for the production of Canadian programs. In 2003/04, federal and provincial tax credits accounted for 22% of the financing for CAVCO-certified television productions (which include television series, movies of the week, and single-episode programs produced for television). This is a significant and much needed source of production financing. The following chart provides the breakdown of the sources of financing of CAVCO-certified television productions from 1998/99 to 2003/04. Note that in 2003/2004 the federal and provincial tax credit regimes provided over $300 million in support for CAVCO certified productions.

Financing of CAVCO-Certified Television Production

	1998/99		1999/00		2000/01		2001/02		2002/03		2003/04	
	%	$ (millions)	%	$ (millions)	%	$ (millions)	%	$ (millions)	%	$ (millions)	%	$ (millions)
Private Broadcasters	12%	198.2	12%	200.8	15%	239.8	17%	248.9	20%	301.9	22%	310.4
Public Broadcasters	6%	100.5	6%	105.4	7%	110.2	8%	124.6	10%	148.9	13%	186.8
Federal Tax Credit	**9%**	**154.4**	**9%**	**153.4**	**9%**	**146.0**	**9%**	**134.4**	**9%**	**135.0**	**10%**	**138.2**
Provincial Tax Credits	**10%**	**161.7**	**10%**	**167.2**	**10%**	**157.8**	**11%**	**163.7**	**12%**	**180.2**	**12%**	**172.3**
Canadian Distributor	13%	219.9	13%	216.8	15%	233.3	11%	161.5	8%	119.8	7%	101.5
Foreign	29%	471.2	28%	474.1	22%	339.6	21%	321.3	16%	241.9	11%	160.1

Public*	7%	110.1	7%	110.0	7%	105.4	8%	122.4	9%	136.3	9%	132.9
Other Private**	14%	231.5	14%	240.3	15%	233.8	15%	229.9	18%	272.5	16%	220.7
Total	**100%**	**1,647.4**	**100%**	**1,668.1**	**100%**	**1,565.9**	**100%**	**1,506.7**	**100%**	**1,536.4**	**100%**	**1,423.0**

*Public includes financing from the Canadian Television Fund (Equity Investment Program), provincial governments, Telefilm Canada and other government departments and agencies. **Other Private includes financing from production companies, corporate production funds, the Canadian Television Fund (Licence Fee Program) and other private investors. Note: Some totals may not add due to rounding. Source: Estimates based on data obtained from CAVCO. See Exhibit Notes 2 and 4. Based on CAVCO classifications.

Tax credits have also been a key element to the production of dramatic programs. The following table shows the financing sources by genre for CAVCO certified film and television productions. Fiction and children's programming (much of which consists of drama) relied heavily on the provincial and federal tax credits, with 22% of the children's programming financing and 21% of the fiction programming financing attributed to federal and provincial tax credits.

Sources of Financing of CAVCO-Certified Film + TV Production, by Genre, 2003/04

	Children's		Documentary		Fiction		Movie, Performing Arts & Variety		Other		All Genres	
	%	$ (millions)	%	$ (millions)	%	$ (millions)	%	$ (millions)	%	$ (millions)	%	$ (millions)
Private Broadcasters	19%	45.8	26%	63.5	11%	108.6	21%	24.5	51%	80.9	19%	327.3
Public Broadcasters	9%	21.0	10%	24.4	8%	76.9	34%	38.9	14%	22.5	11%	192.3
Federal Tax Credit	**10%**	**23.2**	**9%**	**23.2**	**8%**	**80.2**	**10%**	**11.9**	**10%**	**16.6**	**9%**	**155.3**
Provincial Tax Credits	**13%**	**30.1**	**14%**	**33.5**	**13%**	**126.7**	**13%**	**15.6**	**10%**	**15.8**	**13%**	**221.6**
Canadian Distributor	12%	27.5	3%	7.7	10%	99.2	3%	3.1	1%	1.1	8%	135.1
Foreign	8%	19.2	8%	20.9	16%	152.8	3%	3.5	1%	2.0	11%	195.5
Public*	9%	21.5	11%	26.0	19%	178.7	4%	4.1	4%	6.2	14%	233.4
Other Private**	20%	47.7	19%	47.9	14%	138.2	12%	14.5	8%	13.4	15%	258.3
Total	**100%**	**235.9**	**100%**	**246.9**	**100%**	**961.3**	**100%**	**116.1**	**100%**	**158.4**	**100%**	**1,718.7**

*Public includes financing from the Canadian Television Fund (Equity Investment Program), provincial governments, Telefilm Canada and other government departments and agencies. **Other Private includes financing from production companies, corporate production funds, the Canadian Television Fund (Licence Fee Program) and other private investors. Note: Some totals may not add due to rounding. Source: Estimates based on data obtained from CAVCO. See Exhibit Notes 2 and 4. Based on CAVCO classifications.

The Standing Committee on Canadian Heritage heard a great deal of testimony with respect to the federal tax credit regime during its two-year review (2001-2003). In its final report (the Lincoln Report), the Committee made two recommendations with a view to rendering the federal tax credit system more effective and flexible. The following are the recommendations in this regard:

> "5.5: The Committee recommends that the appropriate department evaluate the existing federal tax credit system that supports Canadian television programming to find means to improve the way support is managed and delivered to Canadian independent producers.
>
> "5.6: The Committee recommends that the appropriate department investigate the feasibility of developing a more flexible tax credit system for Canadian television production (e.g. levels of support that increase with more involvement by Canadian creators)."

In its second response to the Lincoln Report, the Department of Canadian Heritage recognized the importance of the federal tax credits for the Canadian television and film production sector. At page 10 of its response, it stated that "[a]nother important and successful tool to support the production of Canadian television and films and to further the development of the production industry in Canada is the Canadian Film and Video Production Tax Credit (CPTC)." It also outlined three ways in which it will be looking to change the CPTC, which are the following:

> "First, the government, through the Canadian Audio-Visual Certification Office (CAVCO), is consulting with stakeholders on several specific proposals to further efficiency.
>
> "Second, the Government, through CAVCO, will be creating an advisory committee to act as a sounding board for future policy and process decisions and to keep abreast of the challenges facing the industry.
>
> "Third, the Government will assess the current CPTC in 2005 with a view to make it a more efficient instrument to support the production of Canadian content."

A continuing issue relating to the tax credit system is the relative support the CPTC gives Canadian productions as compared with the support given to foreign productions by the PSTC. In 2003, the federal government raised the PSTC by almost 50% but no parallel increase was made to the CPTC. More recently, however, the all-party pre-budget report of the Finance Committee recommended an increase to the CPTC from 25% to 30% to encourage domestic production.

CCAU members have consistently argued that the CPTC system must have as its prime consideration the support of 10-point Canadian drama. This will continue to be a preoccupation as reforms are made to the tax credit system.

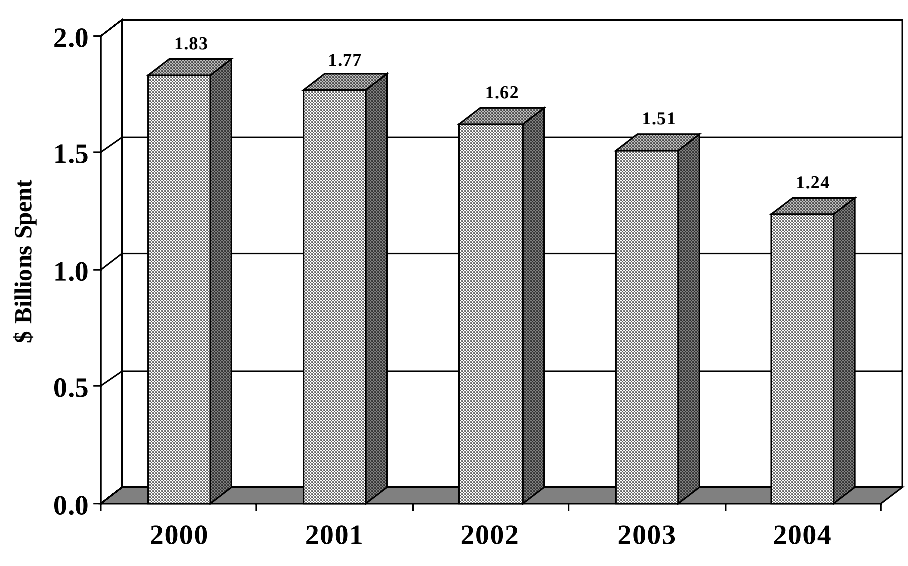
6. The Crisis in Canadian Drama

As reiterated throughout this report, it is evident that in order for Canadian drama to have a future in Canada and to find a strong place in the schedules of Canadian broadcasters, increased funding from broadcasters is essential. In general, that funding should take the form of higher broadcast licence fees as a proportion of the budget.

Throughout the mid-1990s, Canadian independent production and development spending was on a constant rise, peaking in 2000 at $1.18 billion, according to *Playback*'s Report on Independent Production A major contributor to this was the production of Canadian dramatic series and feature films.

Over the last four years, however, there has been a steady decline in independent production generally, and Canadian dramatic series and feature films specifically. Chart 1 below, based on an annual survey of the independent production sector from *Playback*, shows the steady downward trend since 2000. It should be noted that the production and development expenditures shown in Chart 1 include all independent productions, not just drama, and include productions for pay and specialty services as well conventional television.

Chart 1
Canadian Independent Production and Development Expenditures



Source: Playback, May, 2005

As will be seen from Chart 1, independent production in the most recent year (2004) was down 18%, dropping to only $1.24 billion. Within this decline, Canadian dramatic series and feature films were hardest hit, with the production of domestic series down 33% and feature films down 49% in 2004.

This decline has created what has widely been acknowledged as a crisis in Canadian dramatic production. The crisis has also been referred to as a “perfect storm” since it coincided with a decline in foreign service production in Canada.

Two factors combined to increase the financial pressures faced by Canadian drama. One of these was the state of the export market for Canadian drama. That market has experienced a precipitous decline in the last few years, caused in part by the reduction in foreign sales of North American drama on European television. This was largely caused by the surge in the popularity of local television drama in markets like Germany, Italy and Spain.

The decline in foreign sales has also been caused by a reduction in the pre-sales of 6-point industrial Canadian drama to U.S. specialty services like the *Sci Fi Network, USA Network*, and so forth. These networks have reduced their purchase of 6-point industrials and have focused on a fewer number of higher quality “signature” program strands. The result of this is to add significantly to the difficulty in financing 6-point Canadian drama.

By contrast, 10-point Canadian drama relies on higher broadcast licence fees and a significant CTF subsidy. But that too is under pressure, as we note further below.

Dramatic productions, and in particular 10-point productions, continue to be the most expensive type of programs to produce. According to Writers Guild of Canada statistics, the average cost of a one-hour 10-point Canadian drama, based on the nine shows produced under WGC jurisdiction in 2004, was $1.16 million.

With costs at this level, it is very difficult to have these types of productions made without adequate support mechanisms in place. Since the adoption of the 1999 Television Policy, which eliminated broadcaster expenditure and exhibition requirements for Canadian drama, except for transfer benefits, there has been a decline in the amount of English-language drama productions that are being made. The CFTPA’s *Profile 2005* found that in 2003/04, both CAVCO-certified and non-CAVCO production saw a decline of 7% from the previous year, and are down 12% from the peak reached in 1999/00.

The CFTPA’s *Profile 2005* also found that CAVCO-certified fiction productions decreased by 6%, to $961 million. In 1999/00, fiction production amounted to $1.21 billion, but since that time there has been a decline in each year except in 2002/03, when it experienced a slight increase.

The CTF’s data also shows that there has been a decline in the number of hours of 10-point drama productions that are receiving support from the CTF. In 1999/00, the CTF supported 634 hours of fiction. This figure has decreased in each year since, and in 2003/04, the CTF supported 441 of hours of Canadian drama. 241 of these hours were for 37 English-language drama projects, which were supported with $85.1 million in CTF funding.

In the last two years, the level of CTF funding for English-language drama productions has risen by more than $10 million, but the actual numbers of hours of drama production supported by CTF has declined to about 200 hours per year. In 2004, the CTF provided $96.1 million in funding for 42 English-language drama productions, amounting to 198 hours of production. On May 12, 2005, the CTF announced that it would provide $99.2 million in funding to 36 English-language drama productions. These productions were projected to provide some 201 hours of production.

With weak foreign pre-sales, Canadian producers have focused more on 10-point Canadian drama. However, this results in greater pressure being placed on the public subsidy dollars. Direct public funding of CAVCO-certified productions, which includes all drama, not just 10-point drama, amounted to 26% of the productions' financing. This is up from 20% for the previous year. Thus, the limited pool of funds is able to support increasingly fewer productions.

In response to the drama crisis, the CCAU has stated its concerns to the CRTC in a number of submissions. Specifically, the CCAU filed a comprehensive brief with Ms. Trina McQueen in late 2002 within the context of her review of the state of English-language drama in Canada for the CRTC and Telefilm Canada. An updated version of that brief was made public in March 2003. The CCAU also filed a detailed submission with the CRTC on November 28, 2003 in response to the Commission's call for comments on mechanisms to support Canadian dramatic productions set out in Public Notice CRTC 2003-54. Finally, on June 21, 2004, the CCAU filed a submission with the CRTC regarding the CRTC's proposed incentive plan for drama, proposed in Public Notice CRTC 2004-32.

In her report to the Commission of March 2003, Ms. Trina McQueen discussed the challenges that exist with respect to the availability of financing for Canadian dramatic productions. More specifically, she stated that "the achievements in drama have occurred against all odds; and they conceal the central problem, which is financing."

The realization that lack of funding is a key obstacle for Canadian drama was acknowledged by the CRTC at paragraph 24 of Public Notice CRTC 2003-54, which states that:

> "… the Commission agrees that <u>the lack of funding is a key contributor to the difficulties facing Canadian drama.</u> Drama is generally expensive to produce and English-language Canadian drama programs have not, as yet, attracted audiences in the numbers that U.S. drama attracts." [Emphasis added]

One of the principal factors contributing to the lack of funding is the low level of Canadian broadcaster licence fees as a proportion of production cost. The ratio of licence fees paid by English-language Canadian broadcasters to production cost is quite low compared with the equivalent ratios in other countries. In the case of CTF-supported drama, broadcast licence fees have risen to 30% of the production cost because of CTF's own rules. However, non-CTF 6-point drama productions typically get much lower licence fees as a proportion of production cost. This contrasts with licence fees in the U.K. and the U.S. that are closer to 70% or 80% of the production budget.

Thus, it is evident that in order for Canadian drama to have a future in Canada and to find a strong place in the schedules of Canadian broadcasters, increased funding from broadcasters is essential. In general, that funding should take the form of higher broadcast licence fees as a proportion of the budget.

It is also important to note that broadcasters should not rely on CTF support for all their Canadian drama. Given that this is a regulatory obligation, they should be commissioning appropriate amounts of Canadian drama whether or not each project gets CTF support.

7. Problems with the 1999 TV Policy

When the Commission adopted its new Television Policy, it stated that its intention was to provide support to Canadian programming, the Canadian television broadcasting industry, and to improve the regulatory framework for television broadcasting. Indeed the Commission's goals were summarized at page 2 of the Television Policy as follows:

- <u>Ensure quality Canadian programs at times when Canadians are watching</u>.
- Reflect the diversity of Canada's regions and peoples.
- Support an economically successful broadcasting industry.
- Require regulation only where the goals of the Act cannot be met by other means.
- Ensure that regulations are clear, efficient and easy to administer. [emphasis added]

However, when broadcasters implement the new requirements of the Television Policy, it is entirely understandable that they may seek ways in which to meet the requirements of the Policy, while at the same time minimizing the costs of implementation. Given the way in which the 1999 Television Policy is drafted, there are many ways in which broadcasters may elect to minimize their contributions to the Canadian broadcasting system. The following lists some of the perverse incentives created by a number of components of the Television Policy which have undercut the achievement of its purpose.

First, as discussed above, because of the broad definition of "priority programming", the 8-hour priority programming policy does not require broadcasters to air a specific amount of dramatic programming throughout the broadcast year. As dramatic programs are the most expensive to produce or acquire, this gives broadcasters an incentive to air less costly programs such as documentaries and magazine programs.

Second, there is no obligation on television broadcasters to air *original* Canadian dramatic programming. In order to lower their cost, there is therefore an incentive for broadcasters to fill the 8-hour requirement with old repeats of Canadian programs. This results in fewer new and original Canadian stories being developed, produced and aired.

Third, the Television Policy is silent on when broadcasters are required to broadcast Canadian priority programming throughout the broadcast week, and throughout the broadcast year, except for the requirement that priority programs be aired between 7:00 p.m. and 11:00 p.m. There is nothing to prevent broadcasters from scheduling Canadian priority programs in time-slots within the 7-11 p.m. period that attract fewer viewers, and in periods of the year that do not generally attract a large audience.

Fourth, there are no expenditure obligations on Canadian conventional broadcasters to contribute funds to the creation of high quality Canadian dramatic program, apart from obligations that may arise from the award of new licences or the 10% "benefits" arising from ownership transfers. (And in the latter cases, since the choice of what benefits to propose is up to the applicant, the benefits may not necessarily include any drama expenditure obligations.) As will be seen, this has resulted in a decline in the funding to Canadian dramatic programs in the system, and a decline in production itself.

8. Canadian Entertainment Magazine Programs

To encourage the development of a Canadian "star system," the 1999 TV Policy categorized "entertainment magazine" programs meeting certain requirements as priority programs. Private broadcasters in English Canada have responded with programs like *Star TV* on CHUM, *etalkDAILY* on CTV, *Inside Entertainment* on Global and *A-List* on Toronto 1. Certain of these programs, however, focus heavily on non-Canadian celebrities. The Writers Guild of Canada (WGC) filed a letter of complaint with the CRTC on March 17, 2005 in this regard.

Pursuant to CRTC requirements, to qualify as priority programs, entertainment magazine programs produced in Toronto or Vancouver must devote at least two-thirds of their running time (or 16 minutes per ½ hour episode) to the promotion of Canadian entertainment (see Public Notice CRTC 1999-97, and Public Notice CRTC 1999-205). However, if the program is produced in a regional centre, it can qualify as a priority program without the 2/3rds requirement, simply in order to encourage more regional non-news programs.

With respect to Global's entertainment magazine program, *Inside Entertainment*, the focus on Canadian entertainment is quite low. However, that program is logged as a regional program produced out of Calgary. To the extent that it is produced from Calgary, it is therefore not subject to the rule that two-thirds of the content on the magazine program must be dedicated to promoting Canadian entertainment.

CTV's *etalkDAILY* and Toronto 1's *A-List* are logged as entertainment magazine programs produced from Toronto and are counted as priority programs. However, the WGC has shown that they do not consistently comply with the two-thirds requirement set out in the 1999 Television Policy. A recent study conducted by the WGC found that *etalkDAILY* showcased Canadian performers in an average of only 6.3 minutes per episode. This is far below the required 16 minutes. In its reply to the WGC's complaint, CTV maintained that it did indeed meet the requirements of the 1999 TV Policy with respect to entertainment magazines and priority programming. It did not, however, provide any numbers to demonstrate that it has consistently met the two-thirds requirement. CTV also made no commitment to dedicate a greater portion of *etalkDAILY's* schedule to Canadian artists and performers.

With respect to Toronto 1's *A-List*, the WGC's study found that only 4.1 minutes on average of Canadian content were broadcast on that program per episode. In its reply to the WGC, Quebecor Media, the new owner of Toronto 1, stated that a greater portion of its magazine program was dedicated to Canadian artists than that suggested by the WGC (7.04 minutes per episode instead of 4.1). It did, however, concede that it did not meet the two-thirds requirements, but that it would be in a position to do so by the fall of 2005. The CCAU is pleased that Quebecor is committed to meeting the CRTC's requirement with respect to the presentation of Canadian artists and performers on magazine programs.

In light of this, it is clear that many Canadian entertainment magazine programs are not achieving what the CRTC intended them to achieve by classifying them as priority programs, which is that of promoting and creating a Canadian star system. To the extent they focus on U.S. celebrities, they perversely appear to be building audiences for U.S. rather than Canadian shows. The problem of compliance with CRTC policy is also rendered more difficult because logs do not measure such compliance, and the CRTC relies only on complaints to monitor performance.

