I. Introduction

In their paper, "Programming Access and Effective Competition in Cable Television,"[1] James Dertouzos and Steven S. Wildman (hereafter "DW") claim that there are sound theoretical reasons and empirical evidence for believing that complaints about program pricing and exclusivity by competitors of incumbent cable companies have merit. DW claim that entrants suffer from two handicaps: (1) they must pay higher prices than large incumbent cable operators for access to programming; and (2) large incumbents are able to deny entrants access to some programming either by acquiring exclusive licenses or by vertical integration.

DW further claim that the advantages that large cable operators enjoy are not grounded in superior efficiency and, therefore, are a barrier to effective competition in the supply of multichannel video services. DW conclude that the Federal Communications Commission's current program access protections are inadequate, and that the Commission's horizontal cable ownership restrictions and cable ownership attribution rules should not be relaxed without first addressing these concerns.

In this paper, we examine the evidence and analysis presented by DW. We conclude that this evidence and analysis do not provide a basis for the authors' conclusion that the current contractual arrangements between

[1] Filed in MM Docket No. 92-264/CS Docket No. 98-82 as Attachment 2 to the Comments of Ameritech New Media, Inc., August 14, 1998.

programmers and cable operators constitute a barrier to effective competition in multichannel video distribution. We conclude, further, that DW have provided no evidence to support their view that the cable ownership rules should not be relaxed. Indeed, DW present evidence that large cable operators carry more program services – including program services in which they have no ownership interests – and charge lower prices than do smaller operators. Thus, contrary to DW's claim, their evidence shows that consumers would benefit from an immediate relaxation of the Commission's cable ownership rules, to the extent that the current rules have restricted MSO size.

The remainder of this paper is divided into two main sections. Section II considers DW's discussion of the pricing of program services. Section III addresses DW's discussion of exclusivity arrangements.

In Section II, we explain why DW's estimates of the discount obtained by large cable MSOs are likely to be highly inaccurate. Next, we explain why DW's attempt to ascribe virtually the entire estimated difference to bargaining power on the part of large MSOs is defective, and then offer a large number of cost and efficiency-based explanations for this difference.

Section II also analyzes DW's claim that their evidence demonstrates that large MSOs carry their own vertically integrated program services "at the expense" of services offered by independent suppliers. In fact, we point out that DW's own evidence indicates that large MSOs carry more of both integrated and non-integrated services. DW's evidence also shows that consumers benefit from lower cable prices as a result of any reductions in the prices large MSOs obtain from program services, regardless of the reason for those lower prices.

Section II concludes by considering the implications of the rate differences estimated by DW. We distinguish between bargaining power, which affects only the distribution of returns between cable operators and program services, and monopsony power, which affects the amount and prices of programming available to consumers. We then explain why large cable operators are unlikely to exercise monopsony power, because it will adversely affect the supply of programming available to them, and why consumers can, and do, benefit from the exercise of bargaining power in the form of lower prices for cable service.

In Section III, we examine DW's claim that program exclusivity presents a barrier to entry to new Multichannel Video Program Distributors (MVPDs). We show that virtually all important program services are available to new entrants, and that negotiation between entrants and programmers, as well as the Commission's program access rules, have proved adequate to deal with any concerns about program exclusivity.

II. Program Service Prices

DW argue that current programming price arrangements constitute a barrier to competition. First, they attempt to quantify the differences between the fees paid by larger MSOs and those paid by smaller MVPDs – the latter being the rates they argue a new entrant would have to pay. Second, DW purport to show that differences in rates as large as those they have quantified could not be based on cost, but instead must primarily represent the exercise of bargaining power by the larger MSOs. DW conclude that the result is to create a barrier to entry to new MVPDs.

There are problems with each stage of DW's argument. The authors' interpretation of the data on price differences and their analysis of the possible sources of differences in pricing are seriously flawed. Moreover, even to the extent that pricing patterns may reflect the bargaining power of large operators, this is unlikely to create a barrier to increased competition in multichannel video distribution.

A. The Magnitude and Sources of Program Pricing Differences

DW claim to have presented information on the magnitude of programming price discounts provided to large MSOs and then to have shown, by process of elimination, that such differences cannot be attributed to sources other than the bargaining power of such large MSOs. The fundamental problems with DW's analysis are: (1) their measures of the differences in the rates actually paid by larger and smaller MSOs are highly questionable; and (2) they fail to consider a wide variety of other reasons, including cost and efficiency-based reasons, for the calculated rate differences.

