

CEA 2003 HDTV SUMMIT

Industry Insider Super Panel

JEFF JOSEPH

Thank you and welcome back...to the HDTV Summit. My name is Jeff Joseph and I am the Vice President of Communications and Strategic Relationships for CEA. I hope you enjoyed the lunch and the Academy Awards and I invite you all to please stay with us for the closing of the conference this afternoon where you have the chance to win some wonderful gifts from ESPN and a Mitsubishi HDTV. There has been a lot of anticipation for our next session, so I am going to be very brief here. I think this is the first time that we've gathered the heads of the four major trade associations involved in the HDTV transition. I am sure there will be lots of fun and lots of barbs and it takes a special person to handle this panel. So I am pleased to introduce Jon Healey of the Los Angeles Times. I was talking with a counterpart of mine in town and we were talking about Jon and my counterpart said, "Jon, you see, he is such a pain. He always asks questions and he's always researching and he always wants to dig under the story and get all the information possible." And we looked at each other and realized: hey, that means, he's good, doesn't it. I am proud to introduce Jon. Jon's a twenty-year veteran of the news business. He covers the digital living room and he has responsibility for stories on digital interactive television, on-line music, PVR, streaming audio and video, and home networks. So, without further adieu, please welcome me in joining me in welcoming Jon Healey.

JON HEALEY – LA TIMES

Thank you...all I ever write about is lawsuits. And I want to make the standard disclaimer that anything that I say that sounds like an opinion is an observation. The description of this panel is apt; we are going to have a frank dialog on the issues that have divided these industries, on what they agree on and how they are working to make this a successful transition for the consumer. In short, we are going to have a lot of finger pointing here today. But I wanted to start out by sharing some of the results of some research that Josh Burnhoff of Forrester Research did. I think this report is out today. And if it could be summarized in one line, it would be this: The digital transition is profitless for the entire TV value chain. He points out that there are no significant revenues available for producers and networks from digital TV. There are no significant revenues from digital TV for local broadcasters. That current cable HDTV charges barely cover the lease of a set top box and only 6% of 3.5 million households who have digital TV's have over the air antennas. So that's all pretty grim. And leads to a big sort of overview question that I'd like all of you to address, which is: Was the government right in mandating the shift to digital TV or simply should this have been something that evolved through the market? Eddie, do you want to start off?

EDDIE FRITTS - NAB

Sure, thank you. In anything I say, might it only be classified as an observation. The government in 1996 and the TELCOM ACT moved the digital transition forward. And I think all of us recognize...(sound, please)...this could be a broadcasting convention. So the question is, should the government have mandated the digital transition? And for broadcasters and for consumers, I think the answer to the question is definitely yes. If one looks at the universe of tomorrow, the cable industry is obviously going digital. The satellite industry is going digital. The telephone industry is digital. The computer industry is digital. And for broadcasters and consumers, if you are not digital in tomorrow's market place, you are not in tomorrow's market place. And while, it may be profitless at the moment. Hopefully, downstream, this conversion will be seamless for consumers. And I will submit that all four of us have a commonality of interest in making sure that this transition is completed expeditiously on behalf of consumers.

ROBERT SACHS - NCTA

I would say that for the cable industry, our digital transition was not really mandated by government. It was a result of market forces in the industry itself recognizing the importance of migrating from analog to digital technologies and all the benefits to consumers that would flow from that. So, really beginning six or seven years ago, this industry started to invest. To date, we've invested more than seventy billion dollars in the platform that's been created allows us not only does it provide digital and high definition television to our customers but high speed broadband and cable telephony services. So if we were still in the one-way video business with Direct TV and Echo Star being formidable competitors with nothing else to offer our customers, we would not want to be in that position. So it's not so much in our case government mandate as market forces and recognition by the companies in our industry of the importance of conversion to digital.

GARY SHAPIRO - CEA

I think the question is a look back as to whether the government did the right thing in the United States. And I think undoubtedly the government did. You can compare us to other countries, Europe, where they don't have anything called high definition television. Or Japan, where they started with something, they changed their mind and really messed everything up. We are a country, which is now benefiting from high definition. So one important thing was that, it wasn't only government by the way, it was Dick Wiley and many of the people in this room and around this table here that got together in a consensus agreement and basically said, we want to shift to HDTV. Part of the decision recognized that spectrum is a valuable and scarce commodity and broadcasters needed some breathing room as the consumers in making the shift. And of course, it's an extraordinarily difficult shift, unprecedented in history. And I think we have done much better than anyone anticipated, except those four or five budget makers who said 2006 was a hard and fast date. That 2006 date should not be the standard. That was created by people who had no involvement with HDTV and got no input by anyone who had any involvement. By most measures, we are doing really well. If you compare ourselves to the rest of the world and you see how at some point, we will have spectrum which will allow us to enjoy a phenomenal array of very exciting new technologies for uses we can't even envision today.

JACK VALENTI - MPAA

Of course, I am not speaking from a machine standpoint or a broadcaster or a device or cable. I think those of us in the movie industry, television programming, have one singular aim in mind. And that is, how do we protect valuable creative works in the digital age, the arena of zeros and ones. This is the all-encompassing objective, it's occupying all of our times and it's certainly occupying most of my energies and all of my passions.

