Before the
Federal Communications Commission
Washington, D.C. 20554

Inquiry Concerning A La Carte,	)	
Themed Tier Programming and Pricing	)	MB Docket No. 04-207
Options for Programming Distribution on	)	
Cable Television and Direct Broadcast	)	
Satellite Systems	)	
	)	
To: The Commission	)	

COMMENTS

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SUMMARY

This proceeding provides an unprecedented opportunity for the Commission to gain deep insight into the current state of wholesale and retail distribution of satellite programming. This information will help lawmakers better understand how developments in the wholesale programming market affect the important policy concerns of consumer choice, localism, and cost.

ACA speaks here for over 1,000 cable companies. Each company must purchase most of their satellite programming wholesale from five media conglomerates, referred to here as the "Big Five." In dealing with the Big Five, all ACA members face contractual restrictions that eliminate flexibility in how local cable systems can package and distribute programming. ACA members have intimate knowledge of the wholesale practices of the Big Five and how those practices restrict choice and increase costs in smaller markets.

The core problems – distribution restrictions imposed by media conglomerates and non-cost-based price discrimination. For nearly all of the 50 most widely distributed channels, the Big Five contractually obligate ACA members to distribute the programming to all basic or expanded basic customers. Contracts also mandate carriage of less desirable channels. These restrictions prohibit ACA members from offering more customized tiers and channel offerings. Retransmission consent provides another means to impose additional channel carriage obligations. As a result, nearly all customers must purchase basic or expanded basic packages filled with channels owned by the Big Five.

Price discrimination against smaller cable companies makes matters worse. The wholesale price differentials have little to do with differences in cost, and much to do with disparities in market power. In this way, smaller cable systems and their customers subsidize the programming costs of larger distributors, including DirecTV and Echostar, the main competitors to rural cable systems.

Solutions – Allow flexibility for smaller cable companies to package channels for local markets and eliminate non-cost-based wholesale price discrimination. Two changes to current wholesale programming practices would help ACA members provide their customers with more choice and better value:

- allow smaller cable companies more flexibility to tailor channel packages for local markets; and
- eliminate non-cost-based price discrimination against smaller cable operators.

With more flexibility, ACA members could offer a variety of options to their customers, including sports tiers, contemporary adult tiers, children's tiers, and a la carte access to a few of the highest cost channels. With less wholesale price discrimination, ACA members could offer their customers better value and stop subsidizing programming costs of large distributors.

These two changes would go far in addressing the concerns of Congress, consumer interests, and many of the eight million customers served by ACA members.

Pure a la carte is not the answer. For ACA members, these changes do not mean a regulated a la carte regime. Current technology costs make pure a la carte a financial impossibility for ACA member systems. Moreover, ACA members report that most customers prefer a basic or expanded basic package containing a variety of channels at a reasonable price.

Summary of responses to questions. These comments respond to 21 questions raised in this proceeding. Brief summaries of key responses follow.

Nondisclosure provisions and fear of retaliation. Most programming contracts are subject to strict nondisclosure obligations. ACA members are very concerned about retaliation by certain Big Five programmers. As a result, some of our responses are generalized. The Commission should obtain specific programming contracts and rate information directly from programmers. The programmers should agree to waive nondisclosure for purposes of this proceeding. If not, the Commission should use its Section 403 authority.

Historical matters.

ACA Response 1 describes how media conglomerates condition access to popular programming on a range of distribution obligations and additional carriage requirements. These restrictions and obligations eliminate flexibility to offer more customized channel packages in local markets.

ACA Response 2 describes several specific solutions. These include:

Marketplace solutions. ACA members would prefer mutually beneficial carriage arrangements with programmers. For this to occur, certain media conglomerates would need to temper economic self-interest with a heightened concern for the public interest in localism, consumer choice, and reasonable cable rates. For example, owners of high cost sports channels could agree to allow small cable companies to offer the channels on a sports tier. Some ACA members would like to try this in some markets; others not. Because of the diversity and size of the small cable sector, it provides an ideal laboratory for experimenting with different wholesale and retail approaches to program packaging.

Proposals for legislative action. Absent a marketplace solution, legislative action in at least three areas would remove several limitations on smaller cable companies' inability to tailor program offerings to local markets.