9. The New Drama Incentive Program

On November 29, 2004, in Broadcasting Public Notice CRTC 2004-93, the CRTC released details of its new incentive program to increase the amount of original English-language Canadian television drama broadcast on Canadian television and to encourage larger audiences to this type of programming.

Broadcasters who take advantage of this incentive program were required to apply for conditions of licence that would allow them to broadcast additional minutes of advertising per hour if they met the Commission's criteria. All three of the English conventional TV private broadcast groups – CTV, CanWest Global and CHUM -- have applied to take advantage of the plan.

Under the plan, broadcasters can earn the right to broadcast between 30 seconds and 8 minutes of additional advertising for each hour of original Canadian drama they broadcast. The exact amount of additional advertising is dependant upon such factors as the level of Canadian participation in the production, the budget required to produce the drama, the time of broadcast, and the source of the funding.

If broadcasters increase their audience share for Canadian drama by a pre-determined amount, they will be entitled to increase the total additional amount of advertising they broadcast by 25%. And if broadcasters increase their spending on Canadian drama by a pre-determined amount, they will be able to increase the additional amount of advertising they broadcast by another 25%.

While there is no limit to the number of additional advertising minutes that may be earned under the incentive program, broadcasters may not air more than 14 minutes of advertising in any given hour.

For the largest English-language broadcasters, the incentives apply only to qualifying drama in excess of 26 hours per year, except for drama programs that do not receive funding from the Canadian Television Fund. Those programs will also enjoy the greatest additional advertising minutes. This will encourage broadcasters to invest directly in the creation of new independently-produced drama projects.

In evaluating the proposed incentive plan, the CCAU inquired of ad buyers and station rep houses as to the effect of adding this kind of new inventory to the Canadian broadcast market. We were told the following: (1) the main beneficiaries will be the conventional broadcasters of the top 20 programs, i.e. primarily CTV and, to a lesser extent, CanWest Global; (2) the additional minutes will be sold mostly to existing advertisers, not new advertisers; (3) the additional minutes will largely be diverted from existing ad budgets, and will not represent “new money”; (4) some of this diversion may be at the expense of Canadian broadcast services that do not have top 20 shows, i.e. CBC, CHUM and the specialty services; and (5) some diversion will be at the expense of alternative non-broadcast media, including print and billboards.

The incentive plan is complex and its impact will depend on a number of factors that are difficult to predict. Based on our analysis to date, however, a number of concerns do arise.

First, it is clear that the real incentive to a broadcaster does not arise unless it is able to trigger one or both of the “bonuses”. (Absent the bonus minutes, almost all of the money from the additional minutes has to be funneled to the production itself.) Achieving the bonuses would presumably not be difficult for CanWest Global, given its low performance levels to date. But CTV would be a different story, given the unexpected ratings success of *Corner Gas* in the current (base) year.

For this and other reasons, it is possible that CTV may not trigger the incentive program to a significant degree. Yet CTV has the lion’s share of the top 20 TV shows, from which the incentive minutes can de derived. However, CTV continues to have some unsold minutes in some of these shows, which lessens the benefit of having added inventory. It also has a significant inventory of Canadian drama in development derived from its benefits expenditures, lessening the pressure on it to increase this number.

In the case of CanWest Global, the incentive plan would have given it some rewards simply for continuing to broadcast 130 original half-hour episodes of *Train 48*, since the “base” only applies to the first 52 episodes. For broadcasting the next 78 episodes, it would likely have received a reward of $20,000 an episode, or $1.5 million per year. CanWest Global would appear have a significant incentive to broadcast one or more one-hour non-CTF Canadian drama series. The CCAU estimates that the financial benefit to CanWest Global of commissioning a 13 part non-CTF one-hour Canadian drama series could exceed $4 million. However, this assumes that both bonuses are triggered, which adds an element of risk.

The CCAU hopes that the incentive program will lead CanWest Global to commission a number of new Canadian drama series, particularly ones that do not require CTF funding. However, the extent to which this is likely to happen is unpredictable. Given the fact that CanWest Global has far fewer top 20 shows in which to sell extra minutes, it may simply elect to pick off some low-hanging fruit by selling extra ad minutes on a limited number of shows, and declining to do much more. The situation for CHUM and the CBC has even less potential, since neither broadcaster has a number of high-rated shows where additional inventory could be readily sold.

The jury is still out on whether the incentive plan will work. It is particularly hard to measure the impact of such incentives when broadcasters are also facing renewal hearings in the next two years and have an artificial inducement to show an improved performance in Canadian drama in anticipation of those hearings. In addition, as we show later in this report, transfer and new licence benefits alone will require increased drama levels in the next two years.

But the troubling fact is that the transfer and new licence benefits largely disappear after 2008. In the absence of the requirements imposed because of these benefits, what is to prevent private broadcasters from reducing their drama expenditures yet again, as they have in the past?

In light of their performance to date, we have grave concern about the longer term support by the private broadcasters for Canadian drama. Given this circumstance, it is clear that incentives will not be enough. Regulatory requirements will also be needed.

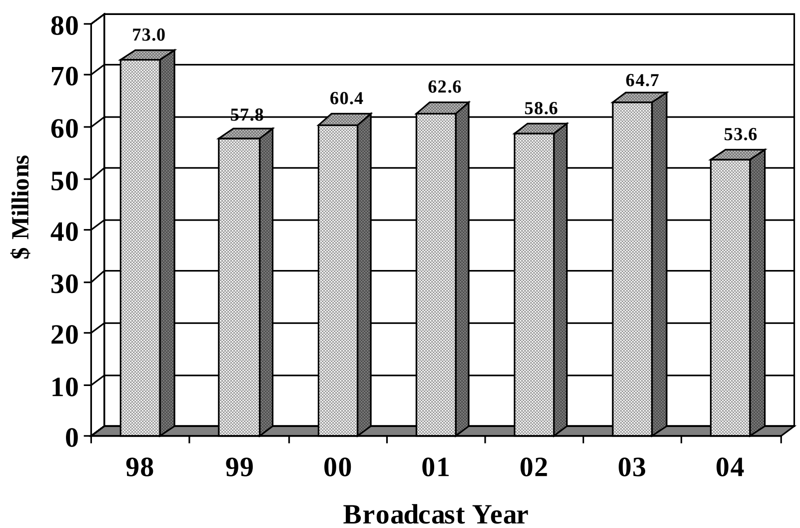
C. The Current State of Play for English-Language Canadian Drama

1. Private TV Broadcasters

In 1998, just before the CRTC hearings on the new TV policy, the private English-language conventional TV broadcasters spent $73 million on Canadian drama, a new high. But their drama spending has declined ever since. In the period from 1999 to 2003, their aggregate financial support for Canadian drama stayed in the $58-$65 million range. But in 2004, their support suddenly declined to only $53.6 million. This is the lowest level it has been for seven years. This decline occurred notwithstanding the fact that the financial support from CTV for drama has significantly increased because of its BCE "benefits" requirements. Spending by the private stations on Canadian drama also declined even though spending over the same period significantly increased on U.S. programs.

Chart 2 below sets out the aggregate expenditures by the private English TV broadcasters on Canadian drama from 1998 to 2004.

Chart 2
Expenditures by Private English TV Broadcasters on Canadian Drama
1998 - 2004

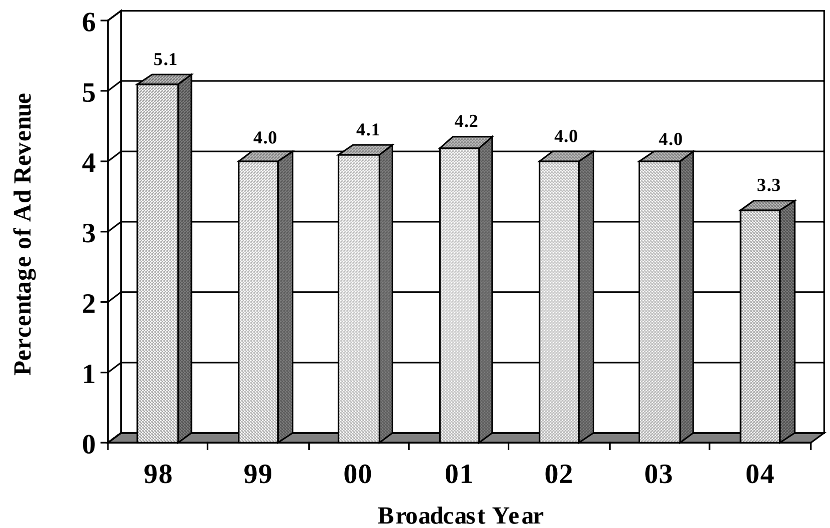


Source: CRTC Statistics

As shown in Chart 2, there has been a 26% decline in Canadian drama spending from 1998 to 2004.

The expenditures on Canadian drama by these stations has also declined as a percentage of advertising revenues. As shown in Chart 3 below, by 2004, Canadian drama expenditures had declined to only 3.3% of revenues, again the lowest level in seven years. In fact, this ratio represents a drop of 35% since 1998.

Chart 3
Ratio of Expenditures on Canadian Drama of Private English TV Broadcasters to Total Advertising Revenue



Source: CRTC Statistics

An analysis of this spending also shows that the financing of English-language Canadian drama by the private conventional TV stations has become increasingly dependent on the benefit packages imposed by the CRTC as a result of ownership transfers or new TV licences.

In the last few years, the CRTC has approved major consolidation in the TV industry in English Canada. These transactions include the BCE takeover of CTV, the CanWest Global takeover of the WIC TV stations, and the CHUM takeover of CKVU Vancouver and the Craig stations in Western Canada. The CRTC has also approved new English-language TV licences in Calgary, Edmonton, Montreal, Vancouver, Victoria and Toronto.

In each of these cases, the CRTC has required programming “benefits” to be provided by the licensee, and many of the benefits have focused on dollars to be expended on Canadian drama production. In addition, the CRTC has generally required the licensees to file annual reports indicating how they have spent the money.

Despite the licensing of a number of new over the air services, the actual number of television reporting units (i.e. stations and their rebroadcasters) in the CRTC’s financial statistics has declined from 99 in 1998 to 95 in 2004. These consolidation activities of broadcasters came accompanied by promises of synergies. Consolidation would result in back office savings, the sharing of capital equipment, buying clout and the “laying off” of program costs across more outlets and so on. In theory, all this was to leave more on the table for Canadian programming expenditures.

It is interesting to see what has really happened in the last decade as far as Canadian conventional television is concerned. CRTC statistics demonstrate that, while revenues have increased steadily over the last seven years, the areas where broadcasters have chosen to spend those dollars have changed substantially.

In 1999, Canadian private English-language conventional television broadcasters spent 27% of their advertising revenues on eligible Canadian programming. They spent about the same amount on non-Canadian programming. Since then, their spending on Canadian programming has stayed in the same range (it was 26% in 2004). However, spending on non-Canadian programming has soared to 34% of ad revenue, a new high.

Overall, as a percentage of revenue, since 1999, less has been spent on technical expenses, not only less as a percentage of revenue but fewer absolute dollars than seven years earlier. Less was also spent as a percentage of revenues on both Sales and Marketing and on General and Administration as well.

The increase in expenditures on non-Canadian programming propelled that category of expense *from 27% of ad revenues in 1999 to 34% of ad revenues in 2005*. Yet increasing non-Canadian program expenditures were one of the key problems that consolidation was supposed to assist in remedying. It was argued that bigger buying groups (i.e. fewer Canadian bidders) would have more clout in Hollywood and drive down programming costs, thus leaving more on the table for the development of high quality Canadian programming.

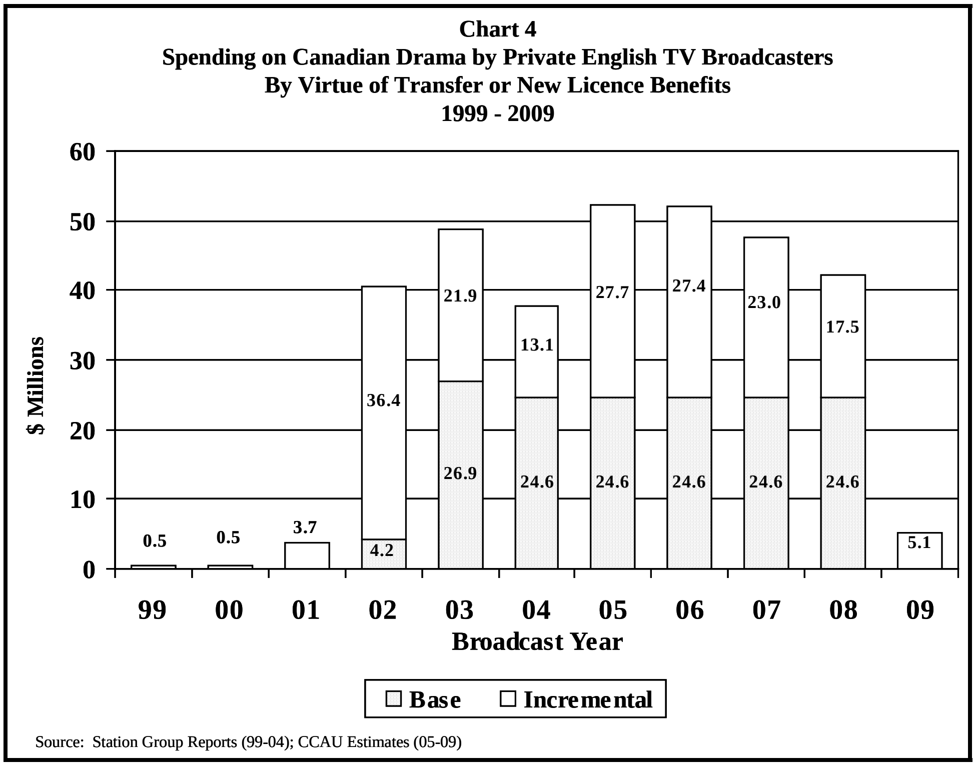
Regrettably, this is not what has happened. Instead, in the last seven years, Canadian broadcasters' appetite for non-Canadian programming has resulted in an increase of just under $200 million in the expenditures in that category, far outstripping the growth in any other category of expenditure.

In dollar terms, Canadian private English-language conventional television broadcasters were spending $404 million on Canadian programming and $327 million on non-Canadian programming in 1998. By 2004, the Canadian programming spend had increased by less than the amount of the CPI during that period to $422 million. However, non-Canadian programming expenses had increased from $327 million to $524 million. This was not what was supposed to happen in exchange for the Commission's approval of broadcasters' consolidation/acquisition applications.

Within these figures, even more disturbing news is found. The $404 million that these broadcasters spent in 1998 on eligible Canadian programming included more than $73 million on Canadian drama and comedy. Seven years later, this total has plummeted to less than $54 million.

The CCAU has reviewed the applicable CRTC decisions and licensee reports to determine how much spending on drama is required to be made under the various benefit packages and how much has actually occurred. (The numbers and methodology are set out in Appendix 4.)

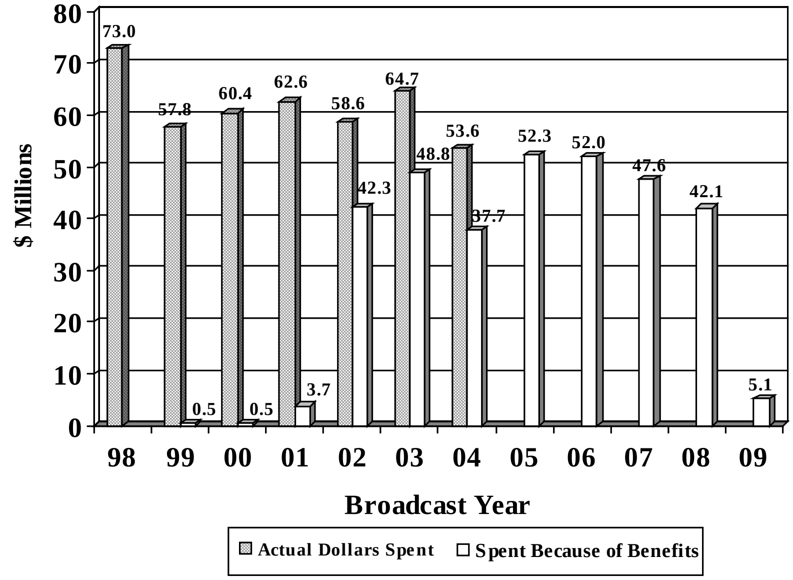
Based on this review, we have developed Chart 4, which sets out the amounts actually spent (1999-2004) or to be spent (2005-2009) by private broadcasters in English Canada on Canadian drama, by virtue of ownership transfer or new licence benefits. The amounts are the cumulative total of the "base" number (i.e. a number derived from previous year expenditures that the CRTC has set as a minimum benchmark beyond which the benefits apply) and the "incremental" number (the actual benefits package spent or required to be spent).



As will be seen, the amounts actually required to be spent on Canadian drama are in the $40-50 million range per year from 2004 until 2008. Thereafter, the amount required to be spent on Canadian drama falls dramatically.

When one compares Chart 2 with Chart 4, however, it becomes clear that in the past few years, an increasing proportion of the amounts spent on Canadian drama are triggered by requirements imposed as part of transfer benefits. This comparison is presented in Chart 5 below.

Chart 5
Expenditures by Private English TV Broadcasters on Canadian Drama, Compared With Transfer or New Licence Drama Benefits
1998 - 2009



Source: CRTC Statistics, CCAU Estimates

As shown in Chart 5, by 2004, the private TV broadcasters in English Canada had reduced their Canadian drama spending to only $53.6 million. This includes spending by virtue of the benefits. However, broadcasters have typically underspent in the early years of benefits, thus increasing the amount they have to spend in the later years. A review of the annual station reports filed with the CRTC shows that, because of this practice, the stations will need to spend at least $52.3 million on Canadian drama in 2005, just to catch up and comply with CRTC regulatory requirements.

With the announcement of the CRTC's new incentive plan, the private TV broadcasters have recently announced a number of new drama projects to be broadcast in 2005-06. However, as noted earlier, the number of hours of CTF-supported English drama projects announced in May 2005 for the coming year is still only 201 hours, barely increased from last year's total of 198 hours. In the mix of projects, two more one-hour drama series have been added, but movies of the week and miniseries have dropped in number.

The jury is still out on whether the incentive plan will work. It is particularly hard to measure the impact of such incentives when broadcasters are also facing renewal hearings in the next two years and have an artificial inducement to show an improved performance in Canadian drama in anticipation of those hearings.

In the longer term, an even more troubling fact is that the transfer and new licence benefits largely disappear after 2008. In the absence of the requirements imposed because of these benefits, what is to prevent private broadcasters from reducing their drama expenditures yet again, as they have in the past?

We address this issue further in Parts E and F of this report, which include specific recommendations for what we call a regulatory "safety net" for drama.

2. *The Canadian Broadcasting Corporation*

As Canada's national public broadcaster, the CBC has a significant obligation to produce and acquire Canadian dramatic programming and drama series that are attractive to audiences. As a major player in the Canadian drama sector, the CBC can play a key role in addressing the crisis in Canadian drama, and there should be a particular focus on its funding and contribution in this regard. Many of Canada's best-known drama series and most provocative mini-series have emanated from the CBC, such as *The Newsroom*, *This Hour has 22 Minutes*, *Trudeau, Da Vinci's Inquest*, *Rick Mercer's Monday Report, Canada, A People's History, Shattered City, Human Cargo, Last Chapter,* and *This is Wonderland*. Additionally, over the last few years, CBC has scheduled significantly more priority programs than did CTV and CanWest Global, and more hours of Canadian drama.

However, the CBC has shifted its focus in the last few years away from drama towards news and sports. In 1999, according to WGC statistics, the CBC had 66 hours of original one-hour dramas. By 2004, this was down to only 30 hours. When all drama is tabulated (one-hours, half-hours, miniseries, movies of the week), there was a decline from 121 hours In 1999 to only 71.5 hours in 2004.

Recently, the Department of Canadian Heritage recognized the important role that the CBC plays within our broadcasting system in its second response to the Lincoln Report (see page 8):

> "The CBC is a unique and essential instrument in the Canadian broadcasting and cultural landscape, and the Government believes it has a special role to play in reflecting Canadians across its radio, television and new media services and in providing high-impact Canadian programming."