1. Reported Rate Card Discounts

DW first provide a summary of information from the rate cards for six networks. For each of these networks, DW report the number of subscribers required to qualify for minimum and maximum discounts, the magnitude of the maximum discount, and the length of the contract.[2] On the basis of this information, DW purport to calculate the dollar cost disadvantage that an entrant receiving no discounts would face compared to an incumbent receiving the maximum discounts.[3]

It is very doubtful that the results of these calculations can be interpreted as reliable estimates or indicators of cost disadvantages faced by an entrant. First, rate card fees may differ substantially from the fees negotiated and actually paid by MSOs. Many MSOs – not only the very largest – pay negotiated fees that differ from rate card fees.[4] Indeed, DW never actually claim that the rate card rates are being paid by anyone, including Ameritech, qualifying their calculations by noting that they are based on the assumption that "the rate cards were strictly adhered to."[5] If entrants such as Ameritech can negotiate rates that are lower than those in the rate cards employed in their calculations, DW's estimate of the cost disadvantage faced by an entrant (or a small cable operator) could be overstated.

Second, DW's calculations are based on the rate cards for only six networks; there is no way of knowing how representative this sample is because these networks are not identified.[6] Indeed, even among the six networks for which DW provide information, there are substantial differences both with respect

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[2] DW, Table 1, p. 5.
[3] DW, Table 2, p. 6.
[4] DW acknowledge that rate card fees may not reflect transaction prices, but see below for a discussion of the alternative set of data on which the authors rely.
[5] DW, p. 6.
[6] DW, p. 5.

to the magnitude of the maximum discounts offered and the number of subscribers required to qualify for those discounts.

Third, the magnitude of the maximum discount and the numbers of subscribers required to qualify for some discounts — and in some cases for the maximum discount — can be quite modest. Rate cards for 2 of the 6 networks are reported to offer maximum discounts of only 2.7 and 7.4 percent. One network offers a discount to an MVPD with only 1,000 subscribers, and two networks offer discounts to an MVPD with only 100,000 subscribers.[7] These are very modest numbers of subscribers for an entrant to reach, particularly an entrant seeking to compete in metropolitan areas, and no fewer than 49 cable MSOs would qualify.[8] For two networks, even the maximum discount is available to an MVPD that reaches as few as 2 percent of all MVPD subscribers.

2. Comparison of Rate Cards and Average Fees

DW recognize that rate cards may not reflect actual fees paid by distributors for programming, so they present alternative calculations based on data for basic cable networks reported by Paul Kagan Associates, which the authors claim are "more realistic" estimates of the cost disadvantage faced by entrants. Their analysis of these data and the interpretations drawn from these analyses are, however, seriously flawed.

For each of 19 basic cable networks, DW report the difference between the "top of the rate card" fee for 1997 and the reported average license fee paid

[7] All three of these networks are among those reported to offer large discounts.
[8] *Broadcasting & Cable Yearbook 1998*, Top 50 MSOs, p. C-10 indicates that there are 49 MSOs with more than 100,000 subscribers.

in 1997. DW then assert that there are only three "candidate explanations" for these discounts: (1) volume discounts to give MSOs an incentive to offer the networks to more subscribers,[9] (2) differences in the cost of supplying different networks, and (3) bargaining leverage by large MSOs. In fact, there are many other possible reasons for differences between the top of the card rate and the average fee per subscriber – reasons that DW do not consider in their analysis.

First, DW fail to consider that the top of the rate card fee and the average fee do not represent fees offered or paid at the same point in time. DW compare the top of the rate card rate *in* 1997 with the reported average rate paid by MVPDs *during* 1997. However, the average rate is based on contracts, many of which were entered into in years prior to 1997. Because rates for most services have been rising,[10] and because program service contracts extend over several years,[11] the average rate paid in any year (other things equal) will be below the top of the rate card rate in that year *even if there were no discounts.*[12] Thus, DW are not correct when they claim that their estimates "almost certainly understate

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[9] DW assert (p. 10) that "giving price breaks to incent system operators to make a network available to more of their subscribers is not a plausible explanation for strictly volume based discounts…." Of course, a discount-based on the subscriber volume delivered by the MVPD is distinct from a discount-based upon the percentage of the MVPD's subscribers delivered. However, the average fees paid by cable operators on which DW's discount calculations are based depend on the entire fee structure of the contract, not simply on the volume-discount provisions. If MVPDs pay lower per-subscriber fees because they increase the percentage of their subscribers that receive a service, DW's calculation would incorrectly ascribe the reduction to a volume-based discount. This is simply one manifestation of the authors' failure to recognize that program service contracts contain a wide variety of provisions affecting the prices that MVPDs pay.