> **Changes to retransmission consent laws.** These include: (i) establish a streamlined procedure for resolving retransmission consent disputes; (ii) prohibit broadcasters from withholding access to a local broadcast signal pending resolution of a retransmission consent dispute; (iii) make the good faith negotiation obligation permanent, and direct the Commission to review and supplement periodically the good faith negotiation regulations; and (iv) prohibit network owners from restricting an affiliate's ability to grant retransmission consent.

> **Changes to program access laws.** These include: (i) make all programmers subject to the program access laws; (ii) expressly include as a prohibited practice non-cost-based price discrimination; (iii) require programmers to disclose regularly to the Commission the prices, terms and conditions of all wholesale programming arrangements to facilitate compliance; and (iv) require the

Commission to report periodically to Congress the status of prices, competition, and diversity in the wholesale programming market.

Changes to antitrust laws. Amend the Clayton Act and the Robinson-Patman Act to bring "satellite and broadcast programming" expressly within the scope of the statutes.

Proposals for regulatory action. Within the Commission's current authority, action in two areas will help address some of the public interest harms resulting from current exploitation of retransmission consent by certain network owners and major affiliate groups. These are: (i) enforce Section 310(d) to prevent unauthorized transfers of control of retransmission consent rights; and (ii) amend the outdated broadcast market protection regulations known as network nonduplication and syndicated exclusivity.

Other changes – Proposals of Mediacom Communications Corporation ("Mediacom"). The Commission should also consider in this proceeding the proposals offered by Mediacom last year in the media ownership proceeding.[1] ACA supports Commission consideration of these thoughtful proposals and asks the Commission to include them in its report from this proceeding.

Rates.

This proceeding seeks information on the impact on wholesale and retail rates if programmers allowed cable operators more flexibility in offering programming in local markets. For ACA members, there is only one legitimate answer to these questions: <u>It depends</u>. Several variables will come into play, most importantly, the market power and pricing practices of the program owner.

Many ACA members report they would like to move high cost sports channels to a tier. ACA Response 3 contains a Sports Tier example that shows how this could lower rates for some consumers, increase rates for other consumers, and how

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[1] *In the Matter of 2002 Biennial Regulatory Review, Review of the Commission's Broadcast Ownership Rules and Other Rules Adopted Pursuant to Section 202 of the Telecommunications Act of 1996,* MB Docket 02-277, Reply Comments of Mediacom Communications Corporation (filed February 4, 2003) ("Mediacom Media Ownership Reply") at 83-84.

programmers could choose to price the channels to generate the same license fee revenue as currently. The key difference – consumers would have more choice.

The same analysis applies to other types of services that some ACA members would like to move off the expanded basic tier – certain music video channels and "racier" entertainment channels – those that contain profanity, partial nudity and sexually suggestive content. In some markets, pervasive concern exists about this content on basic or expanded basic. The ability to tier these services would allow ACA members the flexibility to address this concern.

Retransmission consent.

In answering retransmission consent questions, the Commission can draw on its extensive experience and detailed records developed in other proceedings. The record here should incorporate retransmission consent filings and orders from other proceedings.

ACA Response 7 describes how network owners and major affiliate groups have used retransmission consent to obtain carriage of affiliated programming on smaller cable systems. In this way, network owners have turned retransmission consent into another means to force affiliated programming on smaller cable companies' basic or expanded basic tiers. ACA Response 8 describes how this conduct has increased upward pressure on basic and expanded basic rates. ACA Response 9 describes how the media conglomerates that control networks and broadcast licenses are exploiting current laws and regulations to reduce choice and increase costs for consumers.

Programming diversity.

ACA Response 10 describes how the programming practices of certain Big Five members have hurt program diversity. The main problem: requirements to carry Big Five programming on basic or expanded basic eliminate "shelf space" where the cable operator could offer independent programming. We provide specific examples where ACA member systems have been unable to launch or continue to carry independent channels like the Outdoor Channel, religious channels, and Spanish language programming.

Rural and smaller markets.

ACA Response 11 describes wholesale price differentials between smaller companies and major MSOs up to 30%, and in one case, 55%.

Legal and regulatory matters.

Based in large degree on Commission precedent, ACA Response 19 describes the legal and policy concerns raised by the current programming and retransmission consent practices of the media conglomerates. The Commission's analysis and conclusions in the *News Corp. Order* [2] persuasively establish the market power wielded by owners of "must have" satellite programming and broadcast channels, and how that market power can be used to harm competition and consumers. That analysis applies with equal force to other media conglomerates besides News Corp. In addition, the Commission orders implementing retransmission consent provide ample foundation to show how current retransmission consent practices conflict with the intent of the retransmission consent laws.