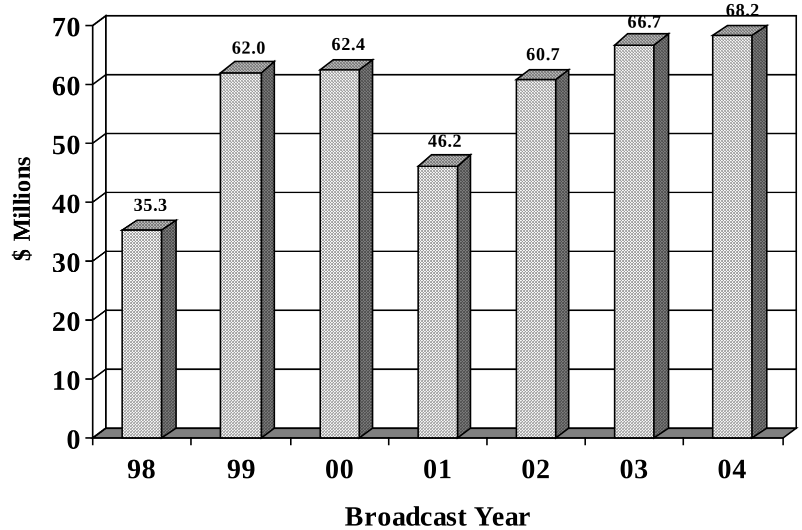
The CBC has expressed a strong interest in taking a leadership role in addressing the crisis in Canadian drama. In an address delivered to the Broadcast Executives Society by Richard Stursberg, the newly appointed Executive Vice President, CBC English Television last February, Mr. Stursburg stated:

> "The most important cultural challenge facing English Canada today happens to be the most important challenge facing Canada's public broadcaster. That challenge is drama. It's also a challenge the CBC is uniquely able to address – and one we're determined to address, with vigour, imagination…and success…
>
> "But aside from available real estate, CBC also has the mandate, the skill, the DNA and the vision to significantly increase and sustain the level of English dramatic programming. It is our job…

> "To begin to address the drama crisis, the CBC proposes to act as the anchor for a significant expansion and renewal of all aspects of drama…but we will need the support of the federal government." [Emphasis added]

Over the past seven years, the CBC's financial support for Canadian drama has generally exceeded that of the private sector, as shown in Chart 6 below.

Chart 6
Expenditures by Canadian Broadcasting Corporation on English-Language Canadian Drama 1998 - 2004



Source: CRTC Statistics

More recently, the CBC has announced that in addition to its traditional support, it intends to invest an additional $33.5 million on Canadian drama in the next two years, which will add 100 more hours of dramatic programming to the CBC's schedule in 2006 and 2007. The CBC has also stated that its goal is to double over the next number of years the amount of drama and entertainment programming broadcast on its main network. In that regard, CBC officials have indicated that they "would like the CBC Television to be overwhelmingly the place that you go for Canadian entertainment programming." In order to achieve this, however, the CBC must be adequately funded, and in particular, it is seeking to increase the amount from the CTF English drama envelope to be directed to CBC projects. Historically, the CBC has received about 47% of the CTF's English drama allocation, amounting to about $45 million a year. It is seeking to increase this allotment by $20 million a year, which would mean receiving 70% of the English drama envelope, instead of 47%. (Overall, under its proposal, CBC's piece of the CTF English envelope for all program genres would rise from 35-37% to 50%).

The CCAU agrees that in order for the CBC to take an important role in the area of Canadian dramatic programs, it must be adequately funded. In 2003-2004, it received a parliamentary appropriation of $873 million for operating expenditures, and an additional

$60 million non-recurring funding from the Government of Canada. However, this level of funding is clearly insufficient given the CBC's broad mandate, and its obligation to develop and broadcast high quality dramatic programming on its network.

In order to help the CBC meet its Canadian programming objectives, in its second response to the Lincoln Report the Department of Canadian Heritage committed to provide the CBC with an additional $60 million in 2005/2006. This was confirmed in the federal budget presented this spring. The Department also committed to set aside an envelope for the CBC within the CTF based on the CBC's historical average contributed by the CTF to CBC projects.

The CCAU believes that the CBC can and should take the lead in addressing the Canadian drama crisis, and that the recent announcements by the federal government should provide the public broadcaster with some meaningful assistance. However, we question whether the government's commitments will be sufficient given the CBC's mandate and its ambitions with respect to drama. As indicated above, the CBC has stated that it requires an additional $20 million per year from the CTF's English drama allotment to support its drama projects. However, at this stage, the government is only protecting the CBC's current allotment from erosion, which will fall short of this target.

The CCAU is supportive of the CBC's plan to commission more Canadian drama. At the same time, its proposal to expand its envelope within CTF is dependent on whether CTV and CanWest Global move almost entirely away from the CTF and use the CRTC incentive plan to support non-CTF productions. (The CBC's plan assumes that the smaller broadcasters that do not have top 20 shows – thereby having no access to the incentive plan -- and which benefit from the CTF would continue to do so.) If CTV and CanWest Global do not reduce their reliance on CTF to finance drama, however, then an increase in the envelope for the CBC would simply "rob Peter to pay Paul," and would not necessarily generate additional drama production. Instead, it might tend to ghettoize Canadian drama onto the CBC, which would not be in the public interest.

In the end, therefore, the viability of the CBC proposal is crucially dependent on whether the incentive plan works for the private broadcasters. For the reasons we have indicated, it is too early to tell whether this is the case. However, the CBC proposal may be worth considering in the context of a broader move to require additional financial resources from the private sector to support drama.

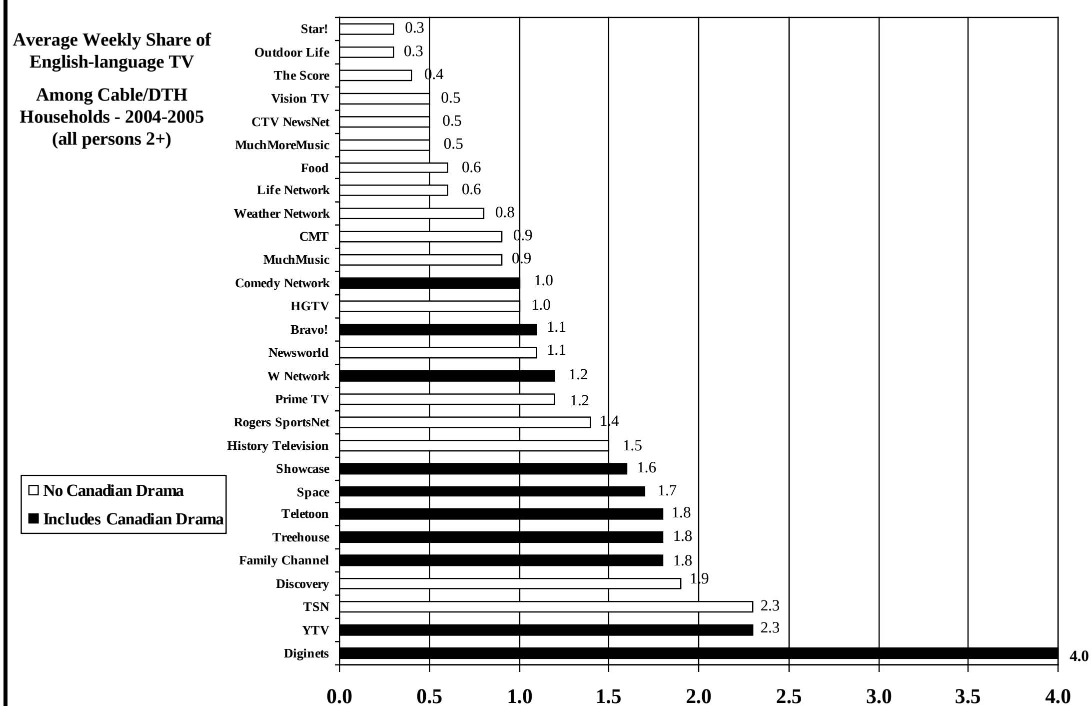
3. Canadian Pay and Specialty Television Broadcasters

Financial support for English Canadian drama from Canadian pay and specialty services is growing and is also an increasingly important part of the solution. Unlike conventional TV services, these services have always had a Canadian content expenditure quota, and as a result, their support for Canadian content has increased as their revenue has increased.

By their nature, specialty services serve particular program niches, and many of these – for example, those that focus on news, sports, lifestyle or documentary niches -- do not include any Canadian drama on their schedule.

However, a number of the services do include Canadian drama as a significant part of their schedule. As seen in Chart 7, below, these services are among the most popular of the Canadian specialty channels in terms of their share of hours viewed. (Note that for the purpose of this chart, Family Channel is included as a specialty channel, although technically it is licensed as a general interest pay television service.)

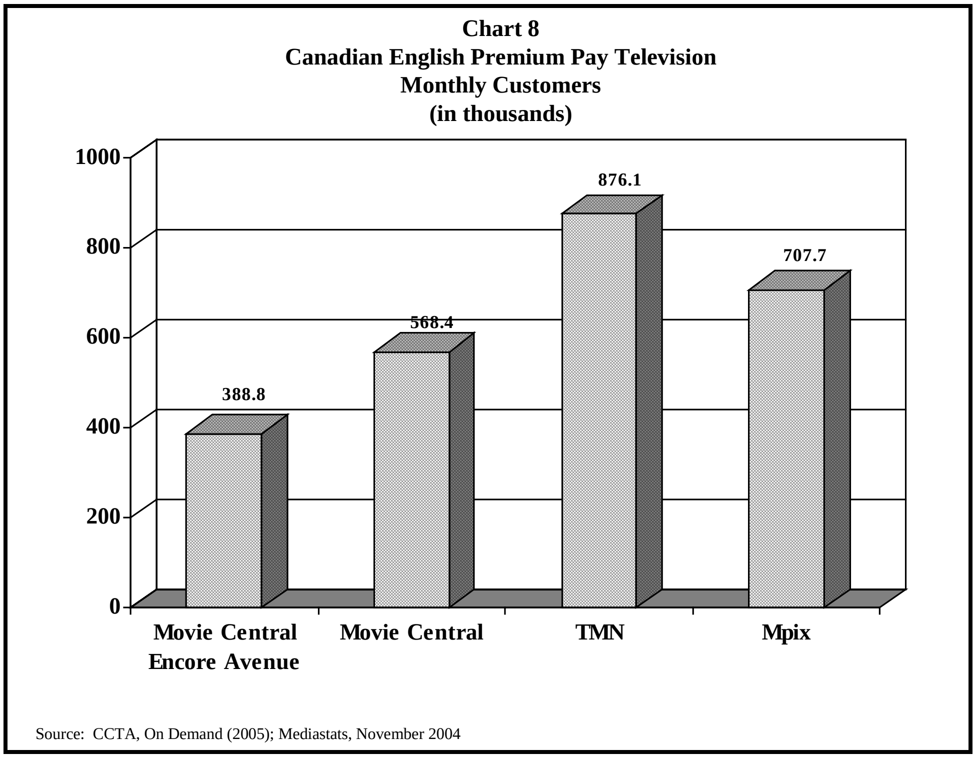
Chart 7
English-Language Canadian Specialty Channels
Share of Hours Viewed



Source: CCTA, On Demand, (2005); from *Nielsen Media Research Share of hours (%) – the percentage of time spent viewing a particular network or station*

Notable among the popular specialty services supporting Canadian drama are *Showcase, Space* and *YTV.* All of them have a combination of scheduling and expenditure rules that require them to finance and exhibit Canadian drama. For example, *Showcase* is required to broadcast 100% Canadian drama from 7 to 10 p.m. each evening, and must spend at least 42% of its previous year's gross revenues on Canadian drama. In complying with these commitments, *Showcase* has also garnered impressive audiences for innovative drama programming.

The pay television services, all of which are required to support Canadian drama through scheduling and expenditure quotas, are also increasingly popular. Chart 8 gives recent subscriber numbers for the English-language premium pay services.



In preparing this report, CCAU examined the financial reports of the Canadian English-language pay and specialty services to estimate how much they actually expended on Canadian drama. Developing this estimate was difficult for two reasons. First, unlike conventional TV licensees, neither pay nor specialty licensees are required to break out their programming expenditures by program genre. Second, even when a licensee primarily programs drama in its schedule , some of the Canadian program expenditures made by the licensee may be filler programs, magazine programs, documentaries or game shows.

The CCAU therefore focused on eight specialty services that program Canadian drama, and made an estimate as to what percentage of each service's Canadian expenditures was directed to support such drama. A similar exercise was done for the five English-language pay television licensees, including *Family Channel*. The methodology is presented in Appendix 5.

Based on the numbers in Appendix 5, the CCAU estimates that English-language specialty licensees now spend about $65 million a year on Canadian drama, while the pay services spend about $31 million a year. As a combined total, this is 6.6% of the total advertising and subscription revenues for all the English-language pay and specialty services, including services that include no drama at all.

That support would be significantly higher if the CRTC policy allowing CTF licence fee "top-ups" to count as eligible expenditures was reversed.

Under that policy, broadcasters get credit for CTF licence fee “top-ups” as if they had spent those monies themselves under their conditions of licence. These are not small amounts. The most recent numbers disclosed by the CRTC show that the eight specialty services identified above counted $21.9 million against their licence conditions in 2003 by reason of the “top-up” policy.

Thus, in a year when they spent $65.4 million on Canadian drama, the CRTC policy excused them from spending $21.9 million more.

The situation was similar for the five English general interest pay television licensees. In a year when they spent $31.5 million on Canadian drama, the CRTC top-up policy excused them from spending $5.8 million more.

Over the next few years, Canadian pay and specialty revenues are expected to increase faster than that for conventional television. So it will be especially important to ensure that their contributions to Canadian drama increase as well.

However, conventional television – CBC and the three private TV station groups in English Canada -- must still be seen as the principal mainstay for high-ticket popular Canadian drama. The main reason for this is simple: the specialty services that include Canadian drama in their schedules have much less revenue <u>per service</u> to work with.

As a result, Canadian specialty services tend to focus on lower-cost drama, rather than high-ticket 10-point drama. Given their limited annual programming budgets, the new drama commissioned by the specialty services tends to be in categories like children’s drama, 6-point “industrial” drama, animation, and comedy sketches.

The specialty services also provide an important service in that they operate as rerun channels for drama programs originated on conventional television. The cost of the second window is a fraction of the cost of the first window on conventional TV, but it does provide a useful stream of revenue for the producer. And from the perspective of the specialty service, they can fill part of their schedule by providing an extra window for reruns of Canadian drama at a much lowered cost.

Given the foregoing, it is clear that the economic driver for high-cost popular Canadian drama must continue to be the conventional television stations.

It should also be noted that the specialty services that are making the inroads as far as audiences are concerned are largely owned by the same three conventional station groups who are free to move management, programming, technical and many other expenses back and forth between them. The CTV, CHUM and CanWest Global families of specialty services attract approximately 35-40% of the revenues of Canada’s specialty industry.

D. Economic Factors Affecting TV Broadcasting in Canada, 2005-2008

1. Introduction

The previous sections of this report have outlined where we are today. But before one can make recommendations for the future, it is necessary to develop economic projections that take into account the impact of future technology, as well as audience and revenue trends.

For this purpose, comments on technological developments affecting the broadcasting sector are provided further below. In particular, we examine the impact of technology on the maintenance of a coherent Canadian marketplace in audiovisual rights. We look at the continued fragmentation of the television broadcasting market by specialty and pay services at the expense of conventional television. And we also review the impact of digital migration and high definition television (HDTV).

Following this discussion, we present revenue projections for private TV broadcasters in English Canada over the next four years, prepared by Nordicity Group Ltd. As will be seen, despite all of the factors noted, the revenues of conventional television are expected to be relatively robust. Working from estimates from PricewaterhouseCoopers LLP, Nordicity concluded that the ad revenue for the conventional private TV stations in English Canada is likely to increase over the next four years from $1.6 billion in 2003-04 to between $1.8 and $1.9 billion in 2007-08. This will mean an increase in revenues of over $200 million.

2. Impact of "Borderless" Technologies

In assessing the future of the broadcast sector in Canada, it is important to realize that its health depends on maintaining a distinct Canadian marketplace for audiovisual rights. To protect that distinct marketplace, Canadian broadcasters benefit from a number of protective measures. These include the following:

(a) limits to the licensing of new competing free-to-air TV broadcasters in Canada, including foreign ownership requirements;

(b) must-carry and priority provisions for local Canadian signals on BDUs;

(c) the simultaneous substitution policy benefiting free-to-air TV broadcasters;

(d) Section 19.1 of the *Income Tax Act* (Bill C-58), which disallows advertising expenses placed by Canadian advertisers on U.S. border stations as a business expense;

(e) far higher degrees of consolidation and concentration in the free-to-air markets than are permitted in the United States;

(f) prohibition of competing U.S. pay and specialty services;

(g) prohibition of local advertising by cable systems, either directly on local community channels or through the use of local avails on specialty services, and prohibition of local advertising by almost all specialty services;

(h) common ownership of niche-protected Canadian specialty services and BDU must-carry provisions for those services; and

(i) financial support for priority programming from the Canadian Television Fund, tax incentives and other sources.

It is sometimes suggested that many of these support measures may be doomed because of the introduction of “borderless” technologies like satellites and the Internet. However, these suggestions are in the view of the CCAU overblown and exaggerated.

First, the foregoing measures are largely derived from the policies set forth in the 1991 *Broadcasting Act* and have broad support from the broadcasting industry itself. There is little likelihood that these policies will be significantly changed over the next five years.

Second, there is no pressure from the United States for Canada to “roll back” these measures. In fact, as shown in the *iCraveTV* case, U.S. program rightsholders completely support the strengthening of measures to protect the integrity of the Canadian border for copyright purposes.

But more important, neither the advent of direct broadcast satellites nor the introduction of the high speed Internet access have eroded the strength of the Canadian broadcast sector in practice.

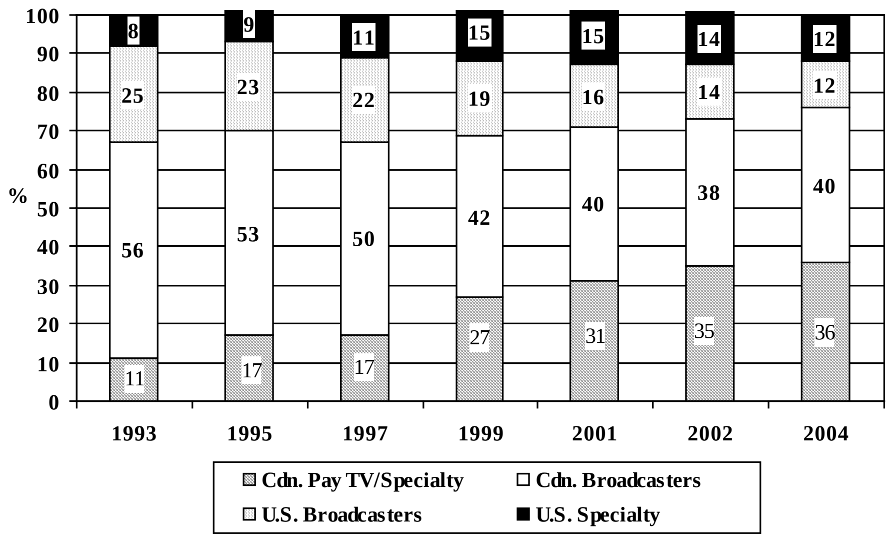
The penetration of U.S. DTH satellite services in Canada continues to be an irritant, and strengthened penalties against the black and grey satellite markets will continue to be necessary. But the penetration of DirecTv and Echostar is still only a fraction of the penetration of the authorized Canadian suppliers, Bell ExpressVu and Star Choice, which have been extremely successful. It is estimated that less than 5% of Canadian households subscribe to black or grey market U.S. DTH satellite services and this number is declining, not growing.

As for the Internet, while the downloads of audiovisual material on an unauthorized basis will undoubtedly grow, both the law and the economics of such downloads do not suggest that they pose any real risk to the viability of conventional, pay or specialty television. Studies by Kagan World Media show that even if bandwidth were free, feature film distribution online would still be an “expensive experiment”. The impact of such distribution is more likely to be felt by the home video and VOD market than by conventional, pay or speciality services, given their low monthly cost, higher quality of transmission, and greater convenience.