[10] The top of the rate card rates for 5 of the 19 services examined by DW increased by at least 100 percent, and the rates for 10 of the 19 services increased by at least 50 percent between 1992 and 1997.

[11] DW (Executive Summary, p. 6) report that five-year contracts are "fairly common."

[12] Technically, the moving average of an increasing series will always be lower than the last term in that series.

the magnitude of an entrant's programming cost handicap by a substantial amount."[13]

Second, when DW translate their estimated discounts into a dollar cost disadvantage for an entrant, they assume that an MSO with 100,000 subscribers pays the top rate.[14] However, that assumption is incorrect for three of the six services for which contract information is provided by DW, and may be incorrect for other services as well.

Third, the fees paid by cable operators and other MVPDs depend on a wide range of provisions in their contracts with program services. Terms that can have substantial effects on the fees actually paid, other than number of subscribers, include length of contract, tier and channel position commitments, limitations on removing the service from the operator's channel lineup, rollout commitments, amount and type of promotional or advertising services provided by a distributor, whether the program is purchased separately or as part of a package, timing of payments, date of purchase (particularly purchase at launch), and penetration guarantees. Without taking these, and other, differences into account, it simply is not possible to compare the prices paid by different operators, but DW's analysis neither recognizes nor controls for these differences.

Fourth, DW apparently believe that transaction cost differences are the *only* possible efficiency explanation for any observed difference in rates. Thus, when they report that they "calculated how costly MSO-network negotiations

[13] DW, p. 7.
[14] DW, p. 8.

would have to be to explain the differences…in per subscriber license fees paid by an entrant and an incumbent MSO receiving the average industry discount,"[15] DW's calculation assumes that transaction cost efficiencies must explain the *entire* estimated discount.[16] By omitting other possible sources of efficiencies, it is hardly surprising that they obtain a high estimate.

In addition, it should be observed that DW's estimate of the amount of transaction costs that would completely explain the estimated rate differences is highly sensitive to their use of 100,000 subscribers to characterize small MVPDs. Many MVPDs serve very few subscribers, and DW would have obtained far lower "breakeven" transaction cost estimates if they had employed a subscriber estimate that was more typical of small operators who arguably pay the top of the rate card rate. For any given estimated price difference, the breakeven transaction cost estimates fall with reductions in the number of subscribers served by the small MVPD. For example, DW's estimates would have been approximately one-tenth as large if they had performed their calculations assuming that small MVPDs had 10,000 instead of 100,000 subscribers.[17]

Finally, there are many possible reasons for charging lower fees to larger MSOs that are consistent with efficient market outcomes.[18] Indeed, the FCC has

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[15] DW, Executive Summary, p. 5. They are even more explicit when they claim (p. 11) that "negotiation cost savings [are] the only remaining cost-based alternative to the leverage due to size explanation for the price breaks networks give large MSOs."
[16] DW, p. 12.
[17] When the comparison is to very large systems, the estimated breakeven transaction cost is approximately equal to the rate difference multiplied by the size of the small system to which it is being compared. Thus, the estimate is roughly proportional to the size of the smaller system.
[18] For a more complete discussion, see S.M. Besen, S.R. Brenner, and J.R. Woodbury, "Exclusivity and Differential Pricing for Cable Program Services," January 25, 1993. There we observed (p. 11) that "Economies in selling and transaction costs provide one reason why it would be efficient for different distributors to pay different per-subscriber fees for the same

recognized that a variety of legitimate cost and non-cost reasons can justify why fees vary. Among the reasons that large MSOs may pay lower program fees (reasons that DW do not recognize) are the following:

