2. Monopsony Power

A second, alternative explanation for the input price differences is variations in outcomes of bargaining between individual networks (or commonly owned network groups) and the various MVPDs. Just as operators of different delivery systems are likely to have different credit risks, it is also apparent that they have different degrees of bargaining—i.e., monopsony—power in the input market.[62] Less established services such as SMATV and MMDS can be expected to hold relatively little sway over cable networks since their retail distribution of those networks accounts for a relatively marginal share of those networks' profits. The larger MSOs, however, are able to threaten a given program supplier with the loss of a relatively large share of its potential revenues, and would thus be likely to negotiate more favorable programming price terms.[63]

The record of congressional testimony and comments to the FCC is consistent with the theory that programming price differences reflect differential bargaining power. Small cable operators, in fact, make essentially the same complaints about discriminatory pricing as do SMATV, MMDS, and HSD owners. In its 1989 Comments to the FCC, the National Cable Television Cooperative, a cooperative formed to secure programming in bulk for small cable operators, complained of the "lack of good terms" for cable network programming.[64] In its 1993 Comments to the Commission, the Community Cable Television Association (CATA), a trade association of mostly rural cable operators, complained to the FCC about unfair terms and practices from both integrated and nonintegrated cable networks.[65]

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recognizes the incentive these firms would have to coordinate input prices, the government's theory behind the decrees' prohibition of MFN price clauses is that even though all the participants were vertically integrated firms, a written document would be instrumental in coordinating the collusion. Obviously, such written documents have not been the rule in the cable industry.

62. In general, monopsony power means the power to force the price of an input (in this case a cable network) below competitive levels, and thus make excess profits. Monopsony is defined as "a market situation in which there is a single buyer for a given product or service from a large number of sellers." WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 1463 (3d ed. 1981).

63. Such a result follows from basic principles of bilateral bargaining theory. For a formal exposition, see David Waterman, Local Monopsony and Free Riders (1994) (paper prepared for presentation to the American Law and Economics Association Annual Convention, May 12-13, 1995, Berkeley, California).

64. *1990 FCC Cable Report*, *supra* note 3, para. 114(g).

65. Comments of the CATA to FCC in MM Dkt. No. 92-265, at 2 (Jan. 25, 1993).

> However, many of CATA's member operators, who tend to be smaller operators in rural areas, have found that certain of the practices of certain video program-

Although systematic data are unavailable, anecdotal evidence also suggests the presence of significant monopsony power of larger MSOs in the programming market. Drawing on press reports, for example, a 1988 NTIA report on the cable industry cited input price differentials larger than one would expect from transactions costs savings[66] for large versus small MSOs.[67] The trade and financial press has also reported several cable industry incidents in recent years, some of them brought out in congressional hearings, that might be explained by monopsony power.[68]

One could respond to the explanation that monopsony power determines input price differentials by arguing that the entry-retarding effect on emerging technologies of higher input prices is basically the same as that of foreclosure behavior. This distinction is important for purposes of this Article, however, because vertical integration has little to do with bilateral bargaining over input prices. The role of integration in this context is limited to providing contracting efficiencies, or possibly giving a program buyer that is integrated with one network a strategic advantage in negotiating with another.[69] The effect of these factors on input prices is obviously minor relative to the large differences reported here.

> ming suppliers, whether integrated or not, result in unfair competition or unfair or deceptive acts or practices, the effect of which has been to hinder significantly (and in some instances to prevent) cable television operators from providing satellite programming and satellite broadcast programming to their subscribers at reasonable cost.

Id.

66. For a variety of reasons, contracting between a buyer and seller is likely to be less expensive, less risky, or otherwise more efficient than is arms length contracting between unaffiliated parties. For a general analysis, see Oliver E. Williamson, *Vertical Integration of Production: Market Failure Considerations*, 61 AM. ECON. REV. 112 (1971).

67. Among specific examples cited by NTIA are a 2¢ per subscriber per month rate for CNN paid to MSOs with over 5 million subscribers compared to 29¢ for MSOs with under 500,000 subscribers. In addition, 90¢ per subscriber was paid for HBO by the largest MSO, TCI, Inc., compared to $5.00 paid by "small" MSOs. As NTIA points out, however, transaction economies are one factor determining these rates, or these may be incomplete descriptions of more complex pricing structures. *See* NTIA, *supra* note 49, at 80-82.