It is interesting to note, in fact, that despite the introduction of satellites and the Internet over the past decade, the share of audience enjoyed by Canadian conventional, pay and specialty TV broadcasters has increased rather than decreased.

This is shown in Chart 9 below. In 1993, over ten years ago, the share of the Canadian audience by U.S. broadcasters (both conventional and specialty) was 33%. But by 2004, this share had shrunk to only 24%. Conversely, the audience share of Canadian broadcasters rose from 67% to 76%.

Chart 9
Audience Share of English-Language
Station Groups
(percent)



Source: CCTA, On Demand, (2005); from *Nielsen Media Research*
Share of hours (%) – the percentage of time spent viewing a particular network or station

Within these numbers, of course, free-to-air broadcasters have suffered from the increased fragmentation of audience caused by the introduction of pay and specialty services. But even there, the aggregate audience share of the Canadian free-to-air broadcasters in English Canada has stabilized at about 40% over the last four years. And as we will see further below, the ad revenue of those broadcasters has not declined but has continued to rise, albeit less dramatically than the revenue of the pay and specialty services.

It is important to realize that these numbers do not reflect the relative viewing to Canadian and non-Canadian programming on these services. As before, the majority of television viewing in English Canada continues to be U.S. programming. However, more of that viewing is to Canadian stations and services, which are the only players in the system that support the creation and exhibition of Canadian programming. To the extent that control over the broadcasting system is repatriated to Canadian stations in this way, and advertising revenue to those stations is maximized, so too is their concomitant ability (and obligation) to contribute more to finance Canadian drama programming.

3. Digital Migration and HDTV

(a) Introduction

The Commission is currently conducting a twinned process which is examining digital migration issues (in the context of pay and specialty services) as well as issues relating to the conversion to high definition television. Previously, in 2003, the Commission published its policy with respect to the migration of conventional television to digital format, including high definition.

In Broadcasting Public Notice CRTC 2003-61, the Commission outlined the parameters of that transition. It has been clear for some time that the world is moving in the direction of high definition television. It is equally clear that there are unique challenges facing both broadcasters and BDUs. There can be no doubt that there will be new costs for broadcasters, in some cases with no new revenue to defray those costs.

But this is not a valid reason for the Commission to refrain from requiring conventional broadcasters to produce and air more Canadian drama.

Generally speaking, the Commission has encouraged broadcasters to move as quickly as possible in making the transition. For its part, the Commission has acceded to broadcaster requests and kept the existing regulatory scheme by and large in place. Two key issues facing broadcasters are a) at what point is a BDU entitled to cease carriage of the broadcasters' analog signal? and b) what are the costs of transitioning from an analog world to an high definition ("HD") world?

(b) Digital Migration

With respect to the first question, the Commission ruled in Broadcasting Public Notice CRTC 2003-61 as follows:

> In light of the concerns raised by the parties in this proceeding, the Commission concludes that, rather than setting a threshold level that would automatically trigger removal of analog services, it would be more reasonable to set a threshold at which it would be prepared to consider applications to discontinue the carriage of analog signals. The Commission has determined that a threshold of 85% penetration would be appropriate for such purposes.

It will be some time before Canada achieves digital penetration of 85%. The United States, meanwhile, according to CDTV (the non-profit Canadian organization monitoring these events) is musing about a hard cutoff in 2009 as their conversion rolls on unabated. Thinking forward to that time, imagine, for example, that the CRTC were to mandate a cutoff in 2009 of the requirement that BDUs carry analog conventional television signals. The spectre of a broadcaster losing 15% of its audience appears at first blush to be significant. However, it is worthwhile to consider the following ameliorating factors.

First, according to the study by Wall Communications Inc. (filed with the CAB brief on Digital Migration and HD on April 22, 2005) approximately 19% of Canadians do not subscribe to cable or DTH and this audience is unaffected by the change should the broadcaster continue to operate an over the air signal. Moreover, that audience has far fewer television viewing alternatives on average.

Second, by the time such a change occurs, the vast majority of Canadian families will have acquired the necessary hardware to continue tuning to the signals of their choice.

Third, while the share of tuning to conventional television stations has been eroded by tuning to pay and specialty services, as shown in Chart 9, this decline did not, however, translate into a diminution of revenues for conventional broadcasters. Rather, revenues rose by almost 35% during the same period. Thus the notion that an undesirable portion of the current audience might be disenfranchised in the case of a hard cutoff of conventional analog signals by cable BDUs should not be seen as cause for jettisoning existing regulatory structures. It should also be noted that the specialty services that are making the inroads as far as audiences are concerned are largely owned by the same three station groups who are free to move management, programming, technical and many other expenses back and forth between them. The CTV, CHUM and CanWest Global families of specialty services attract approximately 35-40% of the revenues of Canada's specialty industry. At the same time, the CRTC will need to ensure that in any digital migration, Canadian analog programming services that include Canadian drama in their mandate are protected from unfair packaging and/or dislocation by BDUs.

Fourth, the U.S. conventional broadcast industry has been undergoing the identical digital transformation yet the attitude seems markedly different. There, broadcasters face the identical sorts of cutoff thresholds (while Congress had originally suggested 2006, that has been abandoned and now parties have indicated that perhaps 2009 might be a more realistic analog cutoff date). Equipment costs are plummeting and broadcasters are effecting the conversion.

Fifth, the Commission has given no indication that there will be any kind of a "hard cutoff". Instead, it has signalled that at the 85% level, the Commission would be prepared to consider applications to discontinue the carriage of analog signals.

In summary, there are a number of valid reasons why the migration to digital, while not painless or without issues, should not be cause for undue alarm or for regulatory relief. There is unlikely to be a loss of audience or revenues, the station groups have options to manage their expenses, costs are plummeting in any case, and the transition is unlikely to be sudden or jarring. All of this discussion would have had to happen without the arrival of HD to complicate matters.

(c) High Definition

The Commission has established regulatory frameworks for the licensing of DTV and HDTV conventional television services (Broadcasting Public Notice CRTC 2002-31) and for the distribution of conventional DTV and HDTV services by cable undertakings (Broadcasting Public Notice CRTC 2003-61). Nevertheless there is a concern that Canadian broadcasters are allowing themselves to fall behind in the production and airing of programming in high definition (HD) as compared with standard definition (SD).

The U.S. is further along in its development, broadcast and distribution of HD content. According to CDTV, the U.S. launched DTV in its 30 largest cities, and currently over 95% of U.S. homes now have access to digital TV signals (see CDTV web site at www.cdtv.ca). In remarks to the CSUA Annual Meeting on February 1, 2005, Michael McEwan, President of CDTV, stated that:

> "Networks and Network owned and operated stations [in the U.S.] are fully digitized. Virtually all prime time drama and sitcoms are shot electronically… Sports and special events are increasingly being broadcasting in HD, to the point that when they are not in the HD format, viewers wonder why. Pay and Specialty services from HBO to Bravo HD and everything in between are moving to HD services, or I should say have moved to HD services. At last count, over 30 pay and specialty services had made the transition in the U.S. That is in addition to 7 over the air networks…Up to 2,000 hours a week of HD programming is available to the viewer by one count, and if you think that is a bloated figure then back it off by 25% and you still have 1,500 hours a week of available HD programming. Staggering numbers!"

The CCAU believes that Canadian programming services should lead the roll-out of HD content in our country. This roll-out should be done in an orderly fashion, and should be one that provides a Canadian solution for HD in Canada. HD will be an important component of the Canadian broadcasting system in the future, and Canadian programming undertakings should and must lead the way in our country. If they do not, they may lose the competition for Canadian audiences.

This concern was echoed by the Chair of the CRTC, Mr. Charles Dalfen, in an address to the CAB's 2004 Convention:

> "I want to take this opportunity to strongly encourage the industry to speed up the transition to digital and to HD, <u>so that Canadian broadcasters will continue to be vigorous competitors for television viewers</u>." [Emphasis added]

The CCAU strongly supports the efforts of the members of the Canadian broadcasting community and the Commission to work out a Canadian solution in a manner that is as fair to all sectors as possible. The CCAU does not have particular expertise in the technical aspects of the conversion, but it does have a perspective grounded in the provisions of the Broadcasting Act. The CCAU appreciates that there will come a time in the not to distant future when most Canadians will be watching HD or variations of it. In the name of short-term expediency, we should not be allowing changes to the rules in a manner that would allow the system to grow in the wrong direction.

For example, we support the Canadian broadcasting community in opposing the introduction of US services to Canada just because they carry HD programming. We feel there must be a moratorium on the addition of such services while Canada creates its own policies and programming. However, the CCAU opposes the idea recently advanced by CAB that suggests that a portion (e.g. 50%) of the costs (both capital costs and incremental programming costs) of the conversion to HD by broadcasters should qualify as eligible Canadian programming expenditures. It is not clear if this proposal is meant to extend to conventional broadcasters as the brief suggests that this plan would encourage "all specialty and services" to undertake the transition more quickly than they would otherwise be able to.

Quite apart from the impossibility of measuring whether or not the transition did occur "more quickly" (i.e. compared to what?), the idea of reducing the amount of money to be spent on on-screen Canadian production in favour of capital equipment replacement is far-fetched. HD is simply a form of technology. Taking funds from programming to pay for capital is unacceptable.

Any suggestion that the Commission allow up to 50% of the costs of the transitioning to HD to be an eligible Canadian programming expense is entirely unacceptable. As has already been noted in this report, a key reason why Canadian drama in the private sector has not been reduced even further than it has in the last 5 years is as a result of transfer or new licence benefits, and these will largely expire by 2008. Broadcasters have increasingly relied on CTF funds to satisfy their Canadian programming spending obligations. The Commission has already given the broadcasters a carrot in the form of additional advertising minutes in order to encourage them to do drama. And now the broadcasters seek the ability to use forthcoming infrastructure costs as eligible programming expenditures. The sum of these changes suggests that broadcasters will not spend money on Canadian programming unless a) they are forced to and b) even then, they get some sort of additional sweetener for so doing.

The CCAU accepts that there will be costs to upgrade to HD. However, we also believe that the movement by the United States in the same direction will result in lower per unit costs even if there is no improvement in technology (and there will undoubtedly be such improvements). Part of the answer depends on the approach of the CRTC. If the Commission sets the bar at a reasonable level, and allows broadcasters to air some HD, and some SD programming in sensible proportions, broadcasters will have time to upgrade and await even lower unit costs. Similarly, if the Commission were to accept that some percentage of programming on an upgraded signal could be upconverted SD, that would allow for a significant cost saving as well. The CCAU understands and expects that the costs of upgraders are declining while the quality of the signal they provide is increasing.

The HD problems are technical and transitional. The drama crisis has been brewing for years. On the one hand, we are talking about the nation's stories, the very essence of the reason Canada has its own broadcasting system. On the other hand, we have a variation of "widgets"; a form of hardware that represents the next generation of picture quality. There should be no question of a tradeoff here; it is imperative that Canada generate the new drama production that the system needs to attract viewers.

4. The Nordicity Projections

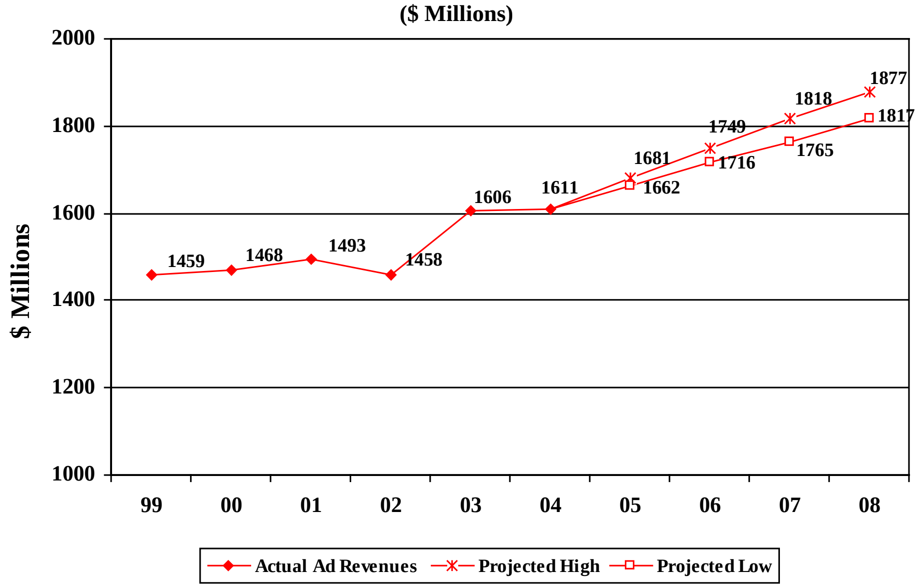
With the foregoing developments in mind, the CCAU retained Nordicity Group Ltd. ("Nordicity") to validate projections for the advertising revenue likely to be generated by CBC and the private broadcast sector in the period up to 2008. In summary, Nordicity concluded that far from declining, ad revenue for conventional TV in Canada will increase over the next four years.

In reviewing available projections, Nordicity relied primarily on estimates developed by PricewaterhouseCoopers LLP (PwC) in its publication, *Global Entertainment & Media Outlook, 2004-2008*.

Chart 10, below, presents the forecast range of ad revenue for English-language conventional television. This forecast range was derived by Nordicity Group from PwC's projections for Canadian conventional broadcaster ad revenue and additional information published by the Department of Finance and Statistics Canada.

Based on its review, Nordicity concluded that the ad revenue for the conventional private TV stations in English Canada is forecast to increase over the next four years from $1.61 billion in 2003-04 to approximately $1.82 to $1.88 billion in 2007-08. The methodology used by Nordicity is set out in Appendix 3.

Chart 10
Actual and Projected Ad Revenues of Private English TV Stations in Canada ($ Millions)



Source: CRTC Statistics, Nordicity, PricewaterhouseCoopers

The actual data in Chart 10 are disaggregated in the table below.

All amounts in millions of Canadian dollars Year	**Historical statistics for English-language conventional television advertising revenue**			**Forecast based on PricewaterhouseCoopers*, English-language conventional advertising revenue**			
	Private broadcasters	**CBC**	**Private + CBC**	**Private broadcasters**		**Private + CBC**	
				Low	**High**	**Low**	**High**
1999/00	1,468	193	1,661				
2000/01	1,493	214	1,707				
2001/02	1,458	216	1,674				
2002/03	1,606	190	1,796				
2003/04 e	1,611	205	1,817				
2004/05 f				1,662	1,681	1,874	1,895
2005/06 f				1,716	1,749	1,935	1,972
2006/07 f				1,765	1,818	1,990	2,049
2007/08 f				1,817	1,877	2,049	2,116

e - estimate, f - forecast
Source: CRTC, Nordicity Group Ltd.., PricewaterhouseCoopers, Department of Finance, Statistics Canada
* The forecast series is based on a forecast prepared by PricewaterhouseCoopers of the overall advertising revenues of conventional television broadcasters. Appendix 3 provides an explanation of how the PricewaterhouseCoopers forecasts were applied to advertising revenues in the English-language conventional television market.

Despite the increased fragmentation of audience and lower ratings arising from competition, therefore, the ad revenue stream for conventional TV broadcasters in Canada has continued to be maintained and is expected to grow significantly in the next five years. Suggestions by some that revenues for conventional TV will decline in this period because of increased fragmentation, new technology and the advent of webcasting, should be strongly discounted. Conventional television in Canada will continue to be a lucrative business.

E. Where Do We Go From Here?

1. Lessons to be Learned

In developing the analysis set out above, we have borne in mind a number of key principles. The foremost of these is the importance of maintaining a distinct Canadian broadcasting market. The second principle is the importance of including a significant amount of new original 10-point Canadian drama on broadcast schedules. A third principle is the importance of maintaining and enhancing a strong independent production sector.

Bearing these principles in mind, what can we do to address the problems faced by Canadian drama? In particular, what lessons can we learn from the foregoing analysis?

Certainly, some of the factors that present problems are ones that we can do little to solve. The decline in export sales or in foreign pre-sales is not something that the CRTC can address. Nor can we wish away the U.S. star system, although our own promotion of Canadian dramas can be significantly enhanced.

However, there are a number of lessons that can be learned if we want to improve the ratings for Canadian drama.

The first is that *we need more original hours of Canadian drama, and less repeats*. For networks to argue that Canadian drama cannot deliver ratings when they fill their schedule with endless reruns is just not tenable. Original hours of distinctive Canadian drama that are well-promoted give the best chance at attracting a meaningful audience. At the same time, we must be prepared to recognize that audience response is inherently unpredictable. Thus, to maximize our chances for ratings success, we must have a number of drama series on offer, not just one or two.

Second, *we need more distinctive Canadian series, not less*. In general, as we have noted, 6-point Canadian drama does not deliver the eyeballs that good 10-point drama telling Canadian stories can deliver.

Third, *we need more support for script and concept development*. This is a crucial area that needs attention, in order to maximize the chances of getting higher ratings. Yet as indicated earlier, screenwriters have often had to fund a large portion, if not all, of the development process themselves, or work without pay to develop part of the project, because broadcasters make little or no investment to develop television drama.

All of this leads to the fourth lesson, namely, that *more money needs to be invested by the private broadcasters in Canadian drama.* That is a simple corollary of the first three points, since original Canadian drama costs more to licence than industrial drama, and infinitely more than the cost to licence repeats. The CTF cannot be expected to make up the difference in cost, given the pressures on its funding. Nor can foreign pre-sales or export sales make up the difference. Export sales for North American drama are declining, not increasing.

2. The Role of the Private Broadcasters

As noted above, the CCAU believes that more money needs to be invested by the private broadcasters in Canadian drama.

There are many reasons why this is essential.

First, as we have noted earlier, drama expenditures by Canadian English-language private TV stations as a percentage of their overall program spending are far lower than is true for other countries. In 2004, English Canadian private broadcasters spent only 5.5% of their total programming budget on Canadian drama.

Some Canadian broadcasters have defended their low licence fees by arguing that they pay no less for Canadian drama than they pay for U.S. acquired programming. But this ignores the fundamental maxim of international television programming sales, namely, *that all broadcasters around the world pay far more for commissioned programs than they pay for acquired programs.*

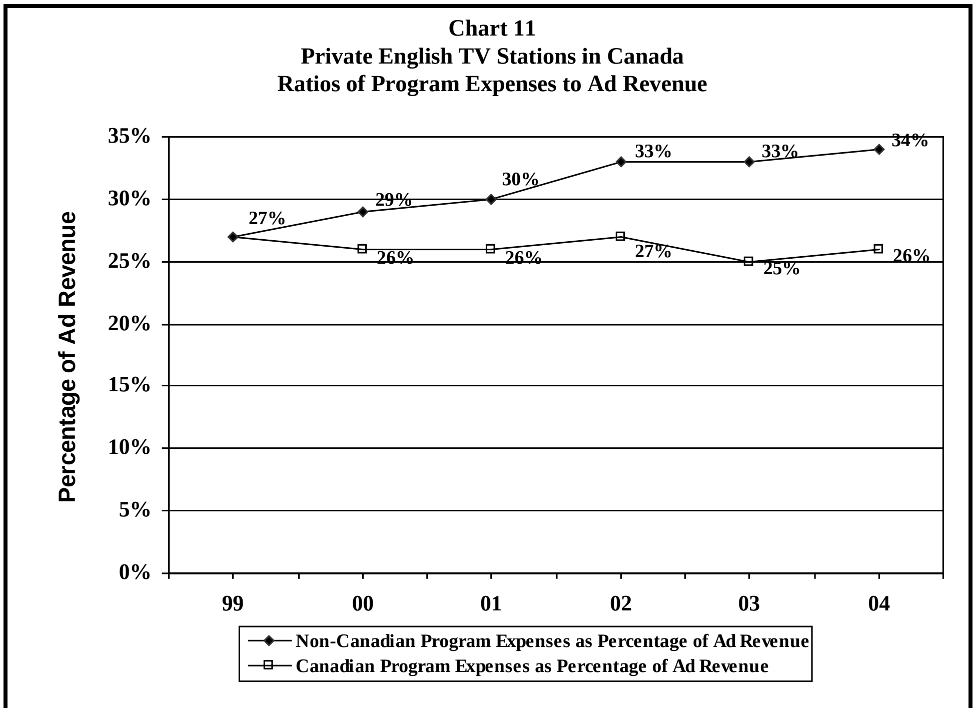
The experience around the world is that broadcasters in other countries pay far more for local drama, either in terms of the proportion of their own overall programming budget or in terms of the licence fee as a percentage of the production cost of the program, than is the case in English Canada.