- Program services sell advertising time, and the value to advertisers of the audience a network can deliver often will increase more than proportionately with the size of the audience. Larger MSOs deliver a greater increase in a network's national "reach" than do smaller MSOs. Such increases in national reach or penetration increase the value of carriage to a program service. As program services compete for carriage by larger MSOs, they will be willing to pay for this more valuable carriage by offering lower fees per subscriber.
- Larger MSOs may undertake more promotional activity on behalf of the programming services they carry, either because they are more likely to be able to insert the local, cross-promotional messages in their own programming or because advertising in other media is more efficient because of their greater concentration of subscribers. Larger MSOs may also engage in more promotion because they capture a larger proportion of the additional subscribers that the promotional activity makes possible.
- Carriage commitments by large MSOs may be particularly important when a service is first introduced. Large MSOs may provide a screening function by their decision to carry a new service. That decision by larger MSOs, who expend more resources to evaluate the likely success of a service, signals to other distributors that the service is worth carrying. This makes carriage by a large MSO attractive to the networks, and they are often prepared to offer lower fees at startup for MSOs that agree to carry the service. Those lower fees seem to persist to some extent over time, perhaps in recognition of the fact that the MSOs cannot be fully compensated for the *ex ante* risk of carrying an unproven network within the timeframe of a single contract, while still paying fees high enough to cover the cash flow requirements of a new network.

DW assert that there are only two cost-based reasons for program service discounts to large MSOs: differences in delivery costs and differences in transaction costs. After rejecting the delivery cost explanation, DW conclude that

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program service. This, however, is only one of many possible reasons why such pricing differences might exist and be efficient."

the transaction cost savings would have to be implausibly large to "explain" the discount. The inference they draw is that the discounts are primarily the consequence of bargaining power exercised by the larger MSOs. As we have seen above, however, there are many other legitimate reasons for the differences that DW estimate between top of the rate card and average fees per subscriber: differences in contract timing, in contract terms, and in the value to the programmer of carriage and services performed by the MSO. DW's conclusion that the estimated differences are due primarily to bargaining power on the part of large MSOs ignores all of these factors. [19]

B. Econometric Evidence of Bargaining Power

DW also present an econometric study that, they claim, "provides further evidence of the bargaining advantages of the largest MSOs."[20] We do not examine here the estimation procedures employed by DW but, even if one accepted their results at face value, they do not support DW's conclusion that "it would be unwise to consider relaxing horizontal ownership restrictions…."[21] In fact, their results support the opposite conclusion.

DW find that:

- "TCI and Time Warner carry more network programming of all types than do other cable system operators."[22] Specifically, after controlling for other factors such as channel capacity, homes passed, and the number of over-the-air channels carried, TCI and Time Warner

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[19] DW also mention, but then ignore, the explanation that discounts are used to give MSOs incentives to deliver programming to more of their subscribers – although they grant that at least one of the rate cards they examined would create precisely these incentives.
[20] DW, p. 18.
[21] DW, Executive Summary, p. 7.
[22] DW, p. 19.

systems on average carry more independent cable networks, more cable networks affiliated with TCI, more cable networks affiliated with Time Warner, and more cable networks in total.

- TCI systems charge 30 percent and Time Warner charges 17 percent less than smaller MSOs, other things equal.[23]

DW claim that such differences "may stem from the license fee discounts that can be observed in published rate cards,"[24] and that "[t]hese findings strongly suggest that TCI and Time Warner, and possibly other large MSOs, have exceeded a critical size threshold at which they are able to influence the market performance of their member systems."[25] However, carrying more services and charging lower prices can hardly be considered evidence of anticompetitive behavior. Moreover, even if DW were correct that these price differences are the result of bargaining power on the part of large MSOs, consumers clearly are the beneficiaries of this bargaining power.

Furthermore, nothing here constitutes evidence that differences in license fees charged various MSOs are due to the exercise of bargaining leverage. At most, DW's empirical results might indicate the *consequences* of lower fees for programming services, but not the reason for those lower rates. Nothing in these results is inconsistent with the interpretation that lower fees, even assuming those fees are the basis for DW's findings that larger MSOs carry more networks and charge lower prices, result from lower costs and other efficiencies in the distribution of programming services through larger MSOs.[26]

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[23] DW, p. 21.
[24] DW, p. 20.
[25] DW, p. 23.
[26] DW, p. 20, claim only that the observed differences "*may* stem from the license fee discounts that can be observed in published rate cards" (emphasis added).