HEALEY

Thank you for wasting no time in putting copyright protection on the table. But let me, would the motion picture studios be better off if we stayed in an analog world where it is a bit more difficult, but not hugely more difficult to transmit your content?

VALENTI

Absolutely not, we want to change with the changing world. And the technologies that allow us to give more pleasure to consumers. That's what we live by. And if there's something else after digital, we want to be involved in that too.

HEALEY

Let me ask each of you, about a year ago. The chairman of the FCC put out several suggestions for what or various parts of the industry might do to speed the transition to digital. So I thought we might check here how the voluntary industry actions are going.

FITTS

Currently there are 779 digital television stations on the air on 186 markets covering 97.44% of all U.S. households. There are currently 72% of U.S. households which can receive five or more off-the-air digital TV signals today. So from that standpoint, the build out is moving at a very rapid pace. There are situations such as, New York, where tower site availability is difficult. There was a problem in Denver in terms of environmental, in terms of the tower site. But by and large, the FCC has mandated two broadcasters that we get on with this transition. And the industry has done quite well in that regard. The affiliates of the Powell plan included, if you recall, which was announced at the NAB convention last year. That the affiliates of the top 4 networks in the top 100 markets have the ability to pass through HDTV. And the most recent analysis of that is of those, 83% of the affiliates said that they would be able to do that in the time prescribed by the chairman and of those, 89% said that they would have the pass through facility, most with HDTV. So from a broadcaster point of view, we think that we are doing our part to meet this build out challenge, recognizing that it's going to take all four industries to work together to make this benefit consumers in a seamless manner.

HEALEY

First Eddie, the broadcasters were supposedly by January 1st, 2003 being encouraged to be able to pass through network DTV without degradation and also to provide value added DTV programming during at least 50% of the prime time schedules. So where are we on those? (See above for answer.)

HEALEY

Do you feel this way about the programming?

FRITTS

Programming has doubled in the last year. And there are now more than 2,000 hours of on air programming. And I think the premium programming such as the Masters, 12 NCAA Basketball games and the final tournament round will be a broadcast. Things like the Oscars, Monday Night Football next year, and a whole array of new programming is reaching the market place. I submit we are really on the brink of a major breakthrough in HDTV and I think it's very exciting for all of us.

HEALEY

Even without Fox?

FRITTS

Fox is offering if you will, not HD per say, but they are offering a wide screen format and that the chairman of the FCC indicated would be prescribed under his plan as value added programming.

HEALEY

On cable, the chairman suggested that by January 1st cable systems with 750 megahertz or higher channel capacity, would be able to offer, at no cost, carriage signals up to 5 broadcasts or other digital programming services that were featuring HD at least 50% of the prime time schedule. Also providing digital connectors on set top boxes when asked for and doing a marketing effort. So Robert address those points if you would.

SACHS

I think that there's been substantial progress made in the year since Chairman Powell called upon all of our industries to take voluntary initiatives to help spur the transition. On the cable report card, first, on the programming side, there is a substantial amount of HD being produced and aired by HBO, by Showtime. Last June, Discovery launched its HD Theater, its 24 hour HD channel. Comcast SportsNet launched earlier this year with several hundred events with HD. MSG in the New York market is offering mix rangers and other events in HD. ESPN will be launching its HD services at the end of this month. Bravo and Cinemax have made announcements that they will be offering HD later this year. So this is in addition to what the three broadcast networks are doing in prime time. As to consumers being able to receive HD over cable, we have come a long way. As of the end of February, in 73 of the top 100 DMA's, cable operators were making HD programming and that's a mix of cable and broadcast available to consumers on at least one system in those markets for a total of 45 million TV households. That represents an increase just since the end of the year of 8 million households from where we were December 31 and we have gone from 62 to 73 of the top DMA's. In all, HD is available in all 103 markets across the country on cable. In more than half of those markets, broadcast is included in the mix with cable. In some of those markets, the affiliates may not be offering the networks HD services.

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SACHS (continued)

In some instances, network owned and operated stations are seeking additional compensation for carriage of their HD signal. The industry committed to and offered to carry available program. Chairman Powell indicated that he thought to promote the digital transition. Cable operators should not be offering this at additional cost to their customers other than equipment and that broadcasters should not be offering this at additional cost to cable operators. So I think we've come a long way in a very short period of time.

HEALEY

Gary, for equipment manufacturers, there was a suggestion about including DTV tuners. There is also an exhortation to do more marketing. And a point made about providing set top boxes through retail and through your manufacturers, so talk about that. Where are you?

