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To Protect Its Empire, ESPN Stays on Offense

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ESPN likes to call itself the Worldwide Leader in Sports, and by most every measure it is in a league of its own.

The network produced 35,000 hours of programming in 2012, including at least half of all live athletic events televised in the United States. It is a prodigious cash machine, regularly generating nearly half of the operating profit of Disney, its parent company. Wielding its wealth, it buys the rights to nearly all it desires: $15.2 billion for “Monday Night Football,” $5.6 billion for Major League Baseball and $7.3 billion for a 12-year deal to broadcast the new college football playoff system, to name just a few. From its sprawling 123-acre campus in Bristol, Conn., ESPN operates seven national channels, an industry-leading Web site, a magazine and international sites like ESPNcricinfo.com, for cricket fans.

So it may be hard to imagine that the sports media conglomerate has arrived at one of the most precarious moments in its nearly 34-year life.

The more than $6 billion in cable fees flowing annually to ESPN from almost 100 million homes is threatened as growing numbers of consumers cut ties with cable providers to avoid rising bills for pay TV, turning instead to video streaming services. In Washington, a renewed push to undo the bundling of channels into cable packages and allow viewers to simply pay for those they want has even drawn the support of Senator Richard Blumenthal, who represents ESPN’s home state.

ESPN’s viewership numbers plunged earlier this year, and that was before the debut this month of Fox Sports 1, a 24-hour network funded lavishly by Rupert Murdoch’s 21st Century Fox. Fox Sports 1 is likely to shape up as ESPN’s most formidable head-to-head rival.

All of this, particularly consumers’ move away from pay TV, is reverberating in Bristol. “This is the most complicated environment we’ve faced in a long time,” said John Skipper, the president of ESPN.

But ESPN has shown over the past decade that it will fight tenaciously and opportunistically to protect an empire it built by using the billions of dollars it collected from cable fees to gobble up the rights to more and more sports events.

In the mid-2000s, ESPN’s appetite for programming was so voracious that the Justice Department looked into complaints that the network was engaging in anticompetitive practices — an inquiry that ESPN executives first acknowledged in recent interviews. The complaint centered on ESPN's practice of buying rights to more college games than it had the capacity to televise, leading to accusations that by "warehousing" games, it was depriving colleges of exposure and other networks of potentially valuable programming.

Although no action was taken against ESPN, it began to share programming with the competitor that brought the complaint, and it went on to create ESPNU, a channel dedicated to college sports.

During the same period, Washington was leveling one of its periodic attacks on what Mr. Skipper calls ESPN's "beautiful business model" — the rising monthly fee that now stands at $5.54, according to the media research firm SNL Kagan, and is paid by homes with expanded basic cable packages, almost all of which include ESPN.

With cable packages known as bundles under repeated attack, ESPN and Disney have gone on the offensive, making it one of their priorities in Washington. Beyond lobbying and campaign donations, they have hosted lawmakers in Bristol and in Burbank, Calif. They brought their stars to Washington, where ESPN, the network that turned competition into 24-hour fare, has often found an eager audience among political players.

"I was proud to call on senators, congressmen, F.C.C. commissioners, staff and talk about ESPN," said George Bodenheimer, ESPN's president from 1998 to 2012. "And by the way, many, many of those folks enjoyed talking about ESPN."

A Fight Over Bundles

Given ESPN's usual reception in Washington, it was perhaps surprising that Mr. Blumenthal decided last month to co-sponsor legislation with Senator John McCain aimed at undoing bundles — a signal that the cable pricing debate had returned.

"The bill certainly puts consumers first and definitely requires the industry to make a change," Mr. Blumenthal, a Democrat, said. "But on the whole, ESPN should fare relatively well, because it has an extraordinarily loyal customer base."

Bundles are clusters of channels that media companies like Disney sell to cable, satellite and telephone companies. Disney's bundle features the stations owned by ABC, as well as the Disney Channel, Soapnet and the seven national ESPN channels. Companies with powerful bundles like Disney's have the leverage to add channels and negotiate for higher monthly fees from providers, which are passed on to viewers.

So powerful is the ESPN-fueled bundle that one veteran cable operator described negotiations with Disney as "total surrender."

As ESPN has added costly programming, it has consistently been able to raise its fees and has used that money to outspend its competitors and sustain a media empire unlike any other.