68. These have primarily involved the alleged use of threats by TCI against networks, including the Learning Channel, ESPN, shopping networks, and other program suppliers. *See* M. Ivey, *The King of Cable TV*, BUS. WEEK, Oct. 26, 1987, at 88, 88; Laura Landro, *Tele-Communications Sets Cable-TV Agenda*, WALL ST. J., Feb. 11, 1986, at A6; Johnnie L. Roberts, *How Giant TCI Uses Self-Dealing, Hardball to Dominate Market*, WALL ST. J., Jan. 27, 1992, at A1; *see also Hearings on Examining the Effects of Megamergers in the Telecommunications Industry*, 103rd Cong., 1st Sess. 177-80 (1993) (statement of Sen. Metzenbaum (D-Ohio)); 138 CONG. REC. S561, S579 (1992) (discussing the testimony of Roy M. Speer, Chairman and CEO of Home Shopping Network, Inc., given before the Senate on March 14, 1991). Several instances are discussed by Donna N. Lampert, *Cable Television: Does Leased Access Mean Least Access?*, 44 FED. COMM. L.J. 245 (1992).

69. *See* Riordan & Salant, *supra* note 42.

D. Summary

It is evident that vertical integration could facilitate foreclosure attempts involving program access that may occur in the cable industry. However, both integrated and nonintegrated cable program suppliers engage in the same range of potentially anticompetitive behavior involving exclusive dealing. Empirical evidence that program suppliers charge consistently higher input prices to alternative MVPDs appears unrelated to vertical integration. To the extent that cost factors are not responsible for these input price differences, they can be explained by variation in outcomes of the bilateral input price-setting process between program suppliers and MVPDs having varying degrees of monopsony power in the programming market.

IV. POLICY ANALYSIS

A. Overall Conclusions

There may be many questions about the wisdom of the FCC's program access regulations in general. The rules are bound to infringe, for example, on whatever efficiency benefits that exclusive dealing may bring. One can also cite administrative burdens on the FCC, and especially, one can question whether the FCC has the necessary expertise and information to make appropriate judgments in access cases.

In the long run, however, the nondiscriminatory access requirements should increase competition with established cable systems. If competition is effectively established, consumer prices should fall, and if alternative delivery systems sufficiently expand total consumer demand, the amount and the variety of programming should increase as well.[70]

The main point of this Article is that whatever the net benefit of program access regulations, one cannot make a reasonable case for separate treatment of vertically integrated and nonintegrated firms. Any program access requirements should apply equally to integrated and nonintegrated program suppliers.[71] If the FCC's program access regulations prove

70. The generally favorable response that cable program suppliers reportedly have had to the FCC's program-access provisions suggests that they have confidence in this model. *See, e.g.*, Rod Granger, *Distributors See Program-Access Rules as a Plus*, MULTICHANNEL NEWS, May 10, 1993, at 6A, 6A; Harry A. Jessell, *Biondi Sees Net Benefit in Cable Act*, BROADCASTING, Oct. 26, 1992, at 38, 38.

71. The Primestar settlements, particularly those at the state level, appear to overlap substantially with the FCC's nondiscriminatory program access requirements. The proposed settlements, however, apply only to the seven vertically integrated MSO defendants. At least

effective in constraining the behavior of vertically integrated program suppliers, then vertical divestiture—or in the case of an entering program service, avoidance of MSO affiliations—is likely to result.[72] If program access regulations are in fact desirable from a public policy perspective, then this divestiture would be the worst possible case. The effectiveness of the rules would be undermined, their enforcement would be arbitrarily unbalanced, and the benefits of vertical integration to programming innovation and financial support, extolled by the FCC,[73] would be diminished.

B. FCC Program Access Rulings to Date

At this writing, the volume of program access cases before the FCC has apparently been light. The Commission reported in September 1994 that twenty-one cases had come under consideration by that date, and that eleven of them had been ruled upon.[74]

Two of these eleven rulings are significant in indicating how the Commission intends to apply the Section 19-based regulations with respect to exclusive contracting. In one of these cases, Time Warner Cable was denied the right to withhold its vertically affiliated network, Court TV, from Liberty Cable Co., an MMDS operator competing with Time Warner cable franchises in the Manhattan area.[75] In the other case, New England Cable News (NECN), a regional news channel launched in 1992, was permitted to maintain exclusivity agreements with several cable operators for the next eighteen months, after which it would have to petition the FCC

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in the federal case they would affect only program suppliers that are controlled by means of a 50% or greater equity share held by one MSO or in common by more than one MSO. The state decrees require programming to be made available to other MVPDs on "reasonable" terms, while the Primestar agreement essentially only controls collusion among the MSOs or their controlled entities, involving one or more party. *See In re* Implementation of the Cable TV Consumer Protection and Competition Act of 1992, *Memorandum Opinion and Order on Reconsideration of the First Report and Order*, 76 Rad. Reg. 2d (P & F) 1177 (Dec. 23, 1994).