As we note earlier in this report, since 1999, the Canadian private broadcasters have spent 25-27% of their advertising revenues on eligible Canadian programming (the number was 26% in 2004). However, spending on non-Canadian programming has soared from 27% of advertising revenues in 1999 to 34% of ad revenue in 2004, a new high.

In dollar terms, Canadian private English-language conventional television broadcasters were spending $389 million on Canadian programming and $393 million on non-Canadian programming in 1999. In other words, spending for the two categories was roughly the same – about 27% of ad revenue.

But by 2004, all this had changed. Canadian program spending had grown to $422.2 million, about 26% of ad revenue. But spending on U.S. programming in 2004 rose to $549.9 million, fully 34% of ad revenue.

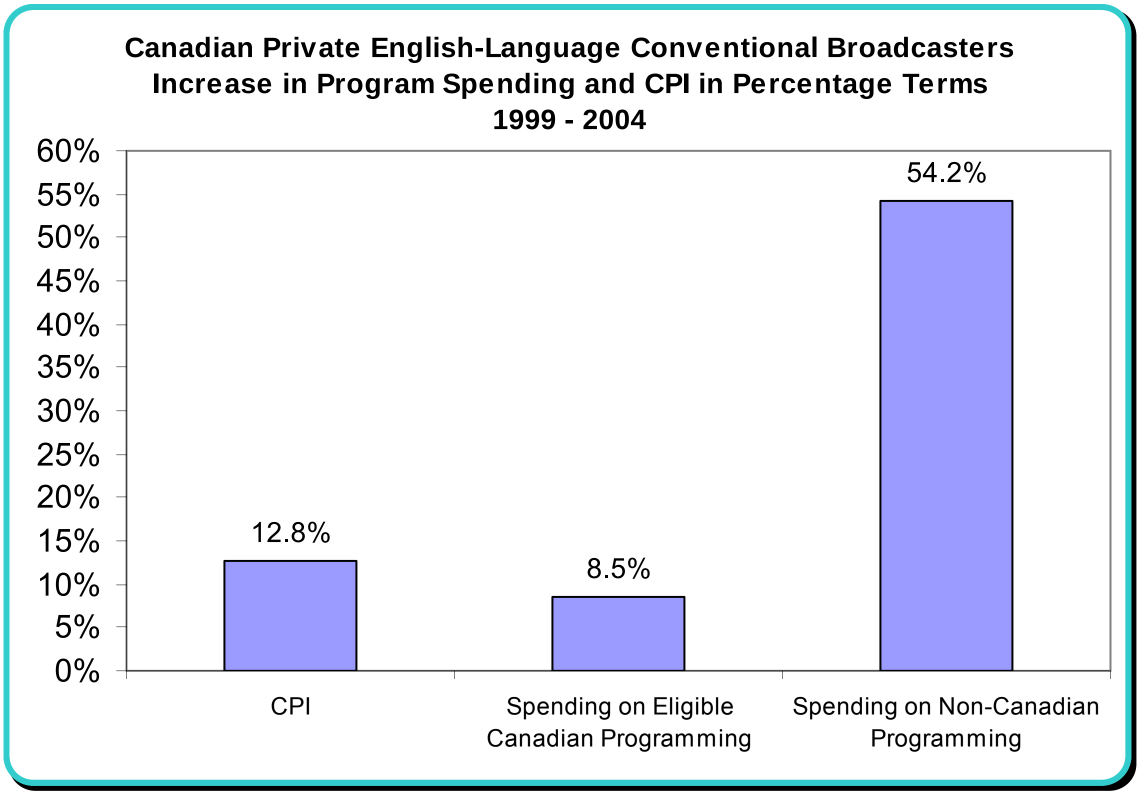
This differential between spending patterns is shown graphically in Chart 11 below.



Source: CRTC Statistics

The disparity is even more pronounced when these spending patterns are compared with the level of inflation over the same period.

Expenditures by Canadian English TV broadcasters on Canadian programming have not even matched inflation in the last five years. However, their expenditures on U.S. programming have gone up by 54% over the same period, as shown in the Chart below.



It is appropriate to note that Canadian television broadcasters benefit in many ways from the protected environment under the *Broadcasting Act*, compared with their counterparts in the U.S. Some of these benefits have been listed at pp.38-39.

Given all these regulatory benefits, any suggestion that a drama expenditure requirement should not be imposed on broadcasters because "Canadian drama is not profitable" needs to be firmly rejected. Not every activity of a broadcaster that operates in the public interest can be expected to be profitable. A requirement to support Canadian drama is of fundamental importance. Such a requirement should be part of the obligations of all Canadian TV broadcasters who make money from the broadcast of foreign drama and benefit from the protection and assistance measures noted above. Canadian TV broadcasting is a valuable franchise and Canadian drama must be a significant part of the obligations of the holders of that franchise, even if it is not a profit centre.

3. Creating a "Virtuous Circle"

The transfer and new licence benefits required to be spent on Canadian drama by private broadcasters run out in a few short years. If no drama expenditure rules are put in place for private conventional TV licensees at the time of the next review of their licences, it is entirely possible that aggregate drama spending by the private sector will decline just as it did in 2004.

The new CRTC incentive plan may provide new money to support Canadian drama. The plan also has the advantage that it may free broadcasters from dependence on CTF. However, the plan raises a number of concerns and may have only limited impact. It would be foolhardy to place complete reliance on an untried plan.

As noted throughout this report, experience has shown that unless private Canadian broadcasters in English Canada are required to spend on Canadian drama they will not do so. CTV, CanWest Global and CHUM are publicly traded companies. Shareholders will penalize managers who do not maximize profit and unless the CRTC compels expenditures in areas where there is less profit those expenditures will go elsewhere.

Broadcasters like to suggest that any policy to support drama should be all “carrot” and no “stick.” CRTC Chair Charles Dalfen reflected this approach in a speech to the Canadian Association of Broadcasters on November 29, 2004, announcing the new incentive plan:

> “I don’t want close out on this subject without noting there were, of course, voices advocating that instead of – or in addition to – using incentives, we should require licensees to broadcast a minimum number of hours of Canadian drama. This approach would certainly have been easier to implement and to monitor. But our view was that regulation will only get us so far. As Trina McQueen said in the study she prepared for us and Telefilm Canada last year, “drama deserves better than to be a forced and resented obligation. It needs the commitment and willing partnership of broadcasters.”…
>
> “Hopefully, the incentive program that we’ve announced today will help to advance the cause, and I hope that many of you will take advantage of it. I would like to be able to show any doubters that this approach, rather than regulatory compulsion, is the best way to get more and better English drama on the air, and have more Canadians choose to watch it.”

Chairman Dalfen’s hope that broadcasters will respond to the incentive program is understandable, and shared by the CCAU.

However, as we have indicated earlier, the incentive program gives rise to some real concerns. For various reasons, it appears that CTV is unlikely to trigger the incentive program to a significant degree. While CanWest Global is given more incentive, its participation is also unpredictable. And the situation for CHUM and the CBC has even less potential, since neither broadcaster has a number of high-rated shows where additional inventory could be readily sold.

Recent funding approvals by the Canadian Television Fund do not signal an increase in Canadian drama production. In fact, the number of hours of new CTF-supported drama approved in May 2005 is roughly the same as the numbers were in 2004. CTF data indicates that while there was a shift to ten one-hour series in 2005, up from six in

2004, there are far fewer MOWs – with only five this year compared with thirteen last year. Similarly, there are only four mini-series in 2005 while there were six in 2004.

This analysis also suggests that the networks' interest in one-hour dramatic series is directly linked to their upcoming license renewals. As license renewals approach, broadcasters may well be doing more one-hour drama series in order to avoid CRTC regulations to support this type of programming. For now, they wish to appear committed to Canadian drama, despite their lacklustre record over the past several years.

We hope that TV broadcasters in English Canada will respond positively to the CRTC's incentive plan with significantly increased production levels. But the jury is still out on whether and to what extent the incentive plan will work.

Moreover, we have grave concern about the longer-term support by the private broadcasters for Canadian drama. The industry has been through a horrendous period where the support of the private sector conventional broadcasters for Canadian drama significantly declined despite the requirements arising from transfer and new licence benefits. The licences issued to those broadcasters come up for review or renewal in the next two years, and the transfer benefits will come to an end. With the disappearance of these requirements, incentives alone will not be able to ensure that production levels will be adequate.

The fundamental problem remains: you can lead a horse to water, but can you make it drink? As shown elsewhere in this report, the track record of Canadian broadcasters has amply shown that unless there is a regulatory requirement -- or the imminent threat of one – broadcasters will do what is in their best financial interest. And from an economic standpoint, it is in their financial interest to broadcast the cheapest form of priority programming they can produce or acquire, in order to meet their priority program scheduling requirement. This will inevitably mean that they will tend to avoid high-cost Canadian drama. Money saved by producing or acquiring cheaper priority programs effectively drops to the bottom line. Shareholders will penalize managers that do not observe this simple logic.

By contrast, if it is made a condition of these valuable conventional TV licences that a certain level of expenditures be made on important but mostly unprofitable categories like indigenous drama, then shareholders will not penalize managers who comply with the conditions. In fact, they will reward managers that commission Canadian drama that garners higher ratings, since that will increase net revenue. Thus a virtuous circle will be created.

4. Creating a Regulatory "Safety Net"

Given these circumstances, <u>we believe that it is crucial that the CRTC put a long term regulatory "safety net" in place, to ensure that Canadian drama levels do not fall below an acceptable level in English Canada</u>.

That safety net should contain two components.

The first component would be a requirement that private conventional TV broadcasters spend a minimum percentage of their gross ad revenue on Canadian drama. The Commission has already indicated that the target for such expenditures over time should be 6%. The CRTC has also stated that this target should not include any credit for CTF licence fee top-ups.

Based on our research, the CCAU believes that the requirement should be at least 7%, and that this should be a minimum level, to be complemented by incentives that will reward broadcasters that meet or exceed that level.

If the CRTC implemented a “safety net” of 7% as a minimum level of support for Canadian drama, the support of Canada’s private conventional broadcasters would finally begin to address the crisis of financing we face. In particular, spending on Canadian drama from those broadcasters would increase from only $53.6 million in 2004 to $129-131 million in 2008, based on the Nordicity revenue projections.

If a 7% requirement had been in place last year (2004), the private TV broadcasters in English Canada would have spent $112.7 million to support Canadian drama, i.e. over double the amount they actually spent.

To put this in context, that total amount is still far less than $156.8 million -- the amount of <u>just the increase</u> in total spending on U.S. programming that the same stations incurred between 1999 and 2004. (The total amount spent on those stations on U.S. programming in 2004 was $549.9 million.)

The second component of the regulatory safety net should relate to the amount of new original Canadian drama production being commissioned by the conventional broadcasters.

The CCAU believes that each private station group should be required to commission at least two hours of original 10-point Canadian drama per week.

In developing this two-part regulatory safety net for Canadian drama, the CCAU does not suggest that incentives should be dispensed with.

The best scenario is to have a combination of incentives coupled with a regulatory safety net. Both are essential. The incentives reward the stations that deliver higher ratings for Canadian drama. The safety net requirements make it possible for those programmers to resist the pressure from shareholders and stock analysts to low-ball station expenditures and thereby maximize profit by avoiding Canadian drama.

Under paragraph 9(1)I of the *Broadcasting Act*, licences cannot be amended for the first 5 years of a 7 year licence, except upon the application of the licensee. The earliest date by which the licences can be amended without consent is shown in the table below. Those amendments can be made on the Commission’s own motion and would affect the final two years of the licence.

Licensee	*Renewal Decision*	*Expiry of Licence*	*Earliest Date for CRTC Amendment to Conditions of Licence*
CBC	Decision CRTC 2000-1	31 August 2007	1 September 2005
CTV*	Decision CRTC 2001-457	31 August 2008	1 September 2006
CanWest Global	Decision CRTC 2001-458	31 August 2008	1 September 2006
CHUM**	Decision CRTC 2002-323	31 August 2009	1 September 2007

*Except for CFCF, Montreal, the licence for which was renewed on November 29, 2002 in Decision CRTC 2002-390
**Except for CIVI-TV, Victoria, the licence for which was renewed on August 31, 2004 in Broadcasting Decision CRTC 2004-395.

Thus, the "safety net" spending and commissioning requirement cannot be legally imposed on private broadcasters until the 2007 broadcast year (for CTV and CanWest Global) and the 2008 year (for CHUM).

Much of the 1999 Television Policy has been incorporated into the conditions of licences noted above. This includes the widened definition of priority programming and the eight hour rule. Accordingly, if changes are to be made in these parameters, they cannot as a practical matter be implemented before September 1, 2006, in the case of CTV or CanWest Global.

However, it is clear that the introduction of a regulatory safety net in the form of a simple percentage of revenue requirement to support drama would have many advantages.

First, using a ratio automatically adjusts to new revenue levels, benefiting producers if ad revenue goes up but reducing the amount required to be spent by broadcasters if revenue goes down. A common ratio also puts all broadcasters on a level playing field.

By setting a simple expenditure quota for drama, broadcasters are also given more flexibility. First, they have the flexibility to determine whether they want to focus on fewer high-cost productions or more lower-cost productions; since in the end the "cost" to them will be the same. Second, an expenditures quota allows broadcasters the flexibility to decide whether they want to focus on series drama, children's drama, mini-series, made-for TV movies, animation, comedy, or other forms of scripted drama. A dollar spent would count towards the quota no matter which genre of drama is supported.

Finally, by coupling the expenditure ratio to the incentive plan, it also means that a broadcaster would be enabled (and even encouraged) to move away from CTF-financed productions and focus on non-CTF productions, since there are more bonus minutes and potentially more net revenue with the latter.

Before leaving the expenditure requirement for drama, there are two elements that need to be addressed. The first is the need for script and concept development support. In the CCAU's view, station groups should be required to allocate a reasonable proportion of their Canadian drama budget for script and concept development.

The second relates to the support by private station groups for Canadian feature films. This is not a report on feature film policy, which is currently being studied by the

Standing Committee on Canadian Heritage. A number of CCAU members have appeared before that Committee and have filed written submissions. However, it should be noted that an important component of any feature film policy will be to enlist the support of broadcasters. In particular, the CCAU considers that station groups should be required to allocate a reasonable proportion of their Canadian drama budget to the licensing of Canadian feature films.

Specialty and pay broadcasters can and must take on increasing role in the support of Canadian drama, but the support of conventional TV broadcasters in English Canada will continue to be critical, particularly for high-ticket popular Canadian drama.

CCAU estimates that English-language specialty licensees now spend about $65 million a year on Canadian drama, while the pay services spend about $31 million a year. As a combined total, this is 6.6% of the total revenue for all English-language pay and specialty services. However, that support would be significantly higher if the CRTC policy allowing CTF licence fee top-ups to count as eligible expenditures was reversed. This issue is discussed further below.

5. Enhancing Existing Reporting Requirements

A vitally important issue is the need to have updated information on the performance of the TV station groups. The CCAU was hampered in preparing this report by the fact that relevant data was often confidential or unavailable or its disclosure was delayed.

Within the licence renewal hearings for the CTV, Global and TVA station groups in 2001, the Commission released financial information to the public that is usually kept confidential in relation to conventional television broadcasters. The financial information made available included the annual revenue and annual expenditures of each of the three broadcast groups for the years 1997 through to 2000. With respect to expenditures, the documents set out breakdowns of dollars spent on the various categories of programs, such as news and drama by each of these station groups.

Prior to releasing the financial information to the public, the Commission held a public process, which was initiated by Public Notice CRTC 2001-5. In that Public Notice, the Commission stated the following:

> "In order to foster open and informed public discussion, the Commission considers that it may be appropriate to place certain information concerning each of these television groups on the public files for these hearings. This additional information would include details that the Commission has not generally made publicly available in the past. The Commission did, however, place similar information on the public file pertaining to Public Notice CRTC 1998-44 dated 6 May 1998 entitled *Canadian Television Policy Review - Call for Comments*." [emphasis added]

Thus, the Commission considered releasing generally confidential financial information in order to encourage an open and informed public discussion. In Public Notice

CRTC 2001-27, the Commission approved the release of certain financial information relating to CTV, Global and TVA. The Commission's rationale for allowing the release of the financial information included the following:

> …"although conditions of licence regarding Canadian programming expenditures are not generally imposed under the Commission's new television policy, *such data will provide an indication as to how the Commission's new policy is working over the next licence term*. Public access to the data will also allow for a more informed public discussion on the wide range of issues facing the industry."

In releasing the conventional broadcasters' financial information during the station group licence renewals of 2001, the Commission provided the public with an opportunity to assess how the Commission's new Television Policy was working. However, the CRTC has not followed-up by disclosing the disaggregated financials of the station groups. While it has disclosed the gross revenue of each TV station group annually, it has not disclosed the program expenditures, either in total or by genre, of each station group.

This kind of information is vitally important for the regulatory process. The CCAU considers that this information should be released on an on-going basis, consistent with the Commission's 2001 ruling. Canadians should be able to access the conventional broadcasters' financial information in order to evaluate the manner in which CRTC policies are being applied, and the extent to which broadcasters are contributing to the system.

The situation with the pay and specialty services is somewhat different, because the CRTC has routinely released the individual financial numbers for individual services until recently. However, the 2004 numbers have not yet been disclosed, pending the CRTC disposition of a request by the CAB that the numbers be kept confidential.

The CCAU filed a submission with the CRTC on May 30, 2005, urging it not only to disclose the financial statements of the individual pay and specialty services, consistent with past CRTC practice, but also to require those services to break out their program expenditures by program genre.

In its submission, the CCAU noted the following:

> "Under section 3(1)(s) of the Broadcasting Act, it is stated that "private networks and programming undertakings should, <u>to an extent consistent with the financial and other resources available to them</u>… contribute significantly to the creation and presentation of Canadian programming…" . (emphasis added)
>
> "This section explicitly requires the Commission to have regard to the financial resources of licensees in setting Canadian content levels. And unless interveners have access to those financial statements, they are hamstrung in their ability to make useful submissions to the CRTC.

"In that connection, the CCAU and its members have intervened regularly in CRTC processes over the years using financial data to advance their arguments. To pick but one example, in 2001, the Directors Guild of Canada ("DGC"), intervened with respect to the pay television renewals. The pay companies were attempting to shrink their Canadian content expenditures from the 31%-32% of revenues range down to 20%. Using disaggregated CRTC data, the DGC and others were able to persuade the Commission that it was inappropriate to grant the request. The difference, using the pay companies' own projections at the time, was approximately an additional $188 million in Canadian content over the proposed licence term. Given the extraordinary financial results of the pay companies since that time, the difference likely would have been even higher.

"A second example occurred at the licence renewal hearings of the "Class of 96" specialty services. In that proceeding, interveners from the unions and from the independent production sector had access to the financials of the services involved and argued for increases in Cancon levels. This turned out to be crucial, since the CRTC in the end decided to increase the Canadian content expenditure requirements of certain services based on their historical PBIT levels, the specifics of which were also disclosed.

"Given these cases, it is understandable why licensees do not want to allow the financial results of their services to fall into the hands of interveners. However, where these results directly affect the determination of their obligations under the *Broadcasting Act*, as they do, it is incumbent on the Commission to make the results public so that interveners can make their case."

The CCAU considers that the availability of broadcaster financial information to the public will not impede in any way the competitive position of these stations in the market-place. The Commission has made public financial information relating to the revenues and expenditures of Canadian specialty services and pay services on an annual basis for many years. This has not limited in any way the competitive position of these television services. Consequently, the CCAU respectfully submits that it would be beneficial to the system to release comparable financial information in order that Canadians and interested parties may closely monitor the effects of the Commission's Television Policy on the Canadian broadcasting system.