A former ESPN senior executive recalled a gathering of his colleagues where "everyone toasted to the concept of compounding"— that is, increases in subscriber fees that several years grew at a compounded annual rate of 20 percent. The current $5.54 average monthly price for ESPN is more than four times the fee for the next most expensive national network.

But the main issue for bundle opponents in Washington and among consumer advocates is that while an expanded basic package offers subscribers a smorgasbord of programming for a single fee, they are most likely paying for channels they never watch. ESPN is a prime example. Of the network's nearly 100 million households, an average of just 1.36 million viewers watched in prime time during the second quarter of this year. Although marquee programming like "Monday Night Football" drew big numbers, the average number of viewers over a 24-hour period in the second quarter was 713,000.

"There is no regulation that says, 'Wait a minute, is it mathematically positive, or reasonable, for 75 million who don't want ESPN to pay for the 25 percent who do, at a false price?' " said Barry Diller, the media executive who is backing the technology of a company called Aereo that streams broadcast channels online and is viewed as a challenge to cable.

Bundling by media giants, Mr. Diller said, "is some game if you've got it: 'Wow, what do I have to do to have this absolute pricing power in a totally closed system?' "

Mr. McCain, an Arizona Republican, declared at a 2004 hearing that cable executives gave consumers "all the choice of a Soviet election ballot." Mr. McCain has been a persistent critic of bundles, and for about 10 years he has pushed for a so-called à la carte plan, which would allow viewers to get only the channels they want.

ESPN, with Disney at its side, has been among the chief defenders of bundles, calling them a great value for consumers given the diversity of the programming. Without revenue from bundles, Disney has argued, it would have to increase the monthly fee for viewers who want ESPN to about $15 a month.

ESPN has long been able to deploy an array of weapons on the field of politics.

In 1999, at a sports-infused reception hosted by ESPN at the Capitol, politicians were photographed posing as sports stars on a mock cover of ESPN the Magazine. They could also pose with actual athletic legends: Muhammad Ali, Johnny Unitas and Carl Lewis.

"Senators and congressmen lined up acting like schoolboys waiting to get their picture taken with these guys," one former Disney lobbyist recalled.

As the cable debate heated up in the mid-2000s, ESPN and Disney representatives played the usual Washington game: testifying to Congress, lobbying on Capitol Hill, meeting with Federal Communications Commission officials and making campaign contributions.

But they also had moves all their own. When Michael Powell, the F.C.C. chairman at the time, needed a platform in the fall of 2004 to pitch to consumers his campaign to convert to digital television, he was welcomed to the halftime show of “Monday Night Football” on ABC, another Disney property.

According to interviews with Preston Padden, Disney’s chief lobbyist at the time, and Mr. Bodenheimer, Mr. Powell’s request for airtime was made to Mr. Padden and approved by Mr. Bodenheimer, who as ESPN’s president was also running ABC Sports. Mr. Bodenheimer relayed his decision to the ABC production truck in Baltimore.

Mr. Bodenheimer recently said he granted Mr. Powell’s request because digital TV was a “critically important subject for all television viewers.”

Critically important to ESPN was an F.C.C. study of cable economics that was under way. Mr. Powell, who declined to comment, supported bundled programming, and a month after his October appearance he released the study, which said an à la carte plan would most likely raise consumer costs by 14 percent to 30 percent and reduce the diversity of channels.

One focus of ESPN and Disney’s largess was Representative Joe Barton, a Texas Republican and the chairman of the House Energy and Commerce Committee, which had purview over television legislation.

In 2004, Mr. Barton had helped derail a legislative move aimed at breaking up bundles. On Super Bowl weekend in February 2005, with the cable controversy bubbling, Disney paid to bring Mr. Barton and his wife to Walt Disney World in Orlando, Fla., records show. ESPN did not carry the game, which was played in Jacksonville, Fla. But in Orlando, Disney was busy entertaining advertisers.

ESPN gathered some of its executives to talk to Mr. Barton about the absence of a college football playoff, an issue that the congressman would eventually explore in hearings.

“It was Preston Padden’s show and Joe Barton’s agenda,” one participant in the meeting said. Mr. Barton’s travel disclosure form for Feb. 5 to 7, 2005, shows that Disney spent $3,354 on the Bartons’ lodging, $1,616 for airfare and $1,200 for meals. He recorded the purpose of the trip as “Speak to executives and fact finding.”

A spokesman for Mr. Barton declined to comment beyond saying that the report “speaks for itself.”