Finally, DW claim that their empirical analysis indicates that "[l]arge MSOs' programming selections seem to be biased in favor of vertically integrated networks, which reduces the number of independent voices available to viewers."[27] Similarly, DW claim that TCI and Time Warner "favor their own networks at the expense of those provided by independent, non vertically integrated programmers."[28] However, the authors' own evidence clearly indicates that the increased carriage of vertically integrated services is *in addition to* and *not at the expense of* non-vertically integrated services. This evidence shows that TCI and Time Warner systems on average carry not only more networks in which they have ownership interests, but also *more independent networks* than do other systems, all things equal.[29] This result is inconsistent with DW's conclusion that favoritism by large MSOs reduces the number of independent voices available to viewers. Indeed, DW are forced to concede that "the largest MSO's subscribers appear to benefit from subscription fees that are lower than the industry average and a larger than average selection of channels."[30]

In short, DW have failed to make either a theoretical or an empirical case for the proposition that existing MSOs are too large. Instead, their evidence indicates that large cable operators, including TCI, give their subscribers more services at lower prices than do small operators.

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[27] DW, p. 24.
[28] DW, p. 22.
[29] For example, DW's results (p. 23) indicate that TCI tends to carry .8 more TCI-affiliated networks than do other MSOs and .5 more independent networks than other non-top ten MSOs. These results are broadly consistent with the results of our own analysis and those from other studies reported in S.M. Besen and J.R. Woodbury, "An Economic Analysis of the FCC's Cable Ownership Restrictions," August 14, 1998, pp. 18-21 and Appendix A.
[30] DW, p. 23.

C. Implications of Differences in Fees among Distributors

DW claim that: "[t]o the extent that these large price differences are not based on true cost differences or legitimate business incentives, they are discriminatory and a barrier to competition."[31] Indeed, this claim is at the heart of DW's position that current policies toward program access and pricing are inadequate.

In making this claim, DW fail to address two basic points. First, bargaining power in negotiations between two parties can affect the division of the gains that the parties realize from an agreement without affecting the efficiency with which resources are utilized. Thus, there is a basic distinction between bargaining power, which affects the distribution of the gains from a transaction, and market power, which affects the allocation of resources. As Dr. Wildman himself noted in an analysis (co-authored with Bruce Owen) of bargaining power that large MSOs may possess:

> Bargaining power is not the same as market power. Market power results in reduced output. Bargaining power merely shifts profits between seller and buyer. There is no basis for policy concern with bargaining power when it does not reduce output...there is little basis for concern that the buying power of MSOs significantly lessens competition.[32]

Second, consumers can and do benefit from the exercise of bargaining power. Economic theory indicates that if bargaining power has the effect of reducing per-subscriber program fees, at least a portion of lower input prices will be passed on to consumers, and this apparently occurs here.

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[31] DW, p. 10.
[32] B.M. Owen and S.S. Wildman, *Video Economics* (Cambridge, MA: Harvard University Press, 1992), pp. 244-245.

As the evidence presented by DW clearly shows, large cable operators not only charge lower prices but they also offer more services than do small operators. In this regard, it is notable that Waterman, whom DW cite for the proposition that "the license fee paid by a MSO for access to a network decreases as its share of industry subscribers rises,"[33] concludes that there are "opposing forces as a retailer coalition becomes larger – increasing power to exert monopsony power, *but decreasing incentives to do so*...."[34] Aggressive bargaining by a small cable operator may not have noticeable effects on the number or quality of program services available, but the same aggressive bargaining by larger MSOs may result in a decline in the number or quality of program services. If such a decline were to reduce the profitability of the larger MSOs by reducing the number or quality of the programming services available to them, large MSOs would bargain less aggressively than small ones.

Moreover, as Owen and Wildman observe in their analysis:

> A large MSO would notice that its action in paying too little for programs in hundreds of individual systems was having the effect of reducing the supply of programming, resulting in lower profits. The MSO, precisely because of its recognition of its own buying power, would find it profitable to expand the supply of programs. If the reduction in supply caused by the problem of local monopsony power were very substantial, the MSO's decision about its purchases would bring output closer to the efficient level than if no MSOs were permitted. In this case, MSOs would have monopsony power, but it would be exercised in

[33] DW, p. 18.
[34] D. Waterman, "Local monopsony and free riders," 8 *Information Economics and Policy* 337 (1996), p. 341, emphasis added.