ACA Response 20 describes the legal and constitutional foundation for Congress to impose content neutral regulation on wholesale programming transactions. The program access laws provide the model and the vehicle, and those laws have withstood First Amendment scrutiny. This proceeding provides the Commission with a key opportunity to help develop a record of the important government interests that are being harmed by current programming practices.

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[2] *In the Matter of General Motors Corporation and Hughes Electronic Corporation, Transferors and The News Corporation Limited, Transferee, For Authority to Transfer Control*, MB Docket No. 03-124, Memorandum Opinion and Order (rel. January 14, 2004) ("*News Corp. Order*").

Other matters.

ACA Response 21 provides information concerning the cost to transform a small cable system into an a la carte platform. Current technology costs make this a financial impossibility.

ACA appreciates the Commission undertaking this important inquiry and will make all its resources available to assist.

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Inquiry Concerning A La Carte, Themed Tier Programming and Pricing Options for Programming Distribution on Cable Television and Direct Broadcast Satellite Systems	)	MB Docket No. 04-207
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COMMENTS

American Cable Association

I. INTRODUCTION

This proceeding provides an unprecedented opportunity for the Commission to gain deep insight into the current state of wholesale and retail distribution of satellite and broadcast programming. As requested by leading members of the House Commerce Committee,[3] this information will help lawmakers better understand how developments in the wholesale programming market affect the important policy concerns of consumer choice, localism, and cost.

From within the cable television industry, ACA brings a different perspective to this inquiry. ACA represents over 1,000 cable companies. This constituency includes an incredible variety of businesses – family-owned systems serving small towns and villages with less than 100 customers, regional multiple system operators serving more than 100,000 customers, the nation's eighth largest cable company, Mediacom

[3] Letter from Congressmen Barton, Dingell, Upton, Markey, and Deal of the Committee on Energy and Commerce, to Chairman Michael K. Powell (May 18, 2004).

Communications Corporation, and hundreds of companies in between. All of these diverse companies share four characteristics important here:

- None of the companies is affiliated with any of the top satellite programming services.

- Each company must purchase most of their satellite programming wholesale from five media conglomerates, referred to here as the "Big Five."[4]

- In dealing with the Big Five, all ACA members face wholesale programming cost increases well above the rate of inflation, especially for sports channels.

- In dealing with the Big Five, all ACA members face contractual restrictions that eliminate flexibility in how local cable systems can package and distribute programming.

As a result, ACA members have intimate knowledge of how the wholesale practices of the Big Five affect retail distribution.

Nearly all ACA members focus on serving smaller markets and rural areas. Many company owners or managers live in the same areas they serve and have daily contact with local consumers. From this contact comes direct knowledge of what their customers want. In many cases, the wholesale programming practices of certain members of the Big Five prevent ACA members doing just that – providing what local customers want.

For these reasons, ACA is well positioned to assist the Commission with solid answers to many of the questions posed.

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[4] The Big Five include Disney/ABC/ESPN, Viacom/CBS, News Corp./Fox, GE/NBC, and Time Warner/Turner.

A. The core problems in smaller markets – distribution restrictions imposed by media conglomerates and non-cost-based price discrimination.

For the smaller cable sector, the problem is this: A handful of media companies now control nearly all basic and expanded basic channels, and those companies charge smaller cable operators far more for those channels than what the large MSOs pay.

For nearly all the Top 50 Channels,[5] the Big Five contractually obligate ACA members to distribute the programming to all basic or expanded basic customers. These contractual distribution restrictions prohibit ACA members from offering more customized tiers and channel packages. In many cases, contractual provisions also mandate carriage of less desirable channels. Retransmission consent provides another means to impose additional channel carriage obligations. Four members of the Big Five own major broadcast networks and use retransmission consent to require carriage of, and payment for, additional channels as a condition to carry local network broadcast signals. This results in nearly all customers having to purchase basic or expanded basic packages filled with channels owned by the Big Five.

Price discrimination against smaller cable companies makes matters worse. Smaller cable operators pay substantially more for programming than the top MSOs. The wholesale price differentials have little to do with differences in cost, and much to do with disparities in market power. In this way, <u>smaller cable systems and their customers subsidize the programming costs of larger distributors, including DirecTV and Echostar.</u>

The bottom-line consequence for smaller market cable operators and consumers? Reduced choice and increased cost.