Within a few weeks, Disney and ESPN employees made donations of $7,500 to Mr. Barton’s political action committee, according to an analysis of records from the Center for Responsive Politics. Disney's corporate PAC contributed $5,000 more, adding to the $10,000 it had donated to Mr. Barton in 2004. Over the years, Disney and ESPN executives, and the Disney PAC, have donated $58,500 to Mr. Barton and his PAC.

Those contributions were a fraction of their donations. ESPN and Disney and their employees have donated more than $400,000, much of it since 2000, to representatives and senators who are key players on issues important to Disney, including cable.

The cable fee debate came to a head again in 2006. Mr. Powell's replacement at the F.C.C., Kevin Martin, released a report that found an à la carte plan could actually reduce costs for 40 percent of households with cable. The industry blasted the report.

In June 2006, Mr. McCain formally proposed legislation that would effectively break up bundles. But it failed by a 20-to-2 vote in the Senate commerce committee.

Mr. McCain said of Disney's lobbying effort, "They beat me like a drum."

Mr. Padden played down both the threat and Disney's role in defeating it. "À la carte is an easy sound bite, but it can't withstand any level of scrutiny," he said.

But Matthew Polka, the industry lobbyist for small cable operators, said, "On à la carte, there was no stronger opponent than Disney and ESPN."

And ESPN has no more stubborn nemesis than Mr. McCain. This past spring, with cable rates and ESPN's monthly fees continuing to rise, he revived an effort aimed at undoing bundles.

"Why do I pick on ESPN?" Mr. McCain said in an interview in May. "I'm not picking on them. But they are the most glaring example of what people are required to watch — I mean pay for — even if they never watch it."

Challenges From Rivals

ESPN has used the billions of dollars in cable fees to build a moat of programming around its empire, which is likely to be tested in the coming challenge from Fox Sports 1, which made its debut on Aug. 17. ESPN's business strategy has been to aggressively buy the rights to as much programming as possible for as long as it can to impede the growth of rivals, including Fox and sports channels owned by NBC and CBS.

With ESPN having locked up the rights to so many professional and college sports contracts beyond 2020, the bidding war between it and Fox Sports 1 over the few remaining prizes is expected to be fierce. One, the Big Ten Conference, has a 10-year, $1 billion deal with ESPN that expires in 2017, but Fox has already built influence through its 49 percent ownership of the Big

Ten Network. The National Basketball Association, which Fox covets, has deals through 2016 with ESPN and TNT.

ESPN's omnivorous strategy has given it such dominance that at one point in the mid-2000s, according to interviews and documents, Justice Department lawyers in Washington began questioning whether ESPN was engaging in anticompetitive behavior in handling college athletics.

No other network invested as much in college sports as ESPN or had the available time to carry more games. But by 2004, it owned the rights to far too many games to fit them on ESPN or ESPN2.

"We had an enormous amount of inventory that we weren't using, and there was a fear that the conferences would accuse us of warehousing," said Mark Shapiro, a former executive vice president of ESPN.

College conferences focused their frustrations on the exclusive contracts they signed with ESPN that prohibited them from taking games that ESPN held the rights to, but did not televise, and reselling them to other national networks.

"We felt that ESPN wanted our rights just to embargo them from other networks," Wood Selig said, recalling part of his tenure as the athletic director at Western Kentucky from 1999 to 2010. "Like, 'If we don't show them, nobody else could.' "

Mr. Selig, now the athletic director at Old Dominion, added, "That was the sentiment on a lot of campuses."

In 2004, College Sports Television complained to the Justice Department. As a fledgling network, CSTV did not have the money to buy the rights to major conferences, but it could afford the rights to midmajor and smaller conferences like the Western Athletic, the Atlantic 10 or the Mountain West. Yet no conference with an ESPN contract could, without ESPN's consent, make a deal with CSTV or any other national rival.

In meetings with Justice Department lawyers, CSTV laid out its case. It presented a report portraying ESPN as a monopolist that controlled the college sports market by using restrictive contracts, by refusing to sell unused games to competitors and by telling conferences they risked losing exposure on ESPN if they fled to CSTV.

In the 2003-4 season, the report noted, 163 Division I-A football games and 561 men's basketball games were not televised nationally because ESPN refused to let conferences resell them.

"The most powerful exhibits we showed the Department of Justice laid out what the conferences were getting paid and how few of the games were actually aired, with the rest remaining in the warehouse," said Chris Bevilacqua, a founder of CSTV. "Something was out of whack."