6. Improving the Integrity of Reporting

In discussing the reporting of drama expenditures, there are two issues that need to be addressed. The first is the CRTC's licence fee top-up policy. The second is its treatment of equity investments by broadcasters. Both issues have the potential of undermining the integrity of the broadcasting system by permitting broadcasters to claim credit for artificial or notional expenditures that were not in fact made by them.

In 1994, at the time the predecessor to the CTF was established, the CRTC indicated that it would permit broadcasters to claim so-called "licence top-up" money received by the producer from the fund as if such money was expended by the broadcaster itself. The DGC raised this matter in the 1998 review and argued that such a "credit" was inappropriate as it allowed the broadcasters to overstate what they actually expended on drama. In the 1999 TV Policy, the CRTC did not deal with the issue. However, when the CRTC eliminated the expenditure rule for conventional television, the issue generally became moot for those broadcasters.

However, the CRTC continues to permit the CTF top-up credit to be claimed by pay and specialty broadcasters, thereby reducing their spending requirements by a commensurate amount. (However, the CTF top-up credit has never been applied to expenditures required to be made as part of transfer benefits in ownership decisions.)

In its decisions in January 2004 on the renewals of the "class of 96," the CRTC declined to reverse its top-up policy. More recently, in its public notice announcing the incentive plan (Public Notice CRTC 2004-93) it stated the following:

> "170. In addition to financing for eligible Canadian television productions, the CTF often supplements the Canadian broadcasters' cash licence fees for the productions in the form of licence fee "top-ups". Pursuant to Public Notice 2003-54, the Commission received a number of requests that it change its definition of eligible Canadian program expenditures to exclude licence fee top-ups. In Public Notice 2004-32, the Commission determined that changing this policy would require a public process and would not result in an increase in spending on Canadian programs. Accordingly, the Commission proposed no change to its current approach.
>
> "171. In its comments pursuant to Public Notice 2004-32, Telefilm argued that licence fee top-ups effectively reduce broadcasters' Canadian program expenditure requirements.
>
> "172. The Commission notes that, in 2002, licence fee top-ups represented less than 5% of total Canadian program expenditures by all specialty, pay and pay-per-view services. Furthermore, the Commission considers that, by allowing equity at risk to count as an eligible expenditure, the concern expressed by Telefilm will be alleviated.
>
> "173. Accordingly, the Commission's current policy with respect to licence fee top-ups will not be altered."

Despite this ruling, the CCAU continues to believe that the applicability of the CTF top-up credit undermines the integrity of the reporting system, and is not an insignificant issue. The CRTC is correct in stating that licence fee top-ups in 2002 ($30.9 million) were less than 5% (in fact, 4.9%) of total Canadian program expenditures by all specialty and pay services that year ($627.0 million). (In 2003, this ratio increased to 6.2%, when top-ups accounted for $43.3 million out of Cancon expenditures of $695.1 million.)

However, since the licence fee top-ups only apply to Canadian drama and documentaries, they represent a far higher proportion of the Canadian program expenditures of those services that focus on those genres.

In fact, as shown in Appendix 5, CRTC statistics show that the eight English-language specialty services identified earlier that include Canadian drama in their schedule counted $21.9 million in 2003 against their licence conditions by reason of the "top-up" policy. Thus, in a year when they spent $65.4 million on Canadian drama, the CRTC policy excused them from spending $21.9 million more.

The situation was similar for the five English general interest pay television licensees. In 2003, when they spent $31.5 million on Canadian drama, the CRTC top-up policy excused them from spending $5.8 million more.

The licence fee top-up policy is therefore having a significant impact on the funding for Canadian drama. The policy would be less problematic if the CRTC adjusted the licence conditions relating to expenditures otherwise applicable to the services upwards to account for the loophole. However, this appears to have been only rarely the case. In the case of the pay television services, in fact, they did not begin to take advantage of the loophole until after their respective licences had been renewed in late 2001 on the basis of financial projections that included no references to any top-up credit. Accordingly, all the benefits of the top-up policy have gone straight to the pay licensees' bottom line, and robbed the system of millions of dollars of support for drama.

In order to give the system more integrity, and to clarify what is actually being spent, CCAU has recommended that the CRTC issue a circular indicating that the licence fee top-up will no longer count as a credit towards spending by any broadcaster. As specialty and pay licenses come up for renewal, any reports or projections filed by such licensees should clearly indicate that they do not include any CTF credits. Any renewal decisions should also clarify that eligible expenditures in the renewal term does not include any CTF credits.

In that regard, the CCAU notes with approval that in setting a target for drama expenditures by the TV station groups in its incentive plan, the Commission specifically excluded licence fee top-ups from the calculation. This is an important first step in reversing a policy that fundamentally undermines the integrity of the system.

The issue of equity investments is more complex. Since 1993, the CRTC has only permitted broadcasters (apart from the pay television services) to claim equity investments as eligible Canadian expenditures if they are not recouped. However, in announcing its incentive plan, the Commission for the first time permitted such investments to count, even if recouped, provided they were genuinely "at risk".

The problem with this policy is that it invites broadcasters to negotiate equity arrangements with producers that are purportedly at risk but in fact give the broadcaster enhanced recoupment rights, resulting in relatively little risk for the broadcaster, and putting most of the risk on the producer, instead of sharing the risk pro rata with the producer.

In the view of the CCAU, the easiest way to address this is to require that any equity investment made by a broadcaster to count as an eligible Canadian expenditure should have no higher recoupment status than the other equity investors, including the producer.

As noted earlier, the CCAU recognizes the importance of maintaining and enhancing a strong independent production sector. In this regard, the CCAU supports the development of so-called “Terms of Trade “ between producers and broadcasters, which can hopefully address the issues raised above. The CRTC’s role in this regard is critical, since producers alone do not have the bargaining power to achieve an equitable result.

F. Recommendations

Based on the foregoing, the CCAU has the following recommendations to make. These recommendations may be subject to refinement and adjustment to take account of changing circumstances. However, taken together, they hold the prospect of greatly improving the environment for Canadian drama.

The first six recommendations focus on the regulatory safety net to be made applicable to the English-language private conventional broadcasters, as well as the role of the CBC and the pay and specialty services in regard to drama.

Recommendation 1

The CRTC should develop and implement a two-part regulatory "safety net," applicable to each of the private TV station groups, comprised of the following obligations:

(1) a minimum of 7% of the previous year's ad revenue to be expended on Canadian drama, and

(2) at least 2 hours per week of new original 10-point Canadian drama to be commissioned.

Recommendation 2

Station groups should be required to allocate a reasonable proportion of their Canadian drama budget for script and concept development.

Recommendation 3

Station groups should be required to allocate a reasonable proportion of their Canadian drama budget to the licensing of Canadian feature films.

Recommendation 4

The CBC should be supported in its efforts to broadcast more original Canadian drama, with more public funding provided for this purpose. The CBC should be given increased access to the CTF only to the extent that private broadcasters are able to replace their dependence on the CTF with non-CTF production funded through the incentive plan or equity participation.

Recommendation 5

Canadian pay and specialty services should be required to make enhanced Canadian content programming expenditures, commensurate with their increased financial resources. Those that include drama in their mandate should be subject to reporting on their contribution to Canadian drama.

Recommendation 6

The CRTC should review its incentive plan so as to make it complementary with the regulatory safety net.

The next four recommendations deal with reporting and transparency.

Recommendation 7

The CRTC should provide enhanced annual reporting on the performance of the TV station groups and the pay and specialty television services, with revenues and drama hours and dollars identified.

Recommendation 8

The CRTC should improve the integrity of the financial reporting process by removing or limiting its licence fee top-up policy.

Recommendation 9

The CRTC should improve the integrity of the financial reporting process by imposing more stringent rules on what qualifies as an "equity investment" entitled to be counted as a Canadian expenditure.

Recommendation 10

The CRTC should schedule broadcast licence review hearings for CTV, CanWest Global and CHUM within the next two years so as to be able to review their Canadian drama expenditures and performance on a coherent and consistent basis.

The next two recommendation focuses on the role of broadcasting distribution undertakings in the Canadian broadcasting system.

Recommendation 11

The CRTC should ensure that contributions from BDUs to the CTF are maintained and enhanced.

Recommendation 12

The CRTC should ensure that in any digital migration, Canadian analog programming services that include Canadian drama in their mandate are protected from unfair packaging and/or dislocation by BDUs.

Finally, we have two recommendations concerning Canadian entertainment magazine programs.

Recommendation 13

To qualify as priority programs, all Canadian entertainment magazine shows should be subject to the rule that 2/3rds of the content relate to Canadian entertainment, not just shows produced from Toronto or Vancouver.

Recommendation 14

Private station groups with Canadian entertainment magazine shows should be required to report regularly on their compliance with the 2/3rds rule, and how they have supported a Canadian star system.

Appendix 1

History of CRTC Regulation of Canadian Drama

This appendix provides a brief outline of the history of regulation of Canadian drama by the CRTC.

1. Regulation of Canadian Drama Scheduling from 1961 to 1999

There has been an overall Canadian content quota applicable to private TV broadcasters in Canada since 1961. However, in the period from 1961 to 1979, the broadcast regulator did not regulate the exhibition of Canadian drama at all. The regulations only dealt with overall Canadian content and did not single out drama as such. Private broadcasters could comply with the quota by running news, sports and game shows.

The original quota established in the 1960's required only 40% Canadian content and was very loosely worded. In 1970, shortly after it succeeded the BBG, the newly created CRTC conducted a review of the Canadian content quota. To the large extent, the overall rules created in 1970 still apply today. The basic quota for private television in Canada requires 60% Canadian content during the 18-hour broadcast day, and 50% Canadian content in the evening hours from 6 p.m. to midnight. The quota is higher for the CBC, which is required to maintain a 60% level in both the 18-hour broadcast day and the evening broadcast period from 6 p.m. to midnight. The quota is subject to some case-by-case exemptions.

As noted above, the overall Canadian content quota in the regulations does not distinguish between particular program categories. History quickly demonstrated, however, that where there are no specific mechanisms in place that require private television broadcasters to air dramatic programs, these productions will get very little air-time.

In the 1960s and 1970s, where no express mechanisms were in place relating to the exhibition of Canadian drama, the private television industry, particularly in English Canada, focused on presenting the least expensive categories of Canadian content to produce, i.e. news, sports and game shows. The result was that there was virtually no Canadian drama on private English television. With few exceptions, the only Canadian drama to be seen was on the CBC.

At the end of the 1970s, however, a new obligation was implemented with respect to the support of Canadian programming by private English television. In 1979, the CRTC decided to impose a category quota explicitly for Canadian drama as a condition of licence for the CTV Television Network. The quota was 26 hours of new drama per year, rising to 39 hours over the 5-year licence term. That licence condition was appealed to the Supreme Court of Canada on a variety of grounds, but was upheld in 1982.[3]

[3] *CRTC* v. *CTV Television Network Ltd*., [1982] 1 S.C.R. 530.

In 1987, the Commission increased the requirements placed on CTV. In the decision renewing CTV's network licence, the Commission required CTV to broadcast 2 ½ hours per week of a regularly scheduled Canadian drama series, rising to 4 ½ hours per week by the end of the 5-year licence term.[4] The proportion of original hours to repeats of regularly scheduled Canadian drama was required to exceed the 70% level. In other words, for each 10 hours of repeats, CTV was required to broadcast at least 7 hours of new drama programming. In addition, all but one hour of the requirement was required to be scheduled after 8 p.m. The decision also required an additional 24 hours per year of Canadian feature films, mini-series and limited dramatic series to be broadcast by CTV.

In 1994, the CTV licence was renewed subject to a condition that the network schedule 3 hours per week of Canadian drama programming rising to 3 ½ hours over the term of the licence, with an additional 48 hours per year of Canadian dramatic features, mini-series and limited series.[5] The Commission also stated that it expected CTV to adhere to its commitment that original first-run hours as opposed to repeats remained above 70%.

Global Television was also subject to special Canadian dramatic programming quotas. Under the terms of its 1986 renewal, Global was required to broadcast approximately 3 hours per week of first-run Canadian drama. This consisted of 1 ½ hours of first-run drama and 1 ½ hours of reruns.[6] In 1992, however, the Commission renewed Global's licence subject to a condition that this amount be increased to 3 ½ hours by the 1994-95 season, all of which was to be broadcast between 8 and 11 p.m. In 1996, the Global licence was renewed subject to a requirement that it broadcast 4 hours of drama per week, at least 2 of which were committed to be original first-run hours.[7]

As each of the pay and specialty programming service licences were issued over the last 18 years, the CRTC has also imposed Canadian content scheduling requirements for these services. However, they are made applicable through customized conditions of licence, rather than through generally applicable regulations.[8]

2. Regulation of Canadian Content Expenditures, 1982 to 1999

A Canadian content expenditure quota was first introduced by the CRTC in 1982 for pay television. It was a quota specified as a fixed percentage of subscription revenue. When penetration levels of pay television turned out to be far less than projected in the next few years, the pay television licensees went back to the CRTC and persuaded the Commission in 1987 to establish lower expenditure levels as a proportion of subscriber revenue. (In the most recent renewals of the pay licensees in 2002, the expenditure levels were increased to reflect increased penetration with the introduction of DTH.)

[4] See Decision CRTC 87-200, March 24, 1987.
[5] See Decision CRTC 94-33, February 9, 1994.
[6] See Decision CRTC 92-220, April 8, 1992.
[7] See Decision CRTC 96-72, February 29, 1996.
[8] For the current conditions of licence applicable to the pay and specialty services, see Peter S. Grant et al, *Regulatory Guide to Canadian Television Programming Services* (Toronto: McCarthy Tetrault, 1st edition, 2002).

The concept of requiring a certain level of expenditures on Canadian programs was later extended to Global in 1986[9] and CTV in 1987.[10] In 1989, the CRTC applied the concept to all major local television stations, as part of their licence renewal decisions. The level of expenditures was tied to the advertising revenues of the station concerned. As a result, the expenditures on Canadian programs required by the CRTC fluctuated up and down with changes in the ad revenue for the stations.[11] The programming expenditures formula was later modified by allowing some averaging to occur between fiscal years.[12] The expenditure rules were also tightened in 1993 to address a number of concerns about double-counting and other accounting issues.[13]

In 1995, the Commission announced that it would permit local television stations earning more than $10 million in annual advertising revenue the option to choose between the continuation of a condition of licence on Canadian programming expenditures or an alternative condition of licence simply requiring certain minimum hours per week of Canadian entertainment programming in the evening broadcast period. The term "entertainment programming" embraced the genres of drama, music and variety programs, and the required minimum scheduling level rose from 5½ hours a week to 7 hours a week over the next seven year period.[14] Local stations across Canada had variously chosen one or the other of these options following their 1995 renewals.[15]

This policy was not extended to two major players, CTV and Global, however, where expenditure conditions applied that were explicitly tied to Canadian entertainment programming, in addition to the scheduling conditions on Canadian drama referred to earlier. For CTV, the expenditure commitment was $18 million per year during its previous licence term; and for Global, the expenditure commitment was $9.3 million per year in its previous licence term.[16] Both levels rose with increases in ad revenue.

Finally, reference should be made to the Canadian expenditure rules applicable to the Canadian specialty programming services. In this regard, the Commission has typically required successful licensees to expend the amount proposed in Year 2 in their applications, and thereafter to expend a minimum annual expenditure on Canadian programming derived from averaging the amounts committed in the business plan submitted with the application, and expressing them as a percentage of the services' gross subscription and advertising revenue.

These expenditure requirements continue to apply to Canadian specialty services, but as noted further below, were eliminated for conventional TV stations in 1999.

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[9] See Decision CRTC 86-1086, November 14, 1986.
[10] See Decision CRTC 87-200, March 24, 1987.
[11] Overview: Local Television for the 1990s, Public Notice CRTC 1989-27, April 6, 1989.
[12] Public Notice CRTC 1992-28, April 8, 1992.
[13] Decision CRTC 92-229, April 8, 1992.
[14] Public Notice CRTC 1995-48, March 24, 1995.
[15] For a listing, see Appendix to Public Notice CRTC 1995-203, November 30, 1995.
[16] Decision CRTC 94-33, February 9, 1994; Decision CRTC 96-72, February 29, 1996.

3. The 1999 TV Policy

In 1998, the CRTC initiated a public process to undertake a broad and fundamental review of its policies relating to television broadcasting.[17] This was an important CRTC proceeding, as the Commission had not undertaken a complete review of its television policies for over a decade. After receiving written and oral submissions from interested parties, the Commission released its new Television Policy entitled *Building on Success: A Policy Framework for Canadian Television*[18] (the "Television Policy"). In that new policy document, the Commission's approach to regulating Canadian programming requirements was significantly altered. The following discusses the ways in which the new Television Policy changed the television broadcast regulatory regime.

First, the Television Policy dispensed with requiring Canadian programming expenditure as a condition of licence. Consequently, private conventional television broadcasters are no longer required to expend a percentage of their advertising revenues, or a fixed amount of money, as set out by condition of their broadcast licences.

CTV and Global are, however, required to spend money on Canadian programming as a result of recent ownership transactions. In particular, CTV is required to spend $140 million over seven years on priority programming as a condition of the Commission approving the acquisition of that broadcaster by Bell Globe Media.[19] Of this amount, $75.5 million must be used for the creation of dramatic programming.

As for Global, it is required to spend $84.2 million over five years in benefits as a result of its acquisition of a number of WIC broadcast assets in 2000.[20] Only $23.9 million of that amount has been earmarked for the creation of Canadian priority programming by independent producers. However, none of the funds have been specifically earmarked for Canadian drama.

The second difference that the new Television Policy brought on is that it does not set any specific requirements with respect to the broadcast of Canadian dramatic programming. Rather, it requires that the larger multi-station groups broadcast an average of eight hours per week of priority programming during the peak viewing periods (7:00 p.m. to 11:00 p.m.) over the course of the broadcast year. The exhibition requirement is set out as follows at paragraph 37 of the 1999 Television Policy:

> "The largest multi-station ownership groups will be required to broadcast, over the broadcast year, on average at least eight hours per week of priority Canadian programs during the 7 p.m. – 11 p.m. viewing period."

Priority programs include dramatic programs. However, they also include a number of other genres of programs. The complete list of Canadian priority programs is as follows:

[17] See Public Notice CRTC 1998-44, May 6, 1998.
[18] See Public Notice CRTC 1999-97, June 11, 1999.
[19] See Decision CRTC 2000-747.
[20] See Decision CRTC 2000-221.

Priority Program Categories:

- Canadian drama programs (Category 7)
- Canadian music and dance, and variety programs (Category 8 & 9)
- Canadian long-form documentary programs
- Canadian regionally produced programs in all categories other than News and information (Categories 1, 2 and 3) and Sports (Category 6)
- Canadian entertainment magazine programs

Thus, the current exhibition requirement sets out no obligation on the television broadcasting industry to exhibit a minimum amount of dramatic programming. Broadcasters may, therefore, meet their priority programming exhibition requirement by broadcasting any of the other program categories included in the definition of priority programming, such as documentaries or entertainment magazine programs. There is also no obligation on broadcasters to air first-run programs.

The Television Policy did not set out any exhibition requirement with respect to the smaller multi-station ownership groups, such as CHUM and Craig. However, when CHUM acquired the Craig stations in 2004, it made commitments to the Commission to meet the 8-hour priority programming requirement established for larger broadcast groups within new licensing proceedings.

A third change bought by the Television Policy is that the Commission has widened the definition of priority programming beyond what were formerly referred to as the "underrepresented categories". The definition added long-form documentaries, regional programs other than news and sports, and entertainment magazine programs.

Finally, the Television Policy altered the manner in which the Commission applies its dramatic programming time credit. Under the regime set out in Public Notice CRTC 1984-94, the Commission granted a 150% time credit to all broadcasters where a program broadcast met all of the requirements set out in Public Notice CRTC 1984-94. In order to qualify, a Canadian program was required to attain at least 6 out of 10 points set out in that public notice relating to the creative functions of the program.

Under the Television Policy, the 150% time credit rule set out in Public Notice 1984-94 continues to apply to the smaller station groups such as Craig and CHUM. However, for the larger station groups, the 150% time credit rule has significantly changed. Under the new regime, larger station groups may only apply the 150% time credit for priority programs broadcast on the station, where these programs meet 10 out of 10 points relating to the creative functions of the production. Moreover, the larger broadcasters have access to a new 125% time credit for priority Canadian programs that meet 6 of 10 points relating to the creative function of the production.