72. While the program access regulations could be a factor in the recent attempts by Paramount-Viacom to divest of its cable system interests, the need for cash to finance the merger is widely reported to be a primary motive. *See, e.g.*, John M. Higgins, *TCI Eyes Viacom Buy*, MULTICHANNEL NEWS, Apr. 4, 1994, at 1, 50.

73. *1990 FCC Cable Report*, *supra* note 3, paras. 82-86.

74. *1994 Cable First Report*, *supra* note 13, paras. 174-74.

75. *In re* Time Warner Cable Petition for Public Interest Determination under 47 C.F.R. § 76.1002(c)(4) Relating to Exclusive Distribution of Courtroom TV, *Memorandum Opinion and Order*, 9 FCC Rcd. 3221, para. 2 (1994) [hereinafter *Courtroom TV Memorandum*].

to continue the agreements.[76] NECN is half-owned by an MSO, Continental Cablevision.

In both rulings, the FCC made clear that its decision was intended to balance the benefits from encouraging competition by alternative MVPDs, with the benefits program exclusivity could have in encouraging entry and investment in new cable program services. In the Court TV instance, the Commission argued that the network was already well-established, so that the balance was in favor of encouraging alternative MVPDs.[77] In the NECN case, the Commission argued that the network was not established enough to ensure its survival, so that the balance was in favor of encouraging competition in program supply.[78] The Commission has thus taken a rather straightforward "infant firm" approach to program access, nurturing newer competitors upstream and downstream.

One can take issue with the source of the FCC's wisdom in deciding which cable firms are most in need of nurturing, either with respect to their financial stability or their potential benefits to subscribers. Under the circumstances, however, these rulings seem reasonable from the perspective of concerns with vertical ownership. Earlier in 1994, the trade press reported that some nascent local cable news channels were threatened by the program access regulations, with some entry plans stalled.[79] The article speculated that "third party packagers" were likely to take the place of MSO ownership due to the vertical integration language in the regulations.[80] By affirming the exclusivity provision in the NECN case, pressures toward ownership separation between MSOs and entering program suppliers are presumably reduced. It also seems reasonable that a relatively new program service is unlikely to be a good foreclosure weapon. Conversely, relatively established networks such as Court TV would probably be more effective foreclosure devices. As of September, the Commission had yet to make substantive rulings on any price discrimination cases or cases not involving vertically integrated programming suppliers.[81]

76. *In re* New England Cable News Petition for Pub. Interest Determination under 47 C.F.R. § 76.1002(c)(4) Relating to Exclusive Distribution of New England Cable News, *Memorandum Opinion and Order*, 9 FCC Rcd. 3231, para. 53 (1994) [hereinafter *New England Cable Memorandum*].

77. *Courtroom TV Memorandum*, *supra* note 75, para. 37.

78. *New England Cable Memorandum*, *supra* note 76, para. 36.

79. *See, e.g.*, Kim Mitchell, *Cable Act Fine Print Threatens News Channels; Cable Television Consumer Protection and Competition Act of 1992*, MULTICHANNEL NEWS, Mar. 28, 1994, at 14.

80. *Id.*

81. Three of the FCC's eleven program access rulings by September 1994 involved complaints of discriminatory pricing. Consumer Satellite Sys., Inc. v. Lifetime Television, 9 FCC Rcd. 3212 (1994); Mid-Atlantic Cable Serv. Co. v. Home Team Sports and

C. A Concluding Remark

The choice by Congress to impose specific program access regulations only on vertically integrated cable firms reflects a misunderstanding of industrial economics similar to that which has characterized antitrust decisions for several decades, though less so in recent years. This misperception is that vertical relationships are the fundamental source of anticompetitive behavior in industry.

Economic analysis has demonstrated that vertical integration is not necessarily benign, and the analysis of this Article suggests that the cable industry is probably no exception. The focus by Congress on the potentially anticompetitive effects of vertical relationships in cable, however, diverts attention from the more fundamental source of whatever excessive market power that may exist in this industry—horizontal market power at the MSO level. Without the bargaining power to induce program suppliers to grant explicit or tacit exclusivity agreements which might have foreclosure effects, or to force input prices to anticompetitively low levels, it is unlikely that cable operators could effectively use program access restraints to stop the entry of alternative MVPDs, with or without vertical integration. An individual local cable system may have bargaining leverage over local or regional program suppliers, whether that system is affiliated with a large MSO or not. Bargaining leverage over nationally distributed cable networks, however, is unlikely without control over a substantial proportion of all U.S. cable subscribers.