The Justice Department began an inquiry in the spring of 2004. ESPN lawyers cautioned executives to take it seriously and save all relevant internal e-mails, two ESPN executives said. The lawyers also told officials not to use words like “dominate” and “markets” in public — to avoid raising the hackles of the government — and to play up the consumer benefits of the broad array of rights ESPN controlled.

The Justice Department spoke to conference commissioners, and one government lawyer, Lawrence Frankel, sought information about contracts from CSTV, according to e-mails and documents obtained in part through the Freedom of Information Act. The Justice Department declined to comment.

In a first public acknowledgment of the inquiry, Mr. Bodenheimer said in an interview, “It came and went quickly because there was nothing there.” He added: “It wasn’t an issue for us. We contracted for product and we aired as much of it as we could.”

Around the same time, though, warehousing became an issue in contract talks between ESPN and the Western Athletic Conference. Karl Benson, the WAC commissioner at the time, instead wanted to make a deal with CSTV that promised more money and more TV appearances than ESPN was offering. But the athletic directors at WAC universities wanted to stick with ESPN, which had far more subscribers and offered wider exposure.

According to a CSTV executive who talked to him shortly afterward, Mr. Benson said he asked John Wildhack, a longtime senior executive at ESPN, “How can you continue this exclusive practice in the face of this continuing D.O.J. investigation?” In the conversation, Mr. Benson described the ESPN executive’s response as “very dismissive.” Mr. Benson did not dispute this account.

Through a spokesman, Mr. Wildhack said he did not recall the incident but said, “Negotiations always cover the gamut of emotions.”

In the end, the government took no action against ESPN, but CSTV executives achieved their real goal: rattling the giant enough to change the way it did business with conferences. “If all they did was open an investigation, we won,” Mr. Bevilacqua said.

During the time the Justice Department was asking questions, CSTV signed an exclusive deal with the Mountain West Conference, which ESPN had previously carried. Soon after, CSTV made deals to carry Conference USA and Atlantic 10 games with ESPN, a rare moment when ESPN shared national cable rights with a rival. CSTV credits the government inquiry for ESPN’s change of heart.

But Mr. Bodenheimer said the Justice Department’s attention had no impact. “Look,” he said, “people — competitors — see the success of ESPN and say, ‘I want some of that; I want that, too.’ ”

What ESPN wanted was to maintain its dominance in college sports — and all sports. Given its many conference contracts, starting a college network would be relatively easy. The new network, ESPNU, would reduce any warehousing and let Disney make more money when it was added to Disney's bundle of channels.

"If we could have a network that would give us a new platform and build a new revenue stream, why not?" said Mr. Shapiro, the network's former executive vice president.

One ESPN executive involved in the start-up said: "This was about warehousing. We needed the real estate."

At CSTV's offices at Chelsea Piers in Manhattan, there was no gloom that ESPN had targeted it for a direct hit. ESPNU was validation of CSTV's focus on college sports.

"We had a party the day they announced ESPNU," said Tim Pernetti, a former CSTV executive. "We were the new guy on the block, and this was all about good gamesmanship."

Nearly a decade later, ESPNU is a prominent part of the Disney bundle, with more than 75 million subscribers paying an average of 20 cents a month, leading to $180 million in annual revenue.

CSTV, which was later sold to CBS and became CBS Sports Network, has nearly 50 million subscribers. Still, CBS lacks a vast array of conference rights or a strategy of spending the billions of dollars that ESPN does to get them.

Mr. Skipper, who became ESPN's president early last year, said the story of ESPNU was not about the Justice Department or warehousing, but about a company that was relentlessly competitive.

"It was much more a response to CSTV and the fact that we wanted to establish a leading position," he said. "They had first mover advantage, and once again we were able to do the right things and emerge as the leader in that space."

Looking to the Future

Almost from its beginning, ESPN has controlled its destiny. One network wasn't enough? It built several more. Altering the course of sports television wasn't enough? It built Internet, international, mobile, radio, print and applications businesses that have perpetuated its dominance.

Central to that success has been a mastery of technology. ESPN runs two research laboratories that develop graphics, mine data, create equipment and package highlights and audio to feed the voracious appetite of fans who cannot get enough sports information from TV. Its ESPN3 online network is capable of showing an unlimited number of games — a godsend to some universities, including some that so crave national exposure that they are willing to pay the costs of production.