4. CTV and Global Renewal Hearings

In April 2001, the Commission held station group licence renewal hearings for both CTV and Global where it considered the licence renewal applications of most of the CTV and Global television stations. This station group licence renewal approach stemmed from a new policy set out in the Television Policy. In both the written renewal applications and at the renewal hearings, CTV and Global stated repeatedly that they were committed to Canadian dramatic programming. Excerpts from the written and oral submissions of CTV and Global are set out in Appendix 2.

Despite these words of support to drama, both Global and CTV, the largest media companies in Canada, came in at their licence renewal hearings with no more than a commitment to meeting the minimum requirements of the Television Policy. That is, they committed to broadcast an average of eight hours of priority programming over the course of the broadcast year. Neither Global or CTV committed to airing a specific number of hours of Canadian drama.

5. Transfer and New Licence "Benefits"

Since 1999, the CRTC has approved major consolidation in the TV industry in English Canada. These transactions include the BCE takeover of CTV, the CanWest Global takeover of the WIC TV stations, and the CHUM takeover of CKVU Vancouver and the Craig stations in Western Canada. The CRTC has also approved new English-language TV licences in Calgary, Edmonton, Vancouver, Victoria, Montreal and Toronto.

In each of these cases, the CRTC has required programming "benefits" to be provided by the licensee, and many of the benefits have focused on dollars to be expended on Canadian drama production. In addition, the CRTC has generally required the licensees to file annual reports indicating how they have spent the money.

An analysis of these benefits is provided in Appendix 4.

6. The CRTC Incentive Plan for Drama

On November 29, 2004, in Broadcasting Public Notice CRTC 2004-93, the CRTC released details of its new incentive program to increase the amount of original English-language Canadian television drama broadcast on Canadian television and to encourage larger audiences to this type of programming.

Broadcasters who take advantage of this incentive program were required to apply for conditions of licence that would allow them to broadcast additional minutes of advertising per hour if they met the Commission's criteria. All three of the English conventional TV private broadcast groups – CTV, CanWest Global and CHUM -- have applied to take advantage of the plan.

Under the plan, broadcasters can earn the right to broadcast between 30 seconds and 8 minutes of additional advertising for each hour of original Canadian drama they broadcast. The exact amount of additional advertising is dependant upon such factors as the level of Canadian participation in the production, the budget required to produce the drama, the time of broadcast, and the source of the funding.

If broadcasters increase their audience share for Canadian drama by a pre-determined amount, they will be entitled to increase the total additional amount of advertising they broadcast by 25%. And if broadcasters increase their spending on Canadian drama by a pre-determined amount, they will be able to increase the additional amount of advertising they broadcast by another 25%.

While there is no limit to the number of additional advertising minutes that may be earned under the incentive program, broadcasters may not air more than 14 minutes of advertising in any given hour.

For the largest English-language broadcasters, the incentives apply only to qualifying drama in excess of 26 hours per year, except for drama programs that do not receive funding from the Canadian Television Fund. Those programs will also enjoy the greatest additional advertising minutes. This will encourage broadcasters to invest directly in the creation of new independently-produced drama projects.

Appendix 2

CTV and CanWest Global Submissions on Drama to the CRTC in 1998 and 2001

(a) Within the TV Policy Review in 1998

The Public Hearing that was held in 1998 to consider the review of the CRTC's television policies, and the submissions of broadcasters were replete with stories about their successes in the field of Canadian drama to date. They left the impression that if the Commission would just slightly loosen the "shackles", there would be a great deal more work to come in the future with respect to the support and presentation of Canadian dramatic programs.

The CTV panel made the following comments during their presentation to the CRTC on September 26, 1998:

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> *MR. FECAN: Personally, I count among my proudest achievements contributions to long-form dramas such as "Love and Hate", "Conspiracy of Silence", "The Donald Marshall Story" and "Boys of St. Vincent"; dramatic series such as "Road to Avonlea", "Street Legal", the Montreal-based "Urban Angel" and "Degrassi Junior High"; and comedies such as "Codco", "Air Farce", "This Hour has 22 Minutes" and "Kids in the Hall".*
>
> *At CTV this season, joining Vancouver-based "Cold Squad", "Double Exposure", "On the Edge", "Gabereau" and "First Story", our aboriginal magazine, are "Due South", our top-rated Canadian drama;*
>
> *…*
>
> *This year, we will add to that two new Canadian drama series: "Power Play", the Hamilton-based hockey drama which debuts tomorrow night; and "Flesh and Blood", a compelling urban drama which covers diversity issues in downtown Toronto.*
>
> *p19 of 131*
>
> *This year, we did manage to help fund four indigenous dramas: "Due South", "Cold Squad", "Power Play" and "Flesh and Blood". But, next year, the funds have signalled us that four is out of the question; three is highly unlikely; two is not guaranteed; and just one is a possibility.*
>
> *…*
>
> *p20 of 131*
>
> *Our fallback is industrial Canadian drama, usually shows developed for foreign specialty services serving narrow niche markets such as science fiction or action genres. To CTV, a general interest network, these are not our ideal programming choices; but they do qualify as Canadian and they can be made without public money.*
>
> *…*
>
> *You will find attached to this presentation our fall/winter schedule. We appreciate that the Commission has been working with historical figures that do not reflect what we are doing now. This year, in prime time, we have introduced a dramatic increase in Canadian indigenous 7, 8 and 9. This*

schedule includes 5.5 hours of Canadian drama series, of which at least four are indigenous. In addition, there is one hour per week of 7, 8 and 9 for almost 6.5 hours per week overall. Added to our substantial local program schedule, it is a significant contribution.

…

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I guess our hope is that, as we can improve viewing and advertiser acceptance to particularly the 7, 8 and 9 Canadian, it will make our business that much stronger, and we have tried to approach the issue in a very professional kind of way with the tools that programmers and developers around the world use to try to get a result.

…

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I think the other thing I just want to chime in is that this particular chart is of course using the figures that we all have available. In our situation, between 1997 and the fiscal 1999 season we are in now, our spending in terms of 7, 8 and 9 has gone up rather dramatically, as evidenced by our schedule and what is actually on the air. That won't show in these numbers for a year or two depending on the timeliness of the reporting systems.

In other words, it was straight up for Canadian drama and expenditures and the references to the numbers that they didn't have yet would have led inexorably to the conclusion that more good things were on the way.

The CanWest Global panel appeared next at the hearing and had the following comments:

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MR. SWARD: Six years ago, we took a long and hard look at the future for Canadian television and developed a brand new course for our stations… We designed a plan consisting of many components. In Canadian programming, this plan focused on three specific areas where we were determined to do better, and eventually be the best.
Number one is prime time Canadian dramatic series programs… That's where we decided to focus our efforts.

You have heard that, despite the addition of hundreds of new hours of Canadian programming and millions of dollars invested in the last ten years, Canadians viewing to Canadian programming has remained flat at about 32 per cent.
This is true of the average but it's not true of Global. Between the fall BBM surveys of 1993 and 1997, our audience to our local supper hour news all across the country has increased by 21 per cent. Viewing to our prime time Canadian drama schedule by Canadians has increased by more than 150 per cent.

In these two important areas, and in the face of many new choices for Canadian viewers, we have increased Canadian viewing to Canadian programs. We are not your average performer when it comes to getting more Canadians to watch Canadian programs. In fact, today, Global's prime time line up of Canadian drama is the top performing Canadian schedule in the private sector by a substantial margin.

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We have heard that licence fees for Canadian drama have not increased. As a matter of fact, some have suggested that they have gone down in recent years. Again, this is not the Global experience. A

sample of three hours per week of Canadian prime time series drama, which we are now licensing for the third season, shows that our average licence fee for these programs has increased by 31 per cent over the last three seasons.
…

Global is not your average performer. We consistently overperform. We have done more Canadian programming, won more viewing to our Canadian programming, and significantly increased our expenditure on Canadian programming, and we have learned an awful lot throughout our journey. Loren.

MS MAWHINNEY:

For the past five years, my specific area of responsibility has concentrated on developing a winning prime time schedule of Canadian drama series. We have done very well and we can do better.

Here are four lessons…

…We at Global have more than doubled our prime time audience to our Canadian drama programming during the last five years by doing more of what works and less of what does not.

…

What do we want more of? We want more Canadian drama series with 22 fresh episodes each season…

<u>*The route we advocate is not the least expensive way. In the majority, indigenous Canadian programming requires funding support, and therein lies the major obstacle.*</u>

…

If we want to do more, we have to change this, and we have advocated an envelope of 40 per cent for the private conventional share, which would bring our portion of the $100 million for next year to $21 million.

In closing, we wish to point out to the CRTC that most industrial programs made in Canada are intended for U.S. specialty networks, not NBC, CBS or ABC, where we buy network programming. We must remember too that every hour added to Canadian prime time broadcasters' schedules allows one more hour of unsubstituted U.S. programming back to the Canadian consumers via the cable market.

…

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MS BELL: Building a loyal audience for prime time quality Canadian programming should be the priority goal of our regulatory framework. Here are some key principles that the CRTC can adopt to achieve that goal.

First, adopt a regulatory platform that seeks to ensure that, from this point forward, viewership growth is a system-wide priority.

Second, enable broadcasters to develop distinctive scheduling strategies by extending the peak prime time period to 7 p.m. to 11 p.m. seven days a week.

Third, recognize promotional efforts as essential to building audiences for Canadian programming.

Fourth, build on the foundation of the 150 per cent drama credit to overcome the unfavourable economics of Canadian drama
…

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Page 10, you talk about if you overperform in Canadian drama in prime time, then the broadcaster would be rewarded by allowing relief from Canadian content in day time on the basis of one to five credit. So each hour of drama in prime time would entitle you to do five hours less of your safety net of 60 per cent.

MS BELL: That is correct.

1725
THE CHAIRPERSON: And over-performance would be based on the 50 per cent Canadian content?

MS BELL: For the evening broadcast period, yes.

THE CHAIRPERSON: And that would be in the six-hour block chosen in prime time between -- I think it's five and 12.

MS BELL: We had suggested, to give some flexibility there, to allow broadcasters to pursue their own scheduling strategies so they could choose a period, any consecutive six-hour period between 5 p.m. and midnight, as their evening broadcast period.

THE CHAIRPERSON: And if you did have hours of exhibition in certain categories in prime time, would the over-performance be measured by reference to that or by reference to the 50 per cent?

MS BELL: The over-performance that we suggested was --

THE CHAIRPERSON: To get the one to five credit.

MS BELL: Yes, was measured against the 50 per cent, not against other commitments.

(b) Within the CTV and Global Licence Renewal Hearings in 2001

In April 2001, the Commission held station-group licence renewal hearings for both CTV and Global where it considered the licence renewal applications of most of the CTV and Global television stations. This station-group licence renewal approach stemmed from a new policy set out in the Television Policy.[21] In both the written renewal applications, and at the renewal hearings CTV and Global stated repeatedly that they were committed to Canadian dramatic programming. The following are excerpts from the written and oral submissions of CTV and Global:

<u>CTV:</u>

MS McQUEEN: 96 With that background, CTV is pleased to announce that in this fall we have achieved the number one position in average audiences for Canadian drama and comedy, ahead of Global and ahead of CBC.

COMMISSIONER WYLIE: 465 Priority programming. …Viewership to Canadian dramas has increased from 7 per cent in 1997 to 8.9 per cent in 1999.

[21] See Television Policy, paragraphs 10 to 16.

466 When we look at your programming mix, how have you taken into consideration your desire, which you expressed this morning, of increasing audiences. I think you said in your presentation "We want more people to watch our Canadian program."

467 So in the mix that you chose, which is 65 per cent drama; 12 per cent variety; entertainment magazine, 11 per cent; and documentaries 11 per cent,

MS McQUEEN: 469 We will always do eight hours of priority programming, but that mix may vary from year to year and it may vary for the very reason that you are talking about, Commissioner, which is our belief in what the audience wants and where the audience is going.

470 But the genres of programming that we have chosen to focus on are, we believe, the genres that most Canadians want to watch. When we talk about drama, I think -- and I see real professional researchers in the audience who can stand up and contradict me, but I think that most of the viewing to television -- most of the viewing to television is in the dramatic genre. That is what people love to see on television. I'm talking overall, not necessarily Canadian or American, but in general folks love a good story, they love an imaginary story and that is what they want from television.

…

476 COMMISSIONER WYLIE: [B]ut it [dramatic programs] is still, you expect, what people want and therefore will remain a big proportion of the mix for a reasonable future?

477 MS McQUEEN: Yes.

…

481 MS McQUEEN: I think we said this at the BCE hearing: that if we could crack that issue, if we could present Canadian drama that was commercially viable, it would solve so many of the problems that you all have been wrestling with year after year after year.

482 We think we have the opportunity to do that. We think the time is right. But we also agree with you that it is very difficult.

483 If we don't pay attention to drama, if we don't commit to investigating that, we will be losing what I think is the critical chance in Canadian television today.
…

556 MS McQUEEN: The results of this complicated issue of scheduling, you pointed out in the data you have so far that there had been a small, but an increase in drama. This fall, according to the figures that we showed you, we have been able to generate, partly because of the quality of the programs, and surely partly because of the scheduling, the top average audiences to Canadian drama in the system.

575 One of our focuses has been on Canadian drama. If you ask me what you should worry about, I agree with Ivan. I think you should worry about the results. You are looking at the 1999-2000 figures, I think. You are always, unfortunately, a year behind.

576 COMMISSIONER WYLIE: …I notice you focused on drama. Would "Twice in a Lifetime" become popular faster if it were not on Saturday night? Would your Comedy Network be, you know--

577 MS McQUEEN: …the figures that you have in front of you are figures from BBM and they are measured during what you will know are considered to be the sweet sweep in November and during *those weeks the American networks put on the most powerful and most audience-attractive of all their programming.*

…

Ms. BOYCE: 764 We have put on 575 hours of drama and another 70-1/2 hours outside of "W5" in documentary programming that comes from across Canada, but also is diverse within that as well. It is really kind of a programming philosophy and corporate philosophy handed down, and emerging talent is also key to us.
…

MR. MUSTOS: 1180 In the dramatic programming area it has led to stories like the half-hour drama that was done through Louise's office out of Vancouver, called "Smudge", which was based on a Downs Syndrome girl and her love for a little puppy by the name of Smudge. This project went on to win the Humanities Award.

1181 We have tackled big movies like "Dr. Lucille". "Dr. Lucille", if you didn't have a chance to see it already, was about Dr. Lucille Teasdale, who was a Quebec doctor who dedicated her life to the sick and dying in Uganda. That movie was an incredibly powerful movie that won many, many Gemini awards. It was an opportunity for us to take a Quebec heroine and bring her to the rest of Canada.

1182 We have ordered two movies this year that we hope will be going into production this summer. One is called "Sleep Murder". It is a movie about a kind of collision between white man's justice and Inuit justice in a compelling, high stakes courtroom drama set in Nunavut.

1183 Another movie that we have ordered is called "Tagged", which deals with racism within teen gangs. It deals with teen violence, and it deals with the Young Offenders Act as it pertains specifically to the horrific beating and miraculous recovery of Jonathan Wambach.

1184 Those are a few examples of what we have been doing on the drama side.

Global:

2230 …Over the next licence period, Global will be a powerful engine for Canadian content in two key areas: news and Canadian drama and comedy.

2231 Indeed, over the next licence term Global will spend over one-quarter of a billion dollars on Canadian drama and comedy alone. This spending is in addition to the $84 million in WIC benefits we are contributing to the system over the next five years.
….

2243 …Through critically acclaimed drama and comedy series, we have created the "signature" of the Global Television Network.

2250 As Gerry has said, the Global vision is to focus on quality Canadian episodic drama/comedy series, issues-driven documentary specials and pop-culture programming concepts. Our 16 hours a week of priority programs will include programs from independent producers from across Canada, such as those we have successfully aired over the past licence term in our prime time schedule.

MR. NOBLE:

2280 …We are proposing as minimum during the seven year licence renewal term: $260 million on Canadian drama and comedy spending; a commitment to continue and expand as promised our local programming, and in particular a commitment to continue to support those markets that are suffering the negative effects of fragmentation; and ….

2790 … viewing to Global's Canadian drama programming in peak time has declined, as it has for CTV.

2791 The figures I have is from 7.6 per cent of all viewing to drama in 1997 to 5.5 per cent in 1998 and 5.1 per cent in 1999. And of course there has been a decrease overall in Canadian viewing in peak time.

2792 With regard to the drama decline, both of your eight hours of priority programming -- that is, for the Global group of stations and for the CHCH and CHEK priority programming rely a great deal on drama.

2814 …about 61 per cent of Global's prime time Canadian audience was drama versus about 58 per cent for CTV being sports.

…..

2835 MS MAWHINNEY: Commissioner Wylie, we have a preponderance of drama because as Ken said we are a network that we want to encourage appointment television, so we have consistent scheduling of series programming and we tend not to do specials and MOWs on the Global system of stations.

2836 We also feel that through dramatic programming, and that includes comedy, we are building a star system. We are encouraging writers. We are contributing to the community and we think that we are going to create wonderful programs that will eventually compete on the same stage as American programs.

2837 We have real faith in "Blue Murder," for instance. I think that's a very successful franchise that will grow and improve and get better in year two and then in year three, et cetera.

2838 As we said in our opening remarks, there has been a trend away from the hour-long dramas to half-hour dramas. So we have tried to pick up on that trend and see if we could develop some franchises in that area. I am proud to say that at one point I think I had every comedy writer in the country working on one of our three shows. I know because a friend of mine is working at CBC Radio and he couldn't get any of them.

2839 So it has been a real challenge to mount that degree of variety of programming over this year. I also want to point out that for Global we had eight different series of dramatic programs this year and that's a huge leap and enabled us to buy programs from across the system -- from across the country.

2840 To that mix we have added our hour long drama specials, as we have got a history in that.

….

2906 …We are drama. We are serious drama but we are also serious comedies. The half hour comedies give us the ability to schedule them in hammocked time periods where they will have an opportunity to succeed.

3021 I think we would be comfortable with 50 per cent of drama as a starting point, as a point of reference.

….

3029 I would have to sit down alone and work out the number of hours. What we were prepared to offer is 50 per cent of the drama hours. I want to sit down and work out in terms of our priority *schedule how many of those going forward for the next seven years do we see at this stage. Of course, the mix may change, how many would fall in the drama, comedy and other category.*

3028 MR. NOBLE: Seventy-five per cent is a fairly big number. I guess if you add up all the priority hours that we have to produce with the two networks, the two systems, there will be a lot of hours that we are going out to the market to get and maybe 75 per cent is a number we could live with.

….

7219 AMPIA also recommended that the Commission set a minimum benchmark for distinctively Canadian drama. We further recommended that this minimum level be set at 40 per cent of priority programming.

….

11076 Our dramatic series from independent producers, including one from B.C., will trigger more than $140 million in production expenditures, much of it in B.C.

11077 Over seven years, more than $53 million will be spent on programming in categories 7, 8 and 9 from independent producers, including $26.5 million for programming from the B.C. community.

….

11290 ….more than $260 million in spending on Canadian drama and comedy; over $1 billion in Canadian programming spending over the licence term; over and above that, we have already fulfilled many of the benefits flowing from the approval of the WIC transaction and we will continue to do so; and finally, we will maintain as a minimum our current levels of commitment to local programming for each of our stations across the country, including those stations which have been experiencing financial hardship due to changes in the broadcasting system

11319 MR. ASPER:

11336 ….CanWest, through Global TV, is committed to continuing its leading role in the drama that is the Canadian broadcast system by building, innovating and investing.

Appendix 3

Nordicity Projections for TV Advertising Revenues
Notes on Methodology

A. Historical statistics for English-language conventional television advertising revenue

- The historical statistics for English-language conventional television advertising revenue for 1999/00 to 2002/03 were obtained from statistics published by the CRTC in the *Broadcasting Policy Monitoring Report 2004*. In this report, total television advertising revenue includes revenues from local advertising, national advertising, network payments and revenue from infomercials.

- At the time that this report was prepared, the CRTC had not yet published the English-language television advertising revenue statistics or 2003/04. So an estimate was derived for 2003/04.