> a benign way, making consumers better off than they would be if thousands of individual systems exercised buying power.[35]

Even if, or to the extent that, fees for program services are affected by bargaining power between distributors and services, it does not follow that the exercise of such bargaining power harms consumers. Indeed, if anything, the evidence presented by DW indicates that consumers benefit when large cable operators exercise bargaining power in their dealings with program services.

III. Exclusivity

DW claim that "there are strong theoretical reasons to expect that...incumbent MSOs will systematically find it profitable to outbid entrants for exclusive rights to popular networks..."[36] They also claim that "[w]hile exclusivity is sometimes viewed as a vehicle by which entrants can differentiate themselves from incumbents and win customers, exclusive rights *always* favor incumbents...."[37]

Arguably the most important currently exclusive programming, NFL Sunday Ticket, is not exclusive to incumbent cable operators but rather is exclusive to DirecTV, an entrant. Apparently DirecTV has found it worthwhile to acquire exclusive programming in order to differentiate itself from cable and to

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[35] Owen and Wildman, *op.cit.,* p. 243.
[36] DW, p. 26.
[37] DW, Executive Summary, p. 2, emphasis added. We should point out here that the empirical results presented in DW's Appendix C, which suggest that large incumbent cable operators have a higher probability of carrying at least one of the 30 regional sports networks than do either overbuilders or small incumbents, do not necessarily mean that these regional sports networks are exclusive to cable. Moreover, the results are likely to be sensitive to the particular locations of the cable systems, a factor that is not taken into account in DW's equation.

promote its more rapid entry. Thus, it is not true that exclusive rights "always" favor incumbents.

It should also be noted that almost no important programming is exclusive to cable. To demonstrate the latter point, we have examined the program lineups of Ameritech's cable systems. Ameritech carries 26 of the top 28 basic programming services for which Paul Kagan Associates provides ratings data — Nickelodeon, TBS, TNT, USA, Cartoon Network, A&E, Lifetime, ESPN, Discovery Channel, Family Channel, TNN, CNN, TLC, MTV, fX, History Channel, Sci-Fi Channel, Weather Channel, Comedy Central, E!, CMT, CNBC, Headline News, ESPN2, Prevue, and VH1 — on all its systems.[38]

Moreover, despite DW's claim to the contrary, negotiations between program services and cable operators have proved adequate to deal with most complaints about exclusivity. Regarding Comcast SportsNet, one of the services about which DW express concern, Sam Schroeder, Senior Vice President of Programming and Operations at Philadelphia Sports Media, L.P., indicates that Comcast SportsNet has been made available to a wide range of terrestrial distributors including "the local cable operators, the local satellite master antenna television ('SMATV') operators, a local open video systems ('OVS') operator and the local multichannel multipoint distribution system ('MMDS') distributor in the Greater Philadelphia area."[39] Schroeder also indicates that Comcast SportsNet "is available to all cable, SMATV, OVS and MMDS operators at the same per-

[38] Rankings by 1997 average total-day ratings are drawn from Paul Kagan Associates, *Economics of Basic Cable Networks 1998*, p. 38.
[39] Affidavit of Sam Schroeder, In the Matter of DirecTV, Inc. v. Comcast Corporation, Comcast-Spectacor, L.P. and Comcast SportsNet, CSR-5112-P, October 23, 1997, ¶ 5.

subscriber price or rate, depending on whether the operator is in the 'inner,' 'outer' or 'fringe' market."[40]

Ameritech was apparently concerned that it would not be able to renew its carriage agreement with Classic Sports Network (CSN) that expires on December 31, 1998 because CSN had signed exclusive distribution agreements with MediaOne, Time Warner, and Comcast.[41] However, all of these contracts have either been renegotiated or the cable operator has agreed to waive its right to distribute CSN exclusively.