SHAPIRO

Well, we've made some voluntary offers, which were not accepted. As most people in this audience know there is a mandate that the said industry is to incorporate TV tuners in their timetable based on screen size. The reality of it is, as many of you heard this morning, the industry has done a heck of a lot and relied pretty heavily on the market place combined though with pain for a lot of HDTV programming that has been broadcast. The announcements that you heard from networks have been directly linked to dollar contributions made by TV set makers. I would be thrilled to read off the lengthy list of TV set introductions but that would take most of the rest of the panel session. Instead, I urge you to go to the DTV guide which is available outside the door and see the tremendous offerings that manufacturers are making and consumers are making decisions every day in the market place weather or not to buy those, as are retailers, weather or not to sell them. Happily, we're doing well. Consumers are making the decision to buy digital television. They are buying in record numbers, even numbers greater than we anticipated. One manufacture told me this morning that they're air shipping TV tuner boxes; that they are actually sold out! Recently there has been a great upsurge in demand. And we see announcements like the ESPN announcement and some of the other announcements in the great programming you saw at lunchtime. I am personally optimistic that the trend line is clear. The research you saw this morning, the trend line is clear. Consumers want a wide screen, they want great sound, and they want HDTV. And that is what they are choosing to watch.

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SHAPIRO (continued)

And they are choosing to invest and then buy. Certainly the price of HDTV is a major investment. Given, the economy of the last two years, it is absolutely phenomenal we have had the success that we have had. The consumer electronics industry is the only other industry other than the home building industry, which has actually increased in 2001. I'm sorry, 2002. And I think the reason is largely driven by digital and specifically HDTV. So there is intense competition and prices will continue to drop, I think we are very optimistic because we see a tremendous array of screen size, we see huge investment in factories and we see consumer willingness and desire to invest in these products. And also the programmers are stepping up in many different and varied ways. So, I think the whole thing is kind of working. I've long maintained that HDTV is inevitable and that the market place is proving that.

HEALEY (FOLLOW UP QUESTION TO SHAPIRO)

Well, I wonder, whose responsibility is it to sell the masses of consumers on the notion that they need to make the transition? Is it Michael Powell's responsibility to goose the transition along? Or is it the responsibility of each of you to convince consumers? That there is, in fact, something in it for them.

SHAPIRO

Well, since many of you asked me at the break, I voted for Michael Powell, I really did. And I think that despite that we had a minor disagreement on that specific ruling, he's done a terrific job in terms of leading the transition and doing what a government leader should do. He's leading and that's sometimes, it takes moral exhortations. It's just not the power of a mandate. And that's what leadership is about. Many of you in this room are leaders and sometimes you just have to do things that people disagree with. Even though we disagreed with it, you know, as part of the big picture, he is doing the right thing as he saw what to do. In terms of whose job it is, you know, you can't force consumers to buy something they don't want. But happily, consumers want HDTV. It's incumbent upon all of us to try to make it work. I don't think it's a patriotic duty or anything else. I think it's just good market place sense. I think it's clear the cable and broadcast, satellite and even internet and prerecorded are competing against each other for consumer eyes. To the extent they are creating compelling, beautiful content that creates a viewing experience than they are going to win in the market place. Manufactures are intensely competing with each other.

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SHAPIRO (continued)

To the sense that they offer an experience with a better view and quite frankly it will lower price than their competitor. So the market place actually resolves most of these issues.

SACHS

I agree with Gary, that in the end it's going to have to be market place forces that drive consumer purchases here. In our case, we see it as offering us a competitive edge vis a vis satellite which has its own capacity and bandwidth issues. So that cable is taken some recent lessons from the past. When satellite launched five or six years ago with a hundred fifty channels, we were playing catch up for a long time. Satellite was out of the box with HD net. It did not take our industry long to recognize that we needed to be in a leadership position with HD. This is where broadcast plays an important role in the mix. Its not just the satellite program networks that I mentioned that are offering HD. As more and more broadcasters do and as there's more HD programming on broadcast and cable is carrying today in an analog world local broadcasters in all markets. Where satellites in fifty or sixty markets, we think it will be a competitive advantage to be able to be offering those broadcasts. Now everything takes time, the transition from black and white to color took 15 and 16 years. We're still in the early stages of the digital transition with three of four million units out there. Roughly, that percentage of HDTV households that could see an HD picture at all. So the concerns about being profitless, today, I think you have to say compared to what? And, compared to when? I think you have to say that we are at the beginning here.

FRITTS

I take a minor exception with Robert. Yes the government does have a role here. And the government should make sure that we have this transition of the greatest ease. Up until now, we have had a technological transition and it's time now to have a consumer transition. Had we in 1992 waited for the cable industry to be enlightened and carry all television signals over the air in the market place, we would still be waiting. Currently, of the 800 stations or so that are on the air, a scant 75 stations are being carried by cable systems around the country. And they are not carrying any market and deeper than five stations and that seems to be the exception rather than the rule. I acknowledge we are early in this transition. But I would suggest the government indeed because of the need to get the spectrum back and our desire to expedite this transition; the government indeed does have a role to play.

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FRITTS (continued)

You can't get to 85% clearly unless you have a mandate for cable's 70% household penetration to carry all of those HDTV signals.

