

January 20, 2016

Marlene H. Dortch
Secretary
Federal Communications Commission
445 Twelfth Street SW
Washington, DC 20554

Re: Media Bureau Request for Comment on DSTAC Report, MB Docket No. 15-64

Dear Ms. Dortch:

As Public Knowledge and other advocates have explained to the Commission in many recent filings,¹ the uncompetitive video set-top market harms consumers in a number of ways. An analysis prepared by the Consumer Federation of America provides concrete evidence of the most egregious harm to consumers: billions of dollars of overcharges. By this estimate, subscribers are overpaying between \$6 and \$14 billion annually.

The pay TV industry collects around \$20 billion in box rental fees per year,² a large enough sum to explain the industry opposition to reform in this area. While that number by itself is enough to demonstrate that something is amiss in the set-top box market, it is possible to more precisely quantify the scale of the set-top box rip-off, as the attached analysis shows.

With the Cable Consumer Protection Act of 1992, Congress directed the Commission to directly regulate cable rates (including equipment rates). Under the Act, the rates for set-top boxes and remote controls were to be reasonable and based on actual costs, and consumers paid (on average) about \$2.60 per month.³ With the 1996 Telecommunications Act, Congress changed its approach, and decided to remedy cable consumer harms primarily through marketplace reforms and competition. Competition is indeed preferable to direct rate regulation when it is possible—and when it works.

But the numbers show that the reforms of the 1996 Act were insufficient to prevent pricing abuse by cable companies. Rates went through the roof. The dramatic increase in rates afflicted all aspects of cable service, including set-top boxes. Today, the average charge for a set

¹ *E.g.*, Letter from Common Cause, Demand Progress, Free Press, Fight for the Future, National Hispanic Media Coalition, New America's Open Technology Institute, and Public Knowledge, MB Docket 15-64 (January 19, 2016); Letter from Consumer Video Choice Coalition, MB Docket 15-64 (December 18, 2015).

² Markey, Blumenthal Decry Lack of Choice, Competition in Pay-TV Video Box Marketplace, July 30, 2015, <http://www.markey.senate.gov/news/press-releases/markey-blumenthal-decry-lack-of-choice-competition-in-pay-tv-video-box-marketplace> (Markey/Blumenthal Statement).

³ Regulated systems in the top 25 markets were charging \$2.48 in equipment per month, per the chart on page 11 of FCC document DA 94-767. All systems in the top 25 markets were charging \$2.59 per the chart on page 12. We use \$2.60 as a conservative estimate.

top box is \$7.43 per month,⁴ an increase of 185% since 1994. This is over three times the increase in the Consumer Price Index (CPI) over that same period, as shown in the attachment.⁵

Set-top boxes today, of course, are more capable than the boxes of 1994. But this is true of all areas of consumer electronics. Indeed, computers, televisions, and mobile phones have gotten better to a greater degree than set-top boxes, and more quickly. But as the attachment indicates, the cost of these devices has not gone up since the 1990s. In fact, it has gone down by over 90%.⁶

This is the expected result in a highly competitive, dynamic technology market. It is simply not credible to argue that the cost of set-top-boxes should behave so differently than other similar and types of complementary customer premise equipment (CPE). The best explanation of the set-top box market's exceptional ability to impose excess charges on consumers is its immunity to market forces and the failure of competition, both in pay TV more generally and in the set-top box market specifically.

The aggregate magnitude of the abuse depends on the extent of the mark-up of prices over costs and the size of the market. As the attached analysis shows, a low estimate assumes that costs increased at the rate of inflation and a market limited to cable subscribers (about 53 million).⁷ The resulting overcharge is \$6 billion per year. A high estimate assumes costs declining as they did in cellular/PC markets and a large market include all wireline MVPD subscribers (65 million). The resulting overcharge is \$14 billion.

An overcharge of \$14 billion in a market of \$20 billion may seem extreme, but a cost increase of 185% in a market where costs and prices would be falling, but for the lack of competition, is also quite extreme. Today, consumers can buy a mobile phone for \$100 that has a vast array of functionalities compared to cell phone in 1994, which cost almost \$1,000.

If the Commission reforms the set-top box market by implementing the virtual head-end proposal, it will help many consumers save substantially. Assuming that the average cost to consumers returns to 1994 levels, this reform could represent between \$6 and \$14 billion dollars in savings annually to the American public. This is in addition to the other benefits the virtual

⁴ Markey/Blumenthal Statement.

⁵ 2015: Inflation from FCC, 2014, *Report On Cable Industry Prices*, MM Docket No. 92-266, p. 10.

⁶ Cell Phone: 1994: \$950 (average of 1993 and 1995) from <http://www.gottabemobile.com/2011/12/28/history-of-cellphones-shrinking-sizes-and-prices-infographic>; 2015: \$100 (widely available from "Smartphones connect users with many of the functions of a laptop computer", <http://electronics.costhelper.com/smartphone.html>); Set top Box, 1994: \$2.60 (FCC, DA94-767); Computers and TV's from the Consumer Price Index).

⁷ Craig Moffett, *U.S. Cable & Satellite: A Funny Thing Happened on the Way to the Graveyard*, Exhibit 5, Moffet/Nathanson, January 13, 2016, estimate cable subscribers at just over 53 million, and telco video subscribers at just over 11 million.

head-end proposal would bring, such as increasing viewer's access to diverse and independent online programming, and giving them access to more intuitive and capable devices that compete by offering features that consumers want, rather than features that match incumbent MVPD's business model.