DW's claim concerning CLTV, a local news channel owned by the Tribune Company, is especially misplaced. In 1994, the FCC granted New England Cable News (NECN) and NewsChannel the right to offer their programming exclusively to cable affiliates. In its ruling on NECN, the FCC stated that:

> NECN has demonstrated that the ability to offer exclusivity to cable affiliates is necessary to attract investment and secure distribution essential to the financial viability of its regional news programming service.[42]

In its ruling on NewsChannel, the FCC concluded that:

> NewsChannel has demonstrated that the proposed exclusive agreement provides an additional incentive to other cable operators to carry the service, thus ensuring financial viability. We also find that the ability to offer exclusivity will ensure continued investment in and rollout of the NewsChannel service, thereby promoting the diversity of programming available to subscribers in the video programming

[40] *Id.*
[41] "MediaOne Ends Fight Over Classic Sports," *Multichannel News*, August 20, 1998; and Ted Hearn, "Time Warner Yields on Access Complaint," *Multichannel News*, July 6, 1998.
[42] Federal Communications Commission's Memorandum Opinion and Order, In the Matter of New England Cable News Petition for Public Interest Determination Under 47 C.F.R. 7 6.1002(c)(4) Relating to Exclusive Distribution of New England Cable News, CSR-4190-P, Released June 1, 1994, ¶ 52.

> market. Moreover, NewsChannel has shown that the limited exclusivity will not have a significant limiting effect on the development of facilities-based competition in the mid-Atlantic distribution market.[43]

In short, CLTV is precisely the type of service for which the FCC has previously found that exclusivity is in the public interest.

More generally, exclusivity can benefit consumers if it leads to an increase in the number of program services that are offered by increasing the profits earned by programmers.[44] Among ways in which this could occur are the following:

- Increases in program service revenue obtained through distribution via multiple outlets may be offset by the cost increases from negotiating agreements with more than one distributor. Thus, a programmer could grant exclusivity to reduce transaction costs. Some of the savings might then be used to improve the quality of the service or to increase the number of services offered.

- A distributor may find it more profitable to pay to differentiate itself by carrying programming that is different from that of its rivals, as is apparently the case for DirecTV's exclusive carriage of NFL Sunday Ticket. The revenues earned by a distributor with an exclusive contract with a program service may be greater than the sum of the revenues earned by multiple distributors of the service.

- Exclusivity can also reduce the risk borne by a distributor when it carries a service and therefore may make it more willing to carry the service. When the same program service is carried by competing distributors, the subscribers that each will attract may be more difficult to estimate with precision than if only a single distributor offered the service. If distributors are averse to bearing more risk, the increased uncertainty from non-exclusive distribution will reduce the fee they are willing to pay the program service.

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[43] Federal Communications Commission's Memorandum Opinion and Order, In the Matter of NewsChannel, A Division of Lenfest Programming Services, Inc., Petition for Public Interest Determination Under 47 C.F.R. 7 6.1002(c)(4) Relating to Exclusive Distribution of NewsChannel, CSR-4295-P, Released December 16, 1994, ¶ 36.

[44] For a more complete discussion see Besen, Brenner, and Woodbury, *op. cit.*, pp. 30-39.

- Exclusivity can also be used by program services to encourage distributors to promote their services more intensively, since exclusivity avoids free riding on promotional activity by other distributors. If multiple distributors in the same area carry a program service, some of the promotional benefits of each may benefit the other. Because each distributor cannot capture the full benefits of its promotional efforts, the incentive of each to undertake those efforts may be reduced below that which would exist if there were a single distributor. As a result, individual distributors will fail to undertake some efforts whose total value exceeds their costs and the program service will not be as profitable as would be the case if exclusivity had been granted to one of the distributors.

If exclusivity either raises the revenues, or reduces the costs, of program services, more services are likely to be created.[45] As Owen and Wildman observe, " because exclusivity may actually enhance the supply of program services, it would be difficult to justify a ban on such arrangements."[46]

Finally, TCI notes in its Reply Comments in this proceeding that it has voluntarily relinquished its exclusivity protection for Chicagoland and fX. In many other cases, entrants who have sought access to programming have successfully invoked the Commission's program access rules. To date, 41 program access complaints have been filed with the FCC (data obtained via LEXIS). Of these, 8 have been decided against the defendant, 4 were denied, 2 were withdrawn, 3 were dismissed as moot, 19 were settled, and 5 are pending. Indeed, Americast itself successfully invoked the Commission's program access procedures this year to obtain access to fX, one of the services about which DW express concern.