SACHS

I guess I identify with some of the things that Gary was saying. We really think that HDTV is the driver here. And it's great that little more than half the television stations in the country are not broadcasting in digital. But frankly standard definition digital television is not what is going to compel consumers to go out today to spend \$1,500 to \$2,000 for a TV set and those costs are coming down. It's really the stations that are providing a significant amount of high definition television, which is precisely what chairman Powell recognized in his plan last spring. And where broadcasters are offering HD and where they are not seeking additional compensation for carriage of over the air free TV station, cable operators are including broadcasters in the mix of HD programming. I'd also agree with Eddie, that it's important that our industries work together to assure that the transition to digital television is smooth and orderly. The digital television transition did not contemplate that cable operators were going to simultaneously be carrying the digital and analog signals of every broadcast station. The important point here is to get the spectrum, the analog spectrum back to the government so it can be used for wireless and public service communications. And that at the point of transition, as broadcasters return that analog spectrum then cable will have considerably more band width capacity available and there won't be any issue with respect to carriage to the carriage of all broadcasters in the market.

HEALEY

Let me ask you a question along those lines. Why should the cable operators be required to carry the digital channels when its simulcasting, if there isn't any unique programming other than the amount of pixels on the screen and the sound quality, why should there be any kind of mandate for that?

EDDIE FRITTS

Well, I think that one could make the case that there should be a mandate if for no other reason to expedite the transition.

FRITTS (continued)

If a cable consumer can buy a set and bring it home, plug it up and watch an over the station in digital, I think that Robert will tell you that while there is an argument to be made for scarcity of spectrum. Indeed, I'm lead to believe that the cable system that allocates the most spectrums to analog television is less than 16 %. Current law requires up to 33 1/3% be allocated for analog television. It's an incentive. If I were in the cable business, I would put it on it. It makes a lot of sense. I'd like to congratulate Gary and Twice Magazine and whoever publishes this HDTV guide on page 19, all of you can look, there is 75 stations being carried and I encourage you to look at it every month and see if you can put all of the stations on more than one page. Hopefully, that will occur in the future.

SHAPIRO

Will you take out an ad in there Eddie?

FRITTS

Is this a profit-making venture?

SHAPIRO

I am trying to take up some costs.

HEALEY

Not to dwell on the negative, but I would like to hear each of you say what you think is the biggest hurdle that you are encountering as you are trying to make this transition. And Gary why don't we start with you.

SHAPIRO

Well, every year it's been a different hurdle are you talking about a hurdle now or previous years. Well, the hurdle today with respect to my friend Mr. Valenti is that there are legitimate concerns that the Hollywood community has which have to be addressed somehow. And there are obviously different views of how to address that. Other than that, I think we have crossed every major hurdle. I mean I certainly think that Eddie's raised a good point about cable carriages, that's clearly an issue. The amount of broadcasting's an issue. Eddie did refer to; all those numbers he gave are accurate.

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SHAPIRO (continued)

But I can equally give you equally accurate numbers. Let's talk about the fact that there are 1338 total commercial stations and there are only 754 in the air. Out of that 754, which is more than half of total stations, most of those are low power. So that is where you get a lot of customer complaints about not being able to receive HDTV even from the station. There are only 332 full power stations on the air. So that's, we're not there yet with broadcasting, we're clearly not there with cable. Although the acceleration curve on cable is very, very fast in the last 14 months. And now the Plug and Play Agreement is coming. Satellite is clearly doing its part. TV is clearly doing its part and Hollywood is producing a tremendous amount of material. But there are issues. It's a tough, thorny issue, involving copyright.

HEALEY

Well, is the copyright dilemma the reason why there are two key pieces of infrastructure still missing? The ability to record a digital TV broadcast and do time shifting and packaged media? I mean there is no HD packaged video. Is that because of copy protection or are there other issues for you guys?

SHAPIRO

Well, I think packaged material in HD is just a matter of time. There is no question that the technology is there or almost there. There are obviously some standards issues being worked out. There will be great consumer thirst. I think the great thing that is going on right now is that the consumers are making the most major investment and the most expensive part of HDTV, which is the monitor. And they have also fallen in love with DVD's and that great viewing experience with a great DVD and a great HDTV monitor together. I think every one of those consumers will go out and rush to buy the package of pre-recorded HDTV when it comes out to combine it with their TV set and surround sound and get the phenomenal viewing experience they have come to expect with their HDTV and their over the air receiver or HDTV/DVS and cable. So that is just a matter of time. In terms of the issue of recording and an HDTV, that is something that will come along. I don't think that the shift of HDTV recording is as fundamental as the shift was of the VCR. It won't be the biggest, newest thing in the world. There are certainly some intermediate steps with personal digital recorders, things like that and we are going to get there.

But in the meantime, obviously, we are hopeful that the cable compatibility agreement, the plug and play compatibility agreement that we provided to the FCC basically sets the standard for copyright for what consumers can do and what they can expect and we hope that kind of resolves that portion of the issue.

HEALEY

For the record there is, there are, DVHS machines and there are 6,7 DVHS titles?

UNIDENTIFIED

Forty

SHAPIRO

Yes, that is true.

HEALEY

Clearly the public is moving toward a universe that uses tapes as opposed to digital. (Laughter) Jack, could you talk about your perception of the hurdles here?

VALENTI

It's very simple; movies cost a lot of money. I just announced this last Tuesday at the Convention of the Theater of America theatrical exhibition that the average cost of the 225 movies made by the seven major studios last year, to make and to market is 90 million dollars. Only two out of ten movies ever get their money back. They must go to other forms: HBO, premium cable, pay per view, basic cable, broadcasters, DVD-home video, International and all to get their money back. Three out of ten never get their investment back. So the movie industry sits on a very fragile and fiscal bottom. What we want to do is to deploy as many avenues as possible: satellite, cable, home video, and pony express. Any place that we can send a movie that people want to see that give consumers more choices as to when they see movies, how they see movies, at their command and at a price the consumer will define as fair and reasonable. But at the very tip of this pyramid is the key question: how in this digital world do you protect this valuable material?

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VALENTI (continued)

Viat (??), which is a Boston based research firm estimated that 400 thousand to 600 thousand movies are being illegally downloaded everyday, even as I speak. I've been going to university campuses where a great deal of this is being traded on file swapping sites, such as Morpheus, Kazaa, Oxster (??), LimeWire, you name it. It's an enormous amount of films being brought down free of charge with no one paying anything for it. Our principal hurdle is we are anxious to deploy everything we can on the Internet. I believe it has the potential to be one of the greatest delivery systems of what society has yet encountered and we want to use it to the fullest extent. But we have to protect our movies and I know a lot of people say that in Hollywood you guys are always whining and get a new business model. Well, that's a swell idea, I wish to hell I thought of it. And guess what? There is no business model that has ever struck off by the hand and brain of man that can compete with free impossible! So, we discarded that business model right fast. So we are trying, we are looking at this. We are looking into this with the best minds outside our business. And I know that this is going to come as a shock to some people, we have a lot of smart people in the movie industry who have been working with the best brains we can find and the universities and other companies who are very much involved in cusp of the new era of digital. So that's our problem, that's our barrier and it doesn't make any sense to put out high value programs if they're going to be abducted in the very first weeks or months of moving through this journey of various forums around the world.

HEALEY

I have a question from the audience that pertains to exactly that point and I can't guess the source of the question but it asks: does the consumer electronic industry have an obligation to protect the costs of someone else's property, namely the NPAA's, put another way, why should I buy another lock for your home? Who bares the costs of protecting the property?

VALENTI

I don't want you to buy a lock for my home; I just don't want you to steal anything out of my home, that's all. I have no problem with you in the neighborhood, just don't come into my home and take the silverware. I think that's the premise. I think it's fair to say that without movies and television programs a lot of the machines that Mr. Shapiro's members make, and a lot of the cable systems that operate on various movie channels, we didn't ask them to invest anything into our movies.

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VALENTI (continued)

Not a dime, we do those ourselves. And by the way, it's all private risk capital that's being put into these movies. So we are not asking that you invest in our movies. All we are saying that it is in your long-term interest to make available to consumers the very finest movies and television programs that are available. We all know that the things that people want to watch are sports, movies, entertainment and television. That's what most people want to watch. And I have nothing wrong with CSPAN but it's not going to get as much of an audience as a channel that has movies or television programming. So it is in the long-term interest of everybody at this table. Just try to see that we do it right. There is no pilfering going on. I know that if Gary, or there was suddenly an outburst of people cloning his recording devices, I think he would get a Maalox moment or two and wouldn't feel too good about it.

SHAPIRO

We have this country called China, Jack, which is doing just that.

VALENTI

So, I'm not antagonistic toward anybody. The only people that I am antagonistic to is, are those people who take things that don't belong to them, don't pay for it and don't ask permission of the owner. I don't think any of you who operate businesses would like to find any employee doing that very same thing to you. So that's the issue, we are working at it. Doing our damndest to find some way in tier-to-tier, closing analog holes and getting a broadcast flag, which we think are the first steps of some way finding the sturdiest protection to these valuable and expensive programs.

HEALEY

It's gratifying to know that this will come to no cost for anyone.

SACHS

Let me go back to your original question and then I will comment on what Jack has said as well. In terms of factors that remain out there that are going to influence the pace of transition, obviously, when HD ready TV's are still in the high teens or in the price of the \$2,000 neighborhood that is a negating factor. And I think that once we see the \$1,000 barrier broken and then these products get down to a \$500-\$600 range, obviously, they are going to be affordable for many more millions of consumers.

SACHS (continued)

But to the credit of the consumer electronics industry, just in the last couple of years time, we've seen those prices fall 40 or 50% and are still falling. So that's positive, but they still have to come down substantially or to be within reach of most consumers. Secondly, we talked about the need for high quality, high value, and digital content. There has been a lot of progress in terms of networks launching HD services in the last year. But truly for first run product to be available, we have to be able to assure the studios that this product is not going to be freely distributed over the Internet. That is very important for our business. If movies that are created and high quality entertainment simply become something available for free over the Internet, it undermines the fundamental economics of all of our businesses. The cable industry finds itself and we define ourselves as program networks and operators. So we have sought to find a balance between the two. Gary made reference to the plug and play TV agreement that fourteen consumer electronics manufactures and eight of the largest cable companies reached last December. I think to the credit of the parties involved, and while CEA and NCA were facilitators, I think that it was the companies themselves that worked through a set of agreements. And in those agreements, which have now been submitted to the FCC are encoding rules which are based on agreements that were reached by several of the Hollywood studios and the 5-C Companies. And we think are a model which strikes a balance between copy protection and home recording rights and we hope to see the commission implement these proposals later on this year.

40:38 FRITTS

I think there are basically six or seven major issues that are stumbling blocks that need to be resolved. 1. The number of stations that are on the air. And we are working on that and the commission is boasting that process along. Robert and Gary have spoken about the compatibility, the plug and play agreement. But I guess if the commission doesn't, when does that take effect, if the commission doesn't...

SHAPIRO

There is a deadline expected shortly. And there is a deadline at the end of the month, I guess. Hopefully, the FCC will act on it. This year, Eddie, this year...

FRITTS

So when do we see those sets?

SACHS

Well, neither of our industries are ones that normally go to the FCC and ask for regulation to be imposed on our member companies. And in this case we are doing that because you have 14 consumer electronics manufacturers and 8 MSO's. There are other companies in our industries; there are similarly situated industries that are parity for some of these requirements. Even without those agreements in place a number of consumer electronics manufacturers have signed manufacturing licenses with cable labs and are going forward with the production of plug and play TVs. I would expect that we would expect such televisions in the market place before Christmas 2003.

FRITTS

Going on my little list, broadcasters need to provide compelling programming. And I believe that we are meeting that challenge. A part of that is the ability to convey high value content, and in that regard, I would suggest that we are in complete harmony with Jack on the broadcast flag and with Robert to make sure that that programming can reach the consumer at the least expensive expense as possible. Beyond that, sets with DTV tuners are very important. The cost of sets are obviously a threshold issue and the cost of cable. Providing that service is considered, because you have to buy basic cable, expanded cable, digital cable with an extra box and if you want HDTV in many instances you have to have a sidecar box to go with that. The cost is as best as I could compute it, in Houston, is \$74.95 per month minimum charges to get to that level. That is a barrier to some families. One of the concerns is retransmission consent and I would suggest that all of the people you see on your screens don't get there for free. I.e. we think that if a station brings value to a system that it should be able to stand on its own and negotiate with a cable system in the market place. But it is important that the consumer have the ability to be able to see that this high value content that is being delivered from the broadcast community to the consumer.

HEALEY

Let's pause on that last point, in that Forrester Report that comes out today, they did a survey that HDTV owners and likely buyers would pay about \$10.00 a month for HDTV service. I know that there are other studies that might quibble with that. But why shouldn't people who view HDTV pay extra HDTV? Why shouldn't there be a flow of money through consumers through cable and satellite operators to broadcasters provide a business models for an industry that doesn't really have a business model?

SACHS

Well...on the subject of broadcast retransmission consent, which really isn't the topic of this conference. But a few points are really worth making. Broadcasters are licensed to use the public airwaves. They do not pay for use of those public airwaves. Unlike the cable networks that Eddie referred to, broadcasters signals are available for free over the air in all of our markets. Broadcasters retain 100% of the advertising revenue for those signals. In this case, since there are fewer than 10 or 15% of the DTVs sold today even have broadcast tuners, there's a mutual benefit being provided. If you are a cable operator and you are carrying the local broadcast signal NHD, then you are likely providing it to a consumer who would not otherwise be receiving it over the air because the set they bought did not include a broadcast tuner. We are extending the reach of the audience for those broadcasters who are offering HD today. So our industry has made a huge, let's be clear here, we've invested a \$1,000 a subscriber in upgrading our networks. And I know broadcasters have invested in their facilities. But it was the broadcast industry that went to Congress and said we would like to make this transition; this is the broadcast transition to digital television. And that is now occurring. But to say that in addition to funding its own transition to digital television, the cable industry should be funding the broadcasters transition, I think exceeds the bounds of reasonableness.

HEALEY

But just to be clear here, you folks are typically charging people here for a tier of...

SACHS

Pricing decisions are made by individual companies and may vary market to market. The most common model today is that operators are charging customers getting HD for equipment costs, which are by the way, are subject to government price caps. Where they are offering a service like HBO or Show Time, for which the consumer otherwise pays, they are not charging any extra. And when they are offering broadcast signals that are in HD, they are not charging extra for those services.

FRITTS

I am glad Robert brought up the costs of consumer use of cable because it seems to me that the cable industry finds ways to pass through either costs for investment or for costs for programming or for costs in general to the consumer at a much higher rate. And it could be but I don't know the specificity of this but certainly broadcasters don't charge the end user. I agree with you, there is a mutual benefit for broadcasters in working with their local cable systems. But in as much as the broadcasters don't get to charge the end user and that has to flow the gatekeeper, not only the programming but also the cost side of that. It seems only fair that broadcast networks who put as much into the cost of their programming as do the cable networks would provide that added benefit and added incentive to distinguish a cable consumer from other consumers.