The cost savings to consumers, in addition to the boosts to independent and diverse programming and innovation, provide a strong impetus for the Commission to finally achieve the goals of Section 629 of Communications Act. For these reasons, Public Knowledge and the Consumer Federation of America urge the Commission to quickly begin a rulemaking proceeding implementing the virtual head-end proposal found in this docket.

Respectfully submitted,
/s Mark Cooper
Director of Research
CONSUMER FEDERATION OF AMERICA

/s John Bergmayer
Senior Staff Attorney
PUBLIC KNOWLEDGE

cc:

| | |
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| Brendan Murray | Nancy Murphy |
| Scott Jordan | David Waterman |
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ATTACHMENT A:

**FIGURE 1: THE CONSUMER PRICE OF CUSTOMER PREMISE EQUIPMENT (CPE):
SET TOP BOXES COMPARED TO OTHER ELECTRONIC CPE**

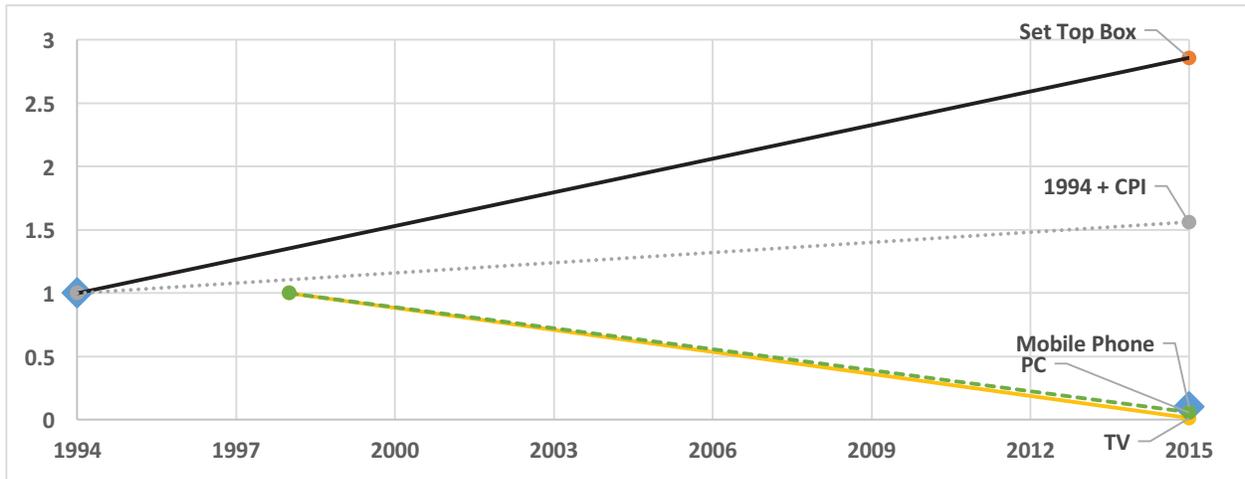


TABLE 1: CALCULATING THE ANNUAL EXCESS COST ON CONSUMERS

| | <i>Overcharge per household</i> | | | | <i>Total Annual Overcharge</i> | |
|-----------------------------|---------------------------------|-----------------|----------------|-------------------|--------------------------------|------------------------|
| | Cost | Monthly per box | Annual per box | Annual, 2.5 boxes | 53 million subscribers | 65 million subscribers |
| 1994 + CPI | \$4.10 | \$3.34 | \$40.10 | \$100 | \$6.0 billion | \$6.5 billion |
| 1994 Flat | \$2.60 | \$4.84 | \$58.70 | \$147 | \$7.8 billion | \$9.6 billion |
| Highest of other CPE | \$0.31 | \$7.13 | \$85.60 | \$214 | \$11.3 billion | \$13.9 billion |

Sources and Notes

Markey, Blumenthal Decry Lack of Choice, Competition in Pay-TV Video Box Marketplace, July 30, 2015, <http://www.markey.senate.gov/news/press-releases/markey-blumenthal-decry-lack-of-choice-competition-in-pay-tv-video-box-marketplace>

Craig Moffett, *U.S. Cable & Satellite: A Funny Thing Happened on the Way to the Graveyard*, Exhibit 5, Moffet/Nathanson, January 13, 2016, estimates cable subscribers at just over 53 million, telco video subscribers at just over 11 million.

Cell Phone Prices

1994: \$950 (average of 1993 and 1995) from <http://www.gottabemobile.com/2011/12/28/history-of-cellphones-shrinking-sizes-and-prices-infographic/>

2015: \$100 (widely available from “Smartphones connect users with many of the functions of a laptop computer”, <http://electronics.costhelper.com/smartphone.html>)

Set top Box Prices

1994: \$2.60. Report on the Cable Service Bureau's Survey on the Rate Impact of the Federal Communications Commission's Revised Rate Regulations, July 14, 1994, DA 94-767.

2015: \$7.43 Markey, Blumenthal Decry Lack of Choice, Competition in Pay-TV Video Box Marketplace, July 30, 2015, <http://www.markey.senate.gov/news/press-releases/markey-blumenthal-decry-lack-of-choice-competition-in-pay-tv-video-box-marketplace>

Inflation from FCC, Report On Cable Industry Prices, MM Docket No. 92-266 (2014), at 10. Other Electronic CPE from Consumer Price Index.