[45] We do not mean to suggest that exclusivity will always, or even usually, be the preferred form of distribution. For an explanation of why program services will often *not* choose exclusivity see Besen, Brenner, and Woodbury, *ibid.*, pp. 28-30.
[46] Owen and Wildman, *op. cit.*, p. 220.

IV. Conclusion

In short, the alleged inadequacy of the Commission's program access rules can hardly provide a justification for the Commission to delay a reassessment and relaxation of its cable ownership rules. The discounts granted to large cable operators are likely based on either the cost savings associated with providing a service to a large MSO or from superior bargaining power that does not adversely affect either the number or quality of program services available. Indeed, given the superior performance of large cable operators with respect to programming and prices that DW themselves report, consumers would clearly benefit if the rules were immediately relaxed to the extent that the current rules have artificially constrained the size of cable operators.

Moreover, there are few services that are available to cable but not to cable overbuilders or other competing MVPDs. If anything, the limited extent of permissible program exclusivity — which is to say, virtually none currently for cable operators — likely harms the development and growth of new and existing services. In any event, the Commission's program access rules appear to have been sufficient to ensure that MVPDs have access to virtually the entire array of program services available to cable MSOs.

B

A RESPONSE TO AMERITECH NEW MEDIA'S ALLEGATIONS OF A "PRICE SQUEEZE" BY VERTICALLY INTEGRATED CABLE OPERATORS

Stanley M. Besen and John R. Woodbury
Charles River Associates Incorporated

September 3, 1998

We have been asked by TCI to briefly consider allegations by Ameritech New Media (hereafter "Ameritech") that a vertically integrated cable operator could accomplish a "price squeeze" by raising the price of its program services both to its own cable systems and to the rivals of those systems, the effect of which would be to diminish competition between it and these rivals.[1] According to Ameritech the vertically integrated operator would regard the higher program service price as an internal transfer, while the rival would regard it as an increase in the cost of providing cable service. As a result, the rival would be forced to raise the price or reduce the quality of its service, providing the incumbent cable operator with an artificial competitive advantage. In fact, current integrated cable operators are unlikely to have either the ability or the incentive to disadvantage rivals in this way, a situation that can be expected to persist if the FCC relaxes the horizontal ownership limits and attribution rules.

With respect to the ability of vertically integrated cable operators to raise prices, it must be recognized that the supply of program services is unconcentrated. Thus, a price increase by one or a few program services owned by any single cable operator would not significantly disadvantage a rival because good substitute program services are typically available to the rival. Less constraining attribution rules are unlikely to have much if any effect on the concentration of program service ownership, or on the availability of substitute services.

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[1] Comments of Ameritech New Media, Inc., Filed in MM Docket No. 92-264 and CS Docket No. 98-82 (August 14, 1998), pp. 23-24.

With respect to incentives, even if a vertically integrated cable operator has the ability to disadvantage its rivals, that disadvantage—and therefore the resulting gains to the operator— is likely to be small. This is because disadvantaged rivals will be able to choose from the substantial number of substitute services that are not affiliated with the MSO employing the price squeeze.

Further, any gains experienced by the MSO must be offset by the losses that will accompany a price-squeeze strategy, losses that make such a squeeze even more improbable. For example, as a result of the FCC's non-discrimination rules, a vertically integrated cable operator would be required to sell its program services to all distributors at the higher price, whether or not these distributors compete with the vertically integrated cable operator. As the out-of-market distributors reduce their purchases of the higher-priced program services, the profits earned by the vertically integrated cable operator from the sale of programming will fall. This loss must be weighed against whatever gains in profits are realized at the cable system level as a result of the diminished competition. Any significant constraint on MSO size (such as that proposed by TCI in this proceeding) guarantees that the out-of-market losses from the strategy will be substantial.

Moreover, most program services affiliated with an MSO are not wholly owned by the MSO. Out of the 75 programming services whose ownership is reported by Paul Kagan Associates, only 12 are wholly owned by a single MSO.[2]

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[2] Paul Kagan Associates, *Economics of Basic Cable Networks 1998*, pp. 54-56; and Paul Kagan Associates, *Cable TV Programming*, October 31, 1997, pp. 3-4.