It created one channel, the Longhorn Network, devoted to a single university, Texas, and is starting a second, the SEC Network, for the powerful Southeastern Conference, in 2014.

Now ESPN is working on an interactive screen project, code-named 2016, that would let viewers simultaneously watch multiple ESPN channels or videos, send social media messages, buy products, watch commercials and summon statistics at the touch of a button.

"ESPN has no reason to have any fear as long as it keeps innovating," Mr. Shapiro said.

Yet ESPN does not appear to have a revolutionary advance that is capable of altering the industry the way the network did when it went on the air in September 1979.

Even as ESPN moves forward, the landscape it pioneered is rapidly changing. It recently announced cuts of up to 400 jobs, yet it will hire as needed, especially in growth areas. Although the revived à la carte legislation has an uphill battle to passage, it underscores a persistent concern with the rising costs of ESPN and other sports networks.

Beyond established cable rivals like NBCSN and CBS Sports Network, ESPN has a new and bold competitor in Fox Sports 1, which has a strong portfolio of rights. Mr. Skipper has made several early moves to strike back at Fox, hiring the political and sports statistician Nate Silver from The New York Times and bringing back Keith Olbermann to host a nightly show on ESPN2.

Meanwhile, companies like Google, Sony and Intel are planning virtual cable services that would be delivered on the Internet. They could lure consumers from traditional pay television as low-cost alternatives to traditional pay TV while also competing for major sports properties when ESPN's contracts eventually expire. Mr. Skipper said he would make deals with these upstarts, but only on ESPN's terms: they must take all of ESPN's offerings, not just the ones they want.

With the rise of new competition come questions about the fate of existing customers.

Consumers are fleeing pay TV at a quickening pace: 898,000 in the past year, nearly twice the number in the previous year, the analyst Craig Moffett said. And in the past two years, ESPN has lost more than one million subscribers.

What's more, ESPN ratings plunged 32 percent in the quarter that ended in June.

Mr. Skipper's task — very different from that of predecessors who built ESPN into a powerhouse — is to negotiate a deeply uncertain future.

"It's a high-class problem," he said.

Brad Adgate, senior vice president for research at Horizon Media, said the triple play of decreased cable customers, fewer ESPN subscribers and lower ratings was a "worrisome trend," but he suggested that ESPN was hurt in the last quarter by reduced interest in the N.B.A. playoffs. “This is not a perfect storm,” Mr. Adgate said. “A lot of big media companies are envious of the model Disney has. Every earnings report, ESPN is always there, a very solid part of their revenue.”

ESPN is relying on its built-in strengths: the dozens of sports and thousands of games on ESPN’s networks that are live and unavailable on other networks; the loyalty of viewers who grew up on ESPN and can hum the “SportsCenter” theme; the passion of fans who crowd every campus where “College GameDay” makes its Saturday morning stops; and the WatchESPN app, which lets more than 20 million users watch all its networks’ live action on mobile devices accessible only with pay-TV subscriptions. An app like WatchESPN is designed not only to keep people connected to ESPN but also to reduce cord-cutting by cable subscribers.

Mr. Skipper described WatchESPN as “a significant measure to preserve the current system. And if you can’t preserve it, it’s our best opportunity convert to something new.”

He added that while he could not imagine more than 10 percent of pay-TV subscribers cutting the cord, “big numbers don’t have to flee the system to have a profound effect on ESPN.”

His strategy is based on carrying live sports well into the next decade and beyond, thanks to Disney’s cash. Mr. Skipper has held onto the rights to the Rose, Orange and Sugar Bowls, then doubled down for the new college football playoff. He has retained control of “Monday Night Football” and Major League Baseball rights, extended SEC rights through 2034 and agreed to share Pacific-12 rights with Fox.

Rich Greenfield, a media analyst at BTIG Research, said ESPN should not be overly concerned because it is stocked with live sports in a video universe that considers it must-see content.

“The landscape has threats,” Mr. Greenfield said. But he added, “The value of sports is going dramatically, even exponentially, higher.” Even if the bundle breaks, he said, ESPN will be one of the very few companies “that will have established a relationship directly with consumers.”

Mr. Skipper, too, believes that ESPN has created a powerful defensive strategy out of live sports contracts that last a decade or two.

“We can’t stand by and say change is unlikely, but we’re taking the steps to preserve and adapt,” he said. “The ecosystem may change, but these unique events cannot be replicated anywhere else.”

Jo Craven McGinty contributed reporting.