In other proceedings, ACA has described the growing power of media conglomerates and the consequences for smaller distributors and their customers.[6] We

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[5] *See infra* p. 10.

[6] *In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming,* MB Docket No. 03-172, Comments of the American Cable Association (filed September 11, 2003) ("ACA Competition Comments") at 1-8 (describing how media consolidation, combined with current laws and regulations, only works to facilitate

have provided many examples of how certain members of the Big Five leverage their broadcast networks, broadcast stations, and satellite programming, and how this conduct has hurt smaller cable businesses and their customers.[7]

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program access and retransmission consent abuses by media conglomerates); *In re Consolidated Application of General Motors Corporation, Hughes Electronic Corporation, and The News Corporation, For Consent to Transfer Control,* MB Docket No. 03-124, Comments of the American Cable Association (filed June 16, 2003) ("ACA News Corp. Comments") at iii-v, 1-3, 8-11, 16-18, 21-23, 30 (describing how media conglomerates leverage programming and broadcast assets to impose costly terms and conditions of program access and retransmission consent on smaller market cable operators) and Reply Comments of the American Cable Association (filed July 1, 2003) ("ACA News Corp. Reply") at 1-5, 10 (describing the powerful incentives and abilities of media conglomerates like News Corp. to disadvantage smaller competitors and raise costs to consumers); *In the Matter of 2002 Biennial Regulatory Review, Review of the Commission's Broadcast Ownership Rules and Other Rules Adopted Pursuant to Section 202 of the Telecommunications Act of 1996,* MB Docket 02-277, Reply Comments of the American Cable Association (filed February 3, 2003) ("ACA Media Ownership Reply") at 1-5, 8-9 (describing how network owners and major affiliate groups exploit retransmission consent when dealing with small cable companies, resulting in higher costs, less choice, and disregard for localism); *Petition for Inquiry into Retransmission Consent Practices,* American Cable Association, Proceeding PRM02MB (filed October 1, 2002) ("ACA Petition for Inquiry") at ii-iii, 1-5, 10-11, 19 (describing retransmission consent tying arrangements that network owners and major affiliate groups impose on smaller cable operators, resulting in increased cable costs and decreased programming choices) and *Petition for Inquiry into Retransmission Consent Practices First Supplement* (filed December 9, 2002) ("ACA Petition for Inquiry Supplement") at 1-3, 19 (examples of retransmission consent abuses); *In the Matter of Implementation of the Cable Television Consumer Protection and Competition Act of 1992; Development of Competition and Diversity in Video Programming Distribution: Section 628(c)(5) of the Communications Act: Sunset of Exclusive Contract Prohibition,* CS Docket No. 01-290, Comments of the American Cable Association (filed December 3, 2001) ("ACA Program Access Comments") at i-ii, 17 (describing how the continuing abuses of market power by broadcasters and affiliated satellite programmers have substantially reduced program diversity, restricted consumer choice, and increased the costs of cable services to smaller market consumers) and Reply Comments of the American Cable Association (filed January 7, 2002) ("ACA Program Access Reply") at 5-7; *In the Matter of Carriage of Digital Television Broadcast Signals*, CS Docket No. 98-120, Comments of Small Cable Business Association ("SCBA") (filed October 13, 1998) and Comments of the American Cable Association (filed June 8, 2001) ("ACA Digital Must Carry Comments") at 2-3 (describing the continuing trend of media concentration in the network broadcast and satellite programming industries).

[7] *See, e.g.,* ACA Competition Comments at 1-8 (abuses by media conglomerates equals less choice and higher costs for consumers and an increasing competitive disadvantage for smaller cable companies); ACA Media Ownership Reply at 6-8 (in retransmission consent negotiations, ACA members face pervasive abuse of retransmission consent by a handful of media conglomerates); ACA Petition for Inquiry at 3-4 (describing how network owners and major affiliate groups use retransmission consent to force additional programming and higher costs on small cable companies and consumers); ACA Petition for Inquiry Supplement at 7-18

B. The Commission and others are recognizing the harmful consequences in smaller markets of market power abuse by media conglomerates.