SACHS

Eddie is very good, and he was able to work in the word gatekeeper. And it is somewhat disingenuous to suggest gatekeeper when the broadcaster in this case is saying I you to pay x or I want this additional consideration for my signal. This is not the case of a cable operator refusing to carry the local broadcast signal. In half the markets where cable systems are offering HD systems today, it includes local broadcast signals in HD. In other in stances broadcasters put up a toll gate and that is fine. That is their right but the cable operators is not functioning as a gatekeeper because they are not signing up for the additional compensation that the broadcaster is seeking to exact.

FRITTS

In all fairness broadcasters don't seek compensation in every instance. Obviously, those agreements were between the cable systems and the broadcasters. The monopoly cable systems in most cases...

SHAPIRO

You have brought up twice, Jon, this Forrester Study twice and I squirm because, Forrester people are paid every time they are quoted from the media. Well, I guess someone from Forrester is here. Forrester has a rich history with HDTV, and I encourage anyone of you to go back and see what they have said. They have done every thing they can to try to dampen the enthusiasm for HDTV. To try to drive down capital markets for HDTV. History has proven them wrong repeatedly. And people pay for this research is something that kind of shocks me. The fact that they would go out and say that you've gone from this and that there is no money in the value chain. And why would you do this profitless change is the same argument that the Forrester predecessors made to the movie industry when they were going from black and white to color. Why would you ever go to color and invest in color films? Black and white films make more money? Why would you ever switch? The fact that someone is out there to dampen the enthusiasm for HDTV and repeatedly uses these conferences you dish out this information, I have great difficulty with.

HEALEY

Well, I think to be fair, Forrester has done everything it can to sell TIVOs. (Laughter). We have brought the plug in play many times, but I would like to hear from Jack on this. Because part of the proposal to the FCC, there was the suggestion that there ought not to be the ability of content owners to strike deals with cable operators and satellite operators to turn off the analog outputs out of concern of piracy. Doing so would disenfranchise the 5 million or so who have already bought HDTV ready or HDTV sets that only have analog input. So Jack, where are you on that particular element of the plug and play discussions?

VALENTI

In 1966 there were a lot of meetings between the CEA and our people. This is before there was a single HDTV set out there. And we suggested at this time that we settle the problems before bad habits occurred. Now you have 4 to 5 million legacy sets out there. IF we had been able to persuade those of whom we talked to, to put the right kind of protection in there, then we wouldn't have these kinds of problems today. But they are here, we have to confront them and they won't go away. The fact is that we do know we have to protect our movies and there are two kinds of analog output. One is regular and the other is HDTV.

VALENTI (continued)

Right now, we are trying to deal with the analog output by closing the analog hole and maybe you know more about this than I do. But the reason of why this is so distressing is that when you have an encrypted movie you have put protected clothing around it. All sorts of armor plate to make sure that it will have sturdy protection. And then it is distributed to a television set that is analog and when it is transposed so the people can view it, its as if you striped away all of the clothing for that movie. And now it is in the clear. And if you digitally retransmit it, we have a problem. And that is why this analog hole has got to be closed because you can't have an encrypted movie that we spent a lot of money to encrypt. So we can sent it to people with the knowledge that it will reach there unscathed and unabducted. And then find out that it is striped of all its clothing and moves into another world that is a serious problem and causes us great anxiety. And that's one of the three objectives we have now. The broadcast flag closing the analog hole and dealing with this insidious file swapping from peer to peer landscape.

HEALEY

So I take it that the NPAA is committed to preserving the right to turning off the analog outputs from set top boxes.

VALENTI

Are you asking me? Our companies are dealing with that. And that is a question that they would have to answer.

SHAPIRO (to VALENTI)

I have a question for Jack, there's a lot of news reports lately that the biggest challenge the motion picture industry seems to face in terms of the unauthorized, I am happy to call it piracy, is people going to movie theaters with camcorders, or the Academy Award preview DVD's that are just being taken to other countries and are being produced there. How would any of there proposals deal with any of those serious problems?

VALENTI

We are dealing with camcorder piracy all over the world. And some of the Japanese camcorders are assisted with great fidelity of sight, sound, and color. It is a problem. It can also come from a lab where corrupt employees are involved in it. Some of these screeners that these companies put out are going to have to rethink how they advertise the Oscars and I've made my views known to all the studios. There's a question of going to a projection booth and overnight taking the film, and copying it. One of the reasons why this has flourished in most countries of the world is that it is high reward and low risk. I am spending an inordinate amount of time to negotiate with other countries to not only have copyright laws that are stern and firm but to have the political will and the political resolve to enforce those laws. When countries like Russia, Taiwan and Malaysia, and others...we're in deep trouble there because there's a laxity of enforcement. In Russia, for example, the export of DVDs is a major trade item. Going into Central and Eastern Europe and now moving into the European Union, and our colleagues in the European Union creative community are very concerned. These thieves are equal opportunity thieves. They will steal anything if they think people will buy on the street. Piracy is a harsh word, but it is stealing. We are doing better in the United States with analog piracy because the Justice Department, the U.S. Attorneys and the FBI have elevated it to a higher standard. But with the war on terrorism and possible war this month or next month, the resources of the FBI will be lessened and we will have this crime problem again. So, it's an ever-vexing, relentless kind of thing and every day we have to be vigilant, because, like virtue, we are every day besieged.