If effective competition for established cable systems successfully develops, most of the cable industry problems with which Congress has been concerned will disappear or diminish. The issue upon which policy-makers must focus in achieving that objective is not vertical integration, but the sources of market power at the MSO level.

Columbia Cable of Va., 9 FCC Rcd. 3991 (1994); Private Network Cable Sys. Co. v. SportsChannel N.Y., File No. CSR-4233-P (1994). All three cases, however, were privately settled and the complaints dismissed by the FCC.

Of the other eight rulings, one waived Walt Disney Co. from program access regulations in distributing to hotel pay-per-view systems. *In re* Petition of Walt Disney Co. for Waiver of Program Access Rules, *Memorandum Opinion and Order*, 9 FCC Rcd. 4007 (1994). The other seven were dismissed on procedural grounds or as a result of private settlements.

Table 1
Input Price Comparisons: Available Data from Public Documents

A. Sample Rate Comparisons Between Wireless Cable and Cable[1] *(cents per subscriber)*

	Top Wireless Rate	Top Cable Rate	Wireless Premium
CNN	$.50	$.28	78.6%
USA	.38	.23	65.2%
Nickelodeon	.35	.22	59.1%
MTV	.35	.22	59.1%
Nashville	.35	.20	75.0%
A&E	.15	.11	36.4%
Headline News	.50	.00	—

[1] Information obtained in the comments of the Wireless Cable Association.

Source: In re Competition, Rate Deregulation and the Commission's Policies Relating to the Provision of Cable TV Service, *Report*, 5 FCC Rcd. 4962, app. G, tbl. 11.

B. Rate Comparisons: Mid-Atlantic Communications' Cable Systems vs. SMATVs[1]

Programmer	SMATV	Cable System	SMATV Premium
HBO*	$6.25 per sub**	$4.00/mo. per sub[a]	56.2%
Cinemax*	6.50 per sub**	3.86/mo. per sub	94.5%
Nick*	0.29 per sub	0.17 per sub	70.5%
MTV*	0.29 per sub	0.17 per sub	70.5%
USA	0.18 per passing	0.18 per sub	not comparable
FNN	0.17 per sub	0.055 per sub	209%
HTS	1.50 per sub	0.75 per sub	100%
CNN*	0.33 per sub	0.25 per sub	32.0%
ESPN*	0.47 per sub	0.32 per sub	46.9%

[1] Information obtained from the comments of the National Satellite Programming Network, Inc., *et al.*
[a] Sub = subscriber
* Cable network has vertical relationship with a cable MSO.
** Sold by cable operator

Source: In re Competition, Rate Deregulation and the Commission's Policies Relating to the Provision of Cable TV Service, *Report*, 5 FCC Rcd. 4962, app. G, tbl. 12.

*C. Wireless Cable vs. MSO Prices***

Network Basic Services	*Wireless*	*MSO*
American Movie Classics *	$0.300	$0.136
Arts & Entertainment	$0.110	$0.070
Black Entertainment *	$0.060	$0.060
Family Channel *	$0.080	$0.040
CNN *	$0.360	$0.195
Discovery *	$0.185	$0.045
ESPN/NFL	$0.560	$0.260
Lifetime *	$0.140	$0.035
MTV *	$0.350	$0.050
Nashville	$0.200	$0.065
Nickelodeon *	$0.350	$0.100
The Weather Channel	$0.200	$0.036
USA	$0.380	$0.157
VH-1 *	$0.350	$0.000
WGN	$0.150	$0.030
WOR	$0.100	$0.030
WTBS *	$0.100	$0.010
Prime Ticket	N/A	$0.450
TNT *	N/A	$0.200
Premium Services		
HBO *	$5.080	$4.100
Cinemax *	N/A	$2.900
Showtime *	$5.050	$2.900
The Disney Channel	$4.000	$2.500

* Indicates presence of a vertical relationship with a cable operator.

** Prices "we believe to be charged by the largest cable MSOs," compared to "prices [for MSOs] supplied to us by the Wireless Cable Association."

Sources: Letter from George Remy, Chairman & Chief Executive Officer, *Cross County Cable*, to the Honorable Alfred C. Sikes, Chairman, *Federal Communications Commission* 4 (April 4, 1990) (on file with the *Federal Communications Commision).* Indications of a vertical ownership relationship are added by Author.