Increasingly, the Commission is recognizing the adverse consequences of the growing disparity in market power between media conglomerates and smaller distributors, and is acting to restrain that market power.[8] Equally important, some industry leaders, most notably Comcast and Time Warner, have made express commitments not to engage in certain conduct potentially harmful to the small cable sector.[9]

Unfortunately, other media conglomerates have declined to follow these examples. Now members of Congress are asking: Why do cable operators not offer programming packages more closely tailored to local markets and customers?

(citing specific examples of how small cable operators are harmed by retransmission consent abuse by media conglomerates); ACA Digital Must Carry Comments (describing the high costs of retransmission consent abuses on smaller market cable systems and their customers); ACA Program Access Comments at 12-18 (describing how media conglomerates have incentives to withhold programming); ACA Program Access Reply at 3-6 (describing risks to program diversity in smaller markets).

[8] *News Corp. Order* at ¶¶ 147-48,169-79, 213-26 (imposing conditions on how News Corp. and its affiliates deal with smaller cable companies for retransmission consent and access to regional sports networks); *In the Matter of Implementation of the Cable Television Consumer Protection and Competition Act of 1992; Development of Competition and Diversity in Video Programming Distribution: Section 628(c)(5) of the Communications Act: Sunset of Exclusive Contract Prohibition*, Report and Order, 17 FCC Rcd. 12,124 (2002) ("*Program Access Order*") (extending the program access laws to protect competition and diversity in the distribution of video programming).

[9] *In the Matter of Applications for Consent to the Transfer of Control of Licenses from Comcast Corporation and AT&T Corp., Transferors, to AT&T Comcast Corporation, Transferee*, MB Docket No. 02-70, Memorandum Opinion and Order (rel. November 14, 2002) at ¶ 113 (in response to ACA's comments concerning continued access to Headend-in-the-Sky ("HITS") Comcast agreed to: (i) provide HITS to small cable systems for the foreseeable future; (ii) honor all existing service contracts; and (iii) communicate in advance any substantial changes in the service relationship); *In the Matter of Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations by Time Warner Inc. and America Online, Inc., Transferors, to AOL Time Warner Inc., Transferee*, Memorandum Opinion and Order, 16 FCC Rcd. 6547 (2001) at ¶ 301 (in response to ACA concerns, Time Warner representatives stated that the merged entity would not tie or condition access to its programming on carriage of AOL service).

For ACA members, the answer is straightforward: The major programming suppliers do not permit it. To gain access to "must have" programming and local network broadcast stations, smaller cable operators must acquiesce to distribution restrictions, bundling, and tie-ins. These practices eliminate flexibility in local packaging of programming. At the same time, ACA members pay far more for the same programming as major MSOs because of non-cost-based price discrimination.

C. Solutions – Allow more flexibility for local cable operators to package channels and eliminate non-cost-based wholesale price discrimination.

With two changes to current wholesale programming practices, ACA members could provide their customers with more choice and better value. These changes are:

- allow smaller cable operators more flexibility to tailor channel packages for local markets; and
- eliminate non-cost-based price discrimination against smaller cable operators.

With more flexibility, ACA members could offer a variety of options to their customers, including sports tiers, contemporary adult tiers, children's tiers, and a la carte access to a few higher cost channels. With less wholesale price discrimination, ACA members could offer their customers better value and stop subsidizing programming costs of large distributors.

These two changes would go far in addressing the concerns of Congress, consumer interests, and many of the eight million customers served by ACA members.

D. Pure a la carte is not the answer.

For ACA members, these changes do not mean a regulated a la carte regime. Current technology costs make a la carte a financial impossibility for ACA member systems. Moreover, ACA members report that most customers prefer a basic or expanded basic package with a variety of channels at a reasonable price. The source of much frustration comes from the operator's inability to design packages according to the local marketplace. In some communities, many consumers do not want to pay for high cost sports channels. In some communities, many consumers find certain music video channels and "racier" entertainment channels offensive. More flexibility in packaging services and eliminating wholesale price discrimination are the keys to addressing consumer concerns, not legislated a la carte.

E. The Media Ownership Reply Comments of Mediacom Communications Corporation should be considered in this proceeding.

Mediacom submitted extensive Reply Comments in the Commission's media ownership docket.[10] That filing contains a detailed and thoughtful analysis of how media concentration and the resultant market power have affected the wholesale market for satellite programming. Mediacom's Media Ownership Reