

May 21, 2004

Canadian
Association of
Broadcasters

L'Association
canadienne des
radiodiffuseurs

Ms. Diane Rhéaume
Secretary General
Canadian Radio-television and
Telecommunications Commission
Ottawa, Ontario
K1A 0N2

Dear Ms. Rhéaume:

Re: Broadcasting Public Notice CRTC 2004-20: Call for comments on a request to amend the *Broadcasting Distribution Regulations* to add provisions governing the audit of affiliation payments

1. The Canadian Association of Broadcasters (CAB) – the national voice of Canada's private broadcasters, representing the vast majority of Canadian programming services, including private television and radio stations, networks and specialty, pay and pay-per-view television services – is pleased to submit this intervention concerning the issues raised in Broadcasting Public Notice CRTC 2004-20 (PN 2004-20).
2. In PN 2004-20, the Commission invited comment on the CAB's request to amend the *Broadcasting Distribution Regulations* (the Regulations) to provide for terms and conditions under which the licensees of programming undertakings could audit the records of broadcasting distribution undertakings (BDUs) for the purpose of verifying the accuracy of affiliation payments.
3. The CAB's request was made in light of growing concern over the number of disputes coming to the Commission relating to affiliation payments. According to the Commission's 2003 Broadcast Policy Monitoring Report:

Utilization of dispute resolution mechanisms at the Commission is increasing. In calendar years 2001 and 2002, 16 and 37 dispute resolution files were received respectively by the Commission. In the first 6 months of 2003, the Commission has received 29 complaint files.

4. In total, between May 12, 2000 and September 20, 2003, the Commission received 83 dispute resolution complaints. Of these, the Commission reported that it had more recently received 27 disputes involving requests to audit BDU records to verify subscriber totals or accounting methodology for the carriage of programming services.
5. The Commission has also invited comment on a number of questions related to the CAB's proposed 10-point framework for affiliate BDU audits, which the Commission included as an Appendix to PN 2004-20.
6. Before addressing these specific questions, the CAB first wishes to raise some general issues with respect to the inadequacy of existing regulatory safeguards and the need for a regulatory mechanism to verify the accuracy of affiliation payments.

Existing regulatory safeguards are inadequate

7. In Public Notice CRTC 2001-66, the Commission outlined the principles that apply to the relationship between programmers and distributors. Among those principles is an assurance that a programming service "...is entitled to obtain, at its own expense and on an annual basis, independently verified subscriber numbers for the service in question to validate the basis for programmer compensation."
8. Subsequently, in Broadcasting Decision CRTC 2003-124, the Commission stated that "...existing regulatory safeguards, including sections 9 [undue preference] and 12 [dispute resolution] of the *Broadcasting Distribution Regulations*, are sufficient to ensure programmers fair and reasonable treatment regarding payments and audit rights."
9. Notwithstanding such safeguards, programmers continue to be frequently frustrated in their attempts to obtain independent verification of subscriber numbers and calculations, a situation evident in the growing number of disputes relating to affiliation payments that are currently before the Commission.
10. Moreover, the Commission's stated principle relating to a programmer's right to audit is silent on many key variables, such as the scope and range of the audit, confidentiality, notice period and what is meant by "independent" verification, as well as on other key administrative considerations.
11. The current regulatory safeguards lend themselves to differences in interpretation – differences that are seized upon by some BDUs to defer and delay any meaningful audit of affiliation payments. As such, the CAB submits that they should be augmented by an amendment to the Regulations that clearly sets out the terms and conditions related to conducting audits of affiliation payments.

12. Section 12 (2) of the Regulations addresses the circumstances under which a programming undertaking could refer to the Commission a request for dispute resolution as follows:

If there is a dispute between the licensee of a distribution undertaking and the licensee of a programming undertaking... concerning the carriage or terms of carriage of programming, including the wholesale rate, originated by the programming undertaking, one of both of the parties to the dispute may refer the matter to the Commission for dispute resolution.

13. While the CAB acknowledges that there is recourse to dispute resolution in circumstances where programmers and BDUs are unable to reach an agreement on matters pertaining to carriage of programming (including accurate payment for that carriage), the CAB submits that the dispute resolution process is often onerous and unduly time-consuming. It is clearly not an appropriate mechanism for ensuring the accuracy of affiliate payments on an annual basis.
14. The dispute resolution process should be seen as a last resort, not the principal means by which programmers can be satisfied that they are being fairly paid for their services.

A regulatory mechanism is needed to verify the accuracy of affiliation payments

15. In paragraph 3 of PN 2004-20, the Commission states that "...many of the issues raised in the [CAB's] proposed audit framework are business-related issues that might best be negotiated by affected parties on an individual basis."
16. As the CAB noted in its December 12, 2003 letter to the Commission, the nature of the broadcasting business is unusual in that few other businesses operate without a clearly established mechanism to verify compensation received in respect of goods and services sold. Programmers do not have a direct relationship with their viewers, who are subscribers of the BDU. Therefore, it is difficult to directly verify that subscribers have actually received programming without the express cooperation of BDUs. Accordingly, in the absence of an audit, programmers are forced to rely solely on the statements provided by BDUs even though they may contain accounting errors.
17. For many years, a programmer's "right" to audit an affiliate's records was simply a generally accepted industry practice. More recently, however, certain BDUs have refused to be governed by this industry practice.
18. At the same time, a BDU's methods of delivering programmers' services to its customers have undergone frequent changes. The CAB submits that the increasing number of services and the various ways in which they are packaged, bundled and sold have increased the likelihood of reporting errors in affiliation payments. Promotional launches and "rolling" free previews with their related customer credits also increase the likelihood of calculation errors. Other factors such as rapid new system acquisitions and consolidation, cost reduction initiatives and employee turnover at some BDUs have also had a compounding effect on the number of reporting errors in affiliation payments.

19. For example, where programmers have been able to conduct audits, typical errors include:
 - failure to capture the complete number of systems carrying a given service;
 - errors in “free preview” calculations;
 - errors in *pro rata* calculations for bulk and transient account calculations;
 - errors in VIP and complimentary account calculations;
 - errors in accounting for seasonal subscribers; and
 - errors in average weighting calculations.
20. In some situations, even where audit provisions have been negotiated by affected parties on an individual basis, programmers have been denied access to the records needed to complete such verifications. This denial of access is particularly troubling where BDUs’ publicly-disclosed subscriber figures are higher than those found on their remittances.
21. The increasing number of dispute resolution requests coming to the Commission is indicative of the difficulty programmers face when attempting to negotiate satisfactory audit rights or to exercise audit rights provided for in affiliation agreements with BDUs. In many cases, BDUs simply refuse to incorporate, under contract, a programmer’s right to undertake affiliate audits, on the grounds that the Commission has already provided programmers with the right to conduct audits, in principle, under existing policy. In other cases, BDUs frustrate any attempt to effect a meaningful audit process.
22. In short, the absence of clear operating principles with respect to affiliate audits clearly frustrates and complicates the audit process, resulting in the increasing number of audit-related dispute resolution files being forwarded to the Commission.
23. In those cases where programmers have been able to conclude affiliate audits through dispute resolution proceedings, the CAB submits that the absence of clear and enforceable audit rules indicates an ongoing shortchanging of the system. Underpayments have been uncovered in the vast majority of such situations, indicating that programmers are routinely being deprived of considerable revenues, 40% of which, on average, would otherwise translate into higher Canadian programming expenditures. This is an untenable situation that reinforces the need to augment the current “honour system” by which affiliate payments are remitted with a clear audit verification process captured in the Regulations.
24. Accordingly, while many of the issues raised in its proposed framework are, as the Commission notes, “business-related,” the CAB submits that appropriate amendments to the Regulations are necessary to ensure that programmers are able to exercise clear and reasonable audit rights.
25. Finally, Section 3(1)(t)(iii) of the *Broadcasting Act* requires that distribution undertakings:

...should, where programming services are supplied to them by broadcasting undertakings pursuant to contractual arrangements, provide reasonable terms for the carriage, packaging and retailing of those programming services...
26. The CAB submits that, in the absence of a meaningful and effective audit requirement codified by regulation, it would be difficult to meet this key broadcasting policy objective. Without transparent rules allowing programming services to verify whether the contractual terms for the

carriage of their services have been effected, it will continue to be difficult, if not impossible, to conclude that BDUs are actually providing “reasonable” terms for the carriage of services.

27. As discussed above, existing regulatory safeguards have proven to be inadequate, leaving programming services in many cases subject to unreasonable terms of carriage. The CAB submits that the implementation of a meaningful and effective audit right will not only help to achieve this broadcasting policy objective, but will also ensure that each element of the broadcasting system will make the appropriate financial contributions to the system.

CAB responses to Commission’s questions

If the Commission decided to include audit provisions in the Regulations or otherwise impose requirements to provide audit access to BDU records, what would be the most efficient and accurate mechanisms for conducting such audits?

28. As the CAB noted in its proposed framework for BDU audits, any audit provisions or other requirements imposed by the Commission should address critical issues such as the range and scope of audits, the choice of auditor, confidentiality, a predetermined interest charge on underpayments, acceptable notice and resolution periods, and what types of documents an auditor will have the right to examine.
29. The CAB submits that these elements are fundamental to a workable audit framework and must be given necessary weight through formalization in regulation. Leaving these matters to contractual negotiation creates opportunities for delay and deferral by BDUs of meaningful audits – opportunities that are being exploited by some BDUs to the detriment of programmers and to the harm of the system.
30. In addressing this issue, the Commission should also satisfy itself that programmers will not face retribution by BDUs as a result of exercising their audit rights.

Who should select the auditor and what, if any, principles should guide this selection? Who should pay for the auditor’s services?

31. The CAB submits that programmers should select and pay for the services of a third party auditor or staff. A BDU should not be permitted to unduly wield “veto” power over the programmer’s choice of auditor.
32. The CAB considers that an “undue” veto over the programmer’s choice of an independent auditor includes, but is not limited to, rejection of an auditor on the grounds that that auditor has previously acted on behalf of that programmer in a separate audit, or has previously acted on behalf of another programmer in a separate audit. These tactics have been employed by some BDUs in the recent past to indefinitely delay programmers’ attempts to exercise their existing audit rights.

How often should the licensees of programming undertakings be permitted to audit BDU records?

33. Programmers should have the right to audit affiliates once per year.

What time period(s) should be examined in an audit (i.e., how far back in time should the audit extend)?

34. Programmers should have the right to audit an affiliate's records for the preceding three year period, where necessary, to verify that payments remitted accurately reflect subscriber levels and contractual terms.

35. A period previously audited should not be re-audited unless new information has surfaced, or there are probable grounds to re-audit.

What types of information should an auditor have access to in the course of performing an audit, and what types of records should BDUs be required to maintain in order to facilitate audits by the licensees of programming undertakings?

36. The programmer's auditor should have access to any documents, business processes or information systems involved in the processing of affiliate payment information.

37. These documents would include as a minimum:

- system documentation on the subscriber fee/billing system;
- copies of schedules and records supporting subscriber fee calculations, including trial balances and ledgers for the period under audit;
- access to billing records, including invoices or statements for the period under audit;
- listing of service codes and rates used by the billing system to identify packages and programming services;
- access to standard and customized reports generated by billing system;
- reconciliations of the number of subscribers in each category in the monthly programmer statements to subscribers in the billing system by programming service – this includes à la carte subscribers, bulk/transient/commercial subscribers and complimentary subscribers;
- reconciliations between the sales reported in the billing system and the sales reported in the general ledger or trial balance;
- copies of subscriber fee payments and evidence of payment;
- monthly subscriber reports substantiating programming service penetration levels, including English/bilingual subscribers, French speaking subscribers and total subscribers by programming service;
- reconciliation of bulk, transient and commercial subscribers by programming service by sales value and number of subscribers, including discounts given; information should include:
 - number of units/rooms for each account;
 - number of basic subscribers for each account;
 - number of extended tier subscribers for each account;

- activation date of each account;
- retail rate per unit/room for each account; and
- contracts between the BDU and the bulk/transient and commercial accounts;
- support for monthly discounts taken for retail establishments, schools, VIPs, charitable institutions and employees of the BDU; and
- channel listings of each system.

38. The auditor should have the right to retain copies of any documentation that directly serves to substantiate the auditor's conclusions.

What measures may be necessary to protect confidential information obtained during an audit?

39. Programmers participating in a group audit would agree to have the selected auditor sign a confidentiality agreement ensuring that any and all information related to unaffiliated programming providers shall not be disclosed to other parties.

What should the minimum and/or maximum period allowable between the request for an audit and its commencement?

40. Within sixty days of notification by a programming service of its intent to audit, the affiliate must agree to a mutually acceptable date for the commencement of the audit.

What should be the minimum and/or maximum period allowable for resolution of any discrepancies following the receipt of the auditor's report?

41. Discrepancies should be resolved and settled within thirty days of receipt by the affiliate of the auditor's report.

42. Affiliates should be assessed an interest charge where the audit uncovers a shortfall on remittances.

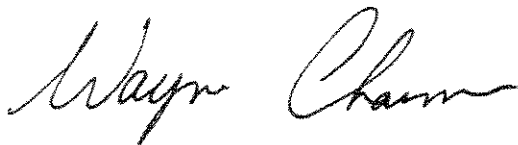
If the Regulations provide for audit rights, should the terms and conditions be set out in the Regulations, or in a document incorporated by reference?

43. The CAB considers that the specific mechanism by which audit rights are incorporated into the Regulations is an administrative matter to be determined by the Commission. In doing so, the key consideration is that such a regulatory amendment, however implemented, must be enforceable and must clearly set out the terms and conditions under which programmers will be entitled to obtain independent verification of affiliate payments from BDUs.

If audit provisions are included in the Regulations, what would be the status of any audit provisions included in current affiliation agreements?

44. Where audit provisions exist within an existing affiliation agreement, the CAB believes that those pre-existing provisions should continue to apply during the term of the agreement. However, to the extent that the amendment to the Regulations offers clarification to the audit clause in an affiliation agreement, then that clarification should be read into the existing agreement.
45. The CAB emphasizes that, where no agreements are currently in place or where existing agreements do not contain audit provisions, the terms and conditions relating to audits, as incorporated in the amended Regulations, would apply.
46. The CAB appreciates the opportunity to provide its comments with respect to this matter.

Yours sincerely,



Wayne Charman
Senior Vice-President
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