Table 1

All amounts in millions of dollars unless specified otherwise	Historical statistics for English-language conventional television advertising revenue		
	Private broadcasters	**CBC**	**Private + CBC**
1999/00	1,468	193	1,661
2000/01	1,493	214	1,707
2001/02	1,458	216	1,674
2002/03	1,606	190	1,796
2003/04 e	1,611	205	1,817

Source: CRTC, *Broadcasting Policy Monitoring Report 2004*

- To estimate the 2003/04 figure for English-language private conventional television advertising revenue, the historical share of English-language private conventional television advertising revenue as a percentage of total Canada private conventional television advertising revenue was used. For 1999/00 to 2002/03, English-language private conventional television advertising revenue comprised 83% of total Canada English-language private conventional television advertising revenue (Table 2). This four-year average share was applied to the total Canada private conventional television advertising amount of $1,934 million (Table 3).

Table 2

All amounts in millions of dollars unless specified otherwise	Historical statistics for private conventional television advertising revenue		English-language share
	English-language	**Total Canada**	
1999/00	1,468	1,762	83%
2000/01	1,493	1,788	84%
2001/02	1,458	1,757	83%
2002/03	1,606	1,924	83%
		Four-year average	83%

Source: CRTC, *Broadcasting Policy Monitoring Report 2004*, CRTC annual financial summaries, and Nordicity Group calculations

Table 3

All amounts in millions of dollars unless specified otherwise	**Historical statistics for total Canada private conventional television advertising revenue**	**Four-year English-language share**	**Estimate for English-language private conventional television advertising revenue**
2003/04	1,934	83%	1,611

Source: Nordicity Group calculations based on data from CRTC, *Broadcasting Policy Monitoring Report 2004* and CRTC annual financial summaries

- A similar approach was used to estimate the English-language conventional television advertising revenue for CBC (Tables 4 and 5).

Table 4

All amounts in millions of dollars unless specified otherwise	**Historical statistics for CBC/SRC conventional television advertising revenue**		**English-language share**
	English-language	**Total CBC/SRC (English + French)**	
1999/00	193	307	63%
2000/01	214	327	65%
2001/02	216	325	67%
2002/03	190	291	66%
		Four-year average	65%

Source: CRTC, *Broadcasting Policy Monitoring Report 2004*, CRTC annual financial summaries, and Nordicity Group calculations

Table 5

All amounts in millions of dollars unless specified otherwise	**Historical statistics for CBC conventional television advertising revenue (English + French)**	**Four-year English-language share**	**Estimate for English-language CBC conventional television advertising revenue**
2003/04	316	65%	205

Source: Nordicity Group calculations based on data from CRTC, *Broadcasting Policy Monitoring Report 2004* and CRTC annual financial summaries

B. Forecasts of conventional television advertising revenue in the English-language market

- A total of four forecast series were prepared. ‘High’ and ‘Low’ scenarios were prepared for each of the following two segments of the Canadian broadcasting sector:
    - English-language private conventional television
    - Total English-language conventional television (private broadcasters + CBC)

- Advertising revenue forecasts specific to the English-language conventional television market in Canada were not available. Instead, we obtained PricewaterhouseCoopers’ forecast for overall conventional television advertising revenue and used the annual rates of change from this forecast as the basis for deriving a forecast of advertising revenue in the English-language conventional television market.

- The ‘High’ scenario for the forecast essentially involved applying the annual growth rates in the PricewaterhouseCoopers (PwC) forecast to the historical time series developed for English-language conventional television advertising revenue.

- We also assessed the key elements of the PwC forecast and found the assumptions for nominal Gross Domestic Product (GDP) growth to be somewhat higher than the current outlook for the Canadian economy published in the federal government’s March 2005 Federal Budget. The PwC forecast was prepared in mid 2004, and so reflects the outlook for the Canadian economy at that time. The forecast in the 2005 Federal Budget reflects a more up-to-date outlook on the Canadian economy obtained through Department of Finance consultations with private sector forecasters in February 2005.

- Given this shift over time in the outlook for the Canadian economy, we also prepared a ‘Low’ scenario to reflect how the growth in conventional television advertising revenue may respond to lower economic growth. The ‘Low’ scenario essentially follows the PwC forecast but incorporates an adjustment to account for the somewhat lower growth in the Canadian economy reflected in the outlook published in the March 2005 Federal Budget.

- In the remainder of this section we present our review of the PwC forecast and describe how the forecasts for the ‘High’ and ‘Low’ scenarios were constructed.

- Nordicity Group assessed the PwC forecast by reviewing its key elements. The table below lists the key elements of the PwC forecast and offers comments about each.

Table 6

Key Elements of PwC Forecast	**Nordicity Comment**
<u>The Economy</u> Entertainment and media spending tends to grow slightly faster than nominal gross domestic product – as income rises, more resources are devoted to leisure and entertainment. This income sensitivity will be offset somewhat in the future by rising defence spending in the U.S. and higher energy costs worldwide – both of which crowd out entertainment and media spending. PwC forecasts nominal GDP growth in Canada to be 6.1% in 2005, 5.8% in 2006, 6.0% in 2007 and 5.2% in 2008. In 2003, Canada had nominal GDP growth of 4.9%. Canada's rates of GDP growth are slightly higher than the rates forecast for the U.S. during the 2004 to 2008 period. Canada's entertainment and media industry, having experienced relatively healthy increases during the past three years, will sustain that growth during the next five years. Economic growth will boost over-the-air broadcast advertising, but this segment's share of the TV market will continue to decline.	Projections of overall economic activity in Canada are a key factor in the projected growth of Canada's entertainment and media industry and television advertising segment. PwC's assumptions for Canadian GDP growth were compared to the federal Department of Finance's latest outlook for the Canadian economy. For the March 2005 Federal Budget, the Department of Finance consulted private sector forecasters in February 2005. Private sector forecasters expect nominal GDP to be 4.9% in 2005 and 5.0% in 2006, and to average 4.9% during the 2007 to 2009 period. Both PwC's GDP forecast and private sector forecasters' forecasts see continued strong growth in the Canadian economy over the next several years. PwC's forecast, however – which was likely prepared nine to twelve months prior to the February 2005 consultations – embodies somewhat higher growth rates in each year of the forecast.
<u>Television Advertising</u> Canada's advertising market will average an annual growth rate of 5.3%; the television (broadcast and specialty services) segment will average 5.5% - Broadcast (conventional) advertising, 3.9% - Specialty channel advertising, 10.8% Viewership on specialty channels is growing rapidly at the expense of over-the-air broadcasting. The combination of new outlets and increased aggregate viewing on those outlets is attracting increased advertising. Broadcast networks will continue to lose viewers to specialty channels. A stronger advertising environment, however, will lead to a modest uptick in growth compared to the past five years.	PwC's forecast for Canada's overall advertising market and television advertising are in line with its economic forecast. Within the television segment, PwC sees the growth tilted to specialty channel advertising, which is forecast to grow by 10.8%. Conventional broadcast advertising will grow more slowly – by 3.9%. This reflects recent trends in the Canadian broadcasting industry as specialty television has been growing more quickly than conventional broadcasting outlets. Between 2000 and 2004, total revenues of pay and specialty services grew by an annual average rate of 12.7%; private conventional services' total revenues grew by an annual average rate of 2.9%.
<u>Conventional Television Advertising</u> CBC permitted to televise U.S. movies during primetime. Changes to the CTF give broadcasters more flexibility. Broadcasters will now be better able to direct funds to the types of programs they want, which should help improve ratings. Broadcasters are finding success in producing Canadian versions of program formats used in other countries (e.g., Canadian Idol).	The PwC forecast takes into account changes in the CTF and the success of Canadian versions of global program formats – each of which are expected to improve conventional broadcasters' advertising revenue. The PwC forecast does not take into account the new drama incentives that private conventional broadcasters may make use of to generate additional advertising revenue.

<u>High Scenario</u>

- As discussed above, a forecast of Canadian conventional television advertising revenue was obtained from PricewaterhouseCoopers' *Global Entertainment & Media Outlook*. The annual rates of change from this forecast were applied to the historical statistics for the English-language conventional television market to derive a forecast for 2004/05 to 2007/08.

- The PwC data were originally reported in U.S. dollars and converted to Canadian dollars at the 2003 average exchange rate of 1.40097 Canadian dollars per U.S. dollar.

Table 7

All amounts in millions of dollars unless specified otherwise	**Conventional television advertising revenue - PwC (USD)**	**Conventional television advertising revenue - PwC (CAD)**	**Annual rate of change**	**Forecasts of English-language conventional television advertising revenue**	
				Private	**Private + CBC**
1999/00	1,481	2,075	--	--	--
2000/01	1,515	2,122	2.3%	--	--
2001/02	1,557	2,181	2.8%	--	--
2002/03	1,606	2,250	3.1%	--	--
2003/04	1,670	2,340	4.0%	--	--
2004/05 f	1,742	2,440	4.3%	1,681	1,898
2005/06 f	1,813	2,540	4.1%	1,749	1,976
2006/07 f	1,884	2,639	3.9%	1,818	2,053
2007/08 f	1,945	2,725	3.2%	1,877	2,120

Source: PricewaterhouseCoopers, *Global Entertainment & Media Outlook, 2004-2008* and Nordicity Group calculations based on data from PricewaterhouseCoopers and CRTC

f- forecast

Low Scenario

- The nominal GDP growth rate assumptions embodied in the PwC forecast were combined with the nominal GDP (current dollars) reported by Statistics Canada for 2004 to generate a forecast of nominal GDP for the 2004/05 to 2007/08 period.

- The forecasts (derived from the PwC forecast) for English-language conventional television advertising revenue were then calculated as a share of the nominal GDP.

Table 8

All amounts in millions of dollars unless specified otherwise	**Nominal GDP based on PwC annual growth rate assumptions**	**Nominal GDP annual growth rate (PwC assumptions)**	**English-language conventional television advertising revenue Private only**		**English-language conventional television advertising revenue Private + CBC**	
			Amount	**Share of GDP**	**Amount**	**Share of GDP**
2003/04	1,293,289	--	--	--	--	--
2004/05 f	1,372,180	6.1%	1,681	0.1225%	1,898	0.1383%
2005/06 f	1,451,766	5.8%	1,749	0.1205%	1,976	0.1361%
2006/07 f	1,538,872	6.0%	1,818	0.1181%	2,053	0.1334%
2007/08 f	1,618,893	5.2%	1,877	0.1159%	2,120	0.1309%

Source: PricewaterhouseCoopers, *Global Entertainment & Media Outlook, 2004-2008* and Nordicity Group calculations based on data from PricewaterhouseCoopers, CRTC, and Statistics Canada.
f- forecast

- To generate the 'Low' scenario forecast, the GDP shares for English-language conventional television forecasts were held constant and applied to a more conservative projection of nominal GDP. This more conservative projection was derived by using the forecast annual growth rates found in the March 2005 Federal Budget. These forecasts were based on consultations with private sector forecasters.

Table 9

All amounts in millions of dollars unless specified otherwise	**Nominal GDP based on forecast annual growth rates from Department of Finance consultations with private sector forecasters**	**Nominal GDP annual growth rate from Department of Finance consultations with private sector forecasters**	**English-language conventional television advertising revenue Private only**		**English-language conventional television advertising revenue Private + CBC**	
			Amount	**Share of GDP**	**Amount**	**Share of GDP**
2003/04	1,293,289	--	--	--	--	--
2004/05 f	1,356,660	4.9%	1,662	0.1225%	1,877	0.1383%
2005/06 f	1,424,493	5.0%	1,716	0.1205%	1,939	0.1361%
2006/07 f	1,494,293	4.9%	1,765	0.1181%	1,994	0.1334%
2007/08 f	1,567,514	4.9%	1,817	0.1159%	2,052	0.1309%

Source: PricewaterhouseCoopers, *Global Entertainment & Media Outlook, 2004-2008* and Nordicity Group calculations based on data from PricewaterhouseCoopers, CRTC, Department of Finance, and Statistics Canada.
f- forecast

Appendix 4

Transfer and New TV Licence Drama Benefits

In the last few years, the CRTC has approved major consolidation in the TV industry in English Canada. These transactions include the BCE takeover of CTV, the CanWest Global takeover of the WIC TV stations, and the CHUM takeover of CKVU Vancouver and the Craig stations in Western Canada. The CRTC has also approved new English-language TV licences in Calgary, Edmonton, Vancouver, Victoria, Montreal and Toronto.

In each of these cases, the CRTC has required programming "benefits" to be provided by the licensee, and many of the benefits have focused on dollars to be expended on Canadian drama production. In addition, the CRTC has generally required the licensees to file annual reports indicating how they have spent the money.

In preparing this report, the CCAU has reviewed the applicable CRTC decisions and licensee reports to determined how much spending on drama is required to be made under the various benefit packages and how much has actually occurred. The results of this review are presented in Table 1 below.

Table 1

Spending on Canadian Drama Made by Virtue of Ownership Transfer or New TV Licence Benefits ($ millions)

Broadcast Year	*CTV Base*	*CTV Benefits*	*CanWest Benefits*	*CHUM Base*	*CHUM/Craig Benefits*	*TVA Benefits*	*TOTAL*
1998-99	-		-	-	0.5	-	0.5
1999-00	-	-	-	-	0.5	-	0.5
2000-01	-	0.3	1.7	-	1.7	-	3.7
2001-02	24.9	7.2	4.2	4.2	1.8	-	42.3
2002-03	22.7	13.1	6.9	4.2	1.9	-	48.8
2003-04	22.2	5.3	2.4	4.2	3.6	-	37.7
2004-05	22.2	12.9	4.3	4.2	7.4	1.3	52.3
2005-06	22.2	12.9	4.4	4.2	7.0	1.3	52.0
2006-07	22.2	12.9	-	4.2	7.0	1.3	47.6
2007-08	22.2	12.9	-	4.2	1.5	1.3	42.1
2008-09	-	-	-	-	3.8	1.3	5.1

Notes:

1. CTV's drama benefits arise from its acquisition by BCE; the base of $24.9 million was based on CTV's actual spending on priority programs in 2000-01. Up to 2004, the numbers shown are the actual expenditures made on drama; later years assume the same proportion of the $24.9 million is spent on drama as was spent in 2004.

2. CTV's drama benefits are based on its reports for 2001, 2002, 2003 and 2004. The remaining amount required to be spent has been allocated equally to each of the remaining years of its 7-year licence.

3. CanWest Global's drama benefits arise from its acquisition of the WIC stations. The amounts for 2000-2004 are based on its spending relating to the Western Independent Producers Fund. The amount for 2005 would have been $8.7 million, but in June 2005, the CRTC granted a request by CanWest Global to make this as a commitment in 2005, but to spread this expenditure evenly over 2005 and 2006.

4. The CHUM base was established in its takeover of CKVU-TV Vancouver in 2001.

5. The CHUM/Craig benefits are the aggregate of the drama benefits for its Victoria station licensed in 2000, its acquisition of CKVU-TV, Vancouver, in 2001, and its acquisition of Craig in 2004.

6. The TVA benefits are the drama benefits arising from its acquisition of Toronto One in 2004.

Appendix 5

Expenditures by Canadian English-Language Pay and Specialty Licensees on Canadian Drama

As part of this report, CCAU examined the financial reports of the Canadian English-language pay and specialty services to estimate how much they expended on Canadian drama.

This estimate was difficult to develop for two reasons. First, unlike conventional TV licensees, neither pay nor specialty licensees are required to break out their programming expenditures by program genre. Second, even when a licensee includes drama programs in its schedule, some of the Canadian program expenditures made by the licensee may be filler programs, magazine programs, documentaries or game shows.

The CCAU therefore began by eliminating from consideration all licensees that do not program Canadian drama at all, e.g, TSN, CBC Newsworld, The Weather Channel, HGTV Canada, etc. The CCAU also decided to focus only on analog specialty channels, i.e. those offered in an analog tier by cable BDUs, given the fact that the diginets have limited revenue and have generally not commissioned any new Canadian drama, although some of them do include reruns of older Canadian drama.

This left a list of eight analog specialty services and five pay services to be analysed.

In regard to the eight analog specialty services, CCAU made an estimate as to what percentage of each service's Canadian expenditures were directed to support Canadian drama. It is recognized that this will vary from year to year for each service; however, a single percentage was arrived at and then applied to the service's Canadian programming expenditures. The result is shown in Table 1 below.

Table 1

Expenditures on Canadian Dramatic Programming by English-language Specialty Programming Services

Name of Service	*Estimated Drama Percentage of Cancon Expenditures*	*1998-99*	*1999-00*	*2000-01*	*2001-02*	*2002-03*	*Credit from Top-Up Policy in 2003*
Showcase	85%	9,057,752	7,416,505	8,727,378	10,617,588	10,913,943	1,586,284
W	25%	2,704,660	3,064,232	3,412,697	3,757,380	3,448,983	2,805,349

YTV	60%	11,156,013	12,484,228	14,992,096	14,086,195	11,808,204	10,318,496
Teletoon	85%	5,210,551	7,917,030	11,926,068	13,277,680	13,762,900	6,113,989
Treehouse	50%	558,030	906,171	937,677	1,143,371	946,301	495,414
Space	85%	1,816,687	2,768,375	3,998,910	12,189,324	12,584,629	28,732
Bravo!	25%	1,257,381	1,430,693	1,281,818	1,873,255	2,608,488	530,923
Comedy Network	80%	4,996,356	5,988,944	7,139,344	9,491,710	10,093,177	-
Total		$36,800,000	$42,000,000	$52,300,000	$66,400,000	$65,400,000	$21,879,187

Source: CRTC Statistics, Second column is CCAU Estimate. Note that the drama expenditures in columns 3 to 7 do not include licence fee top-up credits, noted in the last column.

CCAU also examined the financial reports of the five English-language general interest pay television licensees. The Canadian content presented by these services focuses mostly on Canadian drama (films or series), apart from filler and interstitials. Accordingly, the estimate was based on each service's Canadian content expenditures, less filler and program production. The estimates are presented in Table 2 below.

Table 2

Expenditures on Canadian Dramatic Programming by English-language Pay Television Licensees

Name of Service	*1998-99*	*1999-00*	*2000-01*	*2001-02*	*2002-03*	*Credit from Top-Up Policy in 2003*
Family Channel	2,898,516	5,132,311	6,226,611	4,856,912	4,563,238	2,245,165
Movie Central	3,013,382	4,864,818	4,117,128	6,650,061	9,106,807	1,786,153
MovieMax	322,913	474,114	341,376	1,193,011	801,870	-
MoviePix	662,658	1,003,203	1,003,052	2,125,438	1,666,458	65,870
The Movie Network	6,389,240	5,968,924	7,039,675	10,553,129	15,250,590	1,735,368
Total	$13,300,000	$17,500,000	$18,600,000	$25,500,000	$31,500,000	$5,832,556

Source: CRTC Statistics; numbers are annual expenditures on Canadian content, less amounts spent on filler programming and program production. Note that the drama expenditures in columns 2 to 6 do not include licence fee top-up credits, noted in the last column.

The CCAU also reviewed the aggregate revenues of the English-language pay and specialty services to determine what percentage of those revenues was directed towards Canadian drama. The results are shown in Table 3 below. As will be seen, an average of 6.4% of the revenue of all services was used to finance Canadian drama.

Table 3

Expenditures on Canadian Dramatic Programming by English-language Specialty and Pay Television Licensees as a Percentage of Advertising and Subscription Revenues

	1998-99	1999-00	2000-01	2001-02	2002-03
Res/bulk/smatv subscriber revenue	$490,399,306	$557,027,667	$598,057,238	$641,582,508	$648,242,703
DTH subscriber Revenue	$48,627,516	$115,632,520	$206,139,707	$282,020,369	$337,964,310
Local Advertising	$0	$0	$0	$2,572	$51,900
National Advertising Revenue	$249,594,897	$312,241,035	$359,122,246	$417,570,307	$492,916,374
Total	$788,620,000	$984,900,000	$1,163,318,000	$1,341,174,000	$1,479,173,000
Canadian Drama Spending	$50,100,000	$59,500,000	$70,900,000	$91,900,000	$96,900,000
Ratio	6.4%	6.0%	6.1%	6.9%	6.6%

Source: CRTC Statistics, previous tables