SHAPIRO

Jack, is time shifting piracy?

VALENTI

Of course not, that is legal under the Supreme Court. You've read that decision haven't you? I don't want you to engage in Sophistry. You would have been great in the year 500 BC when the Sophists were alive Gary. It's not piracy and its not stealing. The Supreme Court said, and it's the only thing I might add, that they said is that you can time shift. Of course you can.

SHAPIRO

So you can move it around your home?

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VALENTI

Of course you can. And with the broadcast flag, you can copy to your hearts content. You can serial copy if you like. With the broadcast flag, the customer will never know there is a flag there.

HEALEY

Unless the customer is using an Ethernet card network in his home which is rendered non-compliant, but let's not dwell on that.

VALENTI

You are supposed to be objective, Jon. (Laughter)

HEALEY

Simply an observation. (Laughter) Let me ask a question that Robert might have asked of Jack. If studios are so anxious to support distribution because it really is part of there model and the cable operators are offering a secure distribution pathway through video on demand. Why has it been so hard for cable operators to get the studios to provide movies for video on demand services?

VALENTI

Video on demand I am told and do in part believe by those people who are supposed to be experts is that it is very complex and very abstruse and very complicated and very expensive to do. There are five studios that launched movie link, which went on the air in December, and it's in the fourth venue that is theatrical, hotels and airlines, home video and the pay per view window. And we are trying to see how it works. It's a rental for the time being. They are working out the technological bugs. This is not easy to do. I am told that the VOD needs a lot of technological work on it before you can have video on demand, which is instantaneous display of a movie you want.

HEALEY

So, Robert, you are not ready.

SACHS

Cable operators today are offering interactive real-time video on demand on an increasing number of markets. So technology is not the gating factor here. I am hopeful that the agreement that was reached between the cable manufactures and the cable MSO's will lead to more highly product being available for video on demand. The encoding rules, which are part of this agreement, provide different levels of copy protection for different types of programs. So for basic cable or broadcast it is copy freely. For premium channels like HBO or Show Time, it's maximum of copy once. And for VOD it is maximum of copy never. So there will be and another part of this agreement, the cable set top boxes and the DTV sets there is a schedule by which they will have the appropriate digital connectors, the 1394 5C and DVI, so we will have a more secure environment. And I am optimistic that the studios will be making more programming for cable VOD much like they will be making for movie-link and other on line services.

VALENTI

Let me just say, Robert, I do have respect for you, but I do have a problem with that pact you had with the CEA. Number 1. Content is the issue. No one asked us to be in on the meetings or told us anything about it.

SACHS

Sorry. We told you but we didn't invite you. (Laughter)

VALENTI

That's exactly what you did. And the second thing is, in this compact it asks the FCC to lower the capabilities of satellite to guard our products, high definition. Satellite has a pretty good circumference of protection but in this concord I am told by those who have read it very carefully, that the FCC is being asked to reduce the capability of satellite companies for protecting our high definition. I am not fussing about it, just curious about it.

SHAPIRO

I think it is fair to say that the consumer electronics industry and our consumers were very uncomfortable with the fact a satellite or a cable company has the ability to turn off every product in the house that is connected with any other product from a remote location. It was a fundamental part of the agreement that satellite and cable would have the same rights and that copyright would be treated in the home with the same principals that the movie studios have agreed to.

VALENTI

Why wouldn't cable increase its capability to protect but not lower satellite's capability? Why wouldn't you move up the satellite's capability?

SHAPIRO

I think it had to do with the fundamental rights of consumers to have the products work in their homes work with each other. And its the manufactures desire is to protect their consumers.

HEALEY

At the risk of taking Jack's side here, one might wonder why the consumer electronics manufactures who've known about 5C and HDCP for a long time have continued selling sets without digital inputs without the capability of protected input for all those years.

SHAPIRO

I think the manufactures are selling the sets that they feel the consumers want. In terms of...those sets work. They only not work if someone else is used to turn them off and cannot provide the appropriate signal. In any event, it is just like the question of the analog set. Why should I buy an analog set? The analog set is going to be working for a very long period of time with a VCR, DVD, and video game, with pre-recorded products. Those sorts of things. Those sets are being sold, as described will work for a very long period of time unless someone chooses to not provide a signal to them.

SACHS

One small point, though the agreement between the cables manufactures and cable MSO's includes some encoding rules. Those rules were not changed at all from the 5 C agreement which have been negotiated between Warner and Sony and the 5 C companies. The only thing that would change is if there were future modifications of those rules. It would create public and administrative process at the FCC, which would allow content owners, consumers, cable operators, satellite providers, CE manufactures to participate. So there is no change what so ever as the subject of those rules as they are incorporated into this agreement.

VALENTI

I'm certainly impressed with the idealism expressed here, I am glad it had nothing to do with profit.

HEALEY

And on that happy note, I am going to say that we are out of time. I want to thank the audience for setting up some really great questions. And if I didn't ask your question it is because it is too sophisticated for me to understand. I also want to thank very much the members of our panel for being frank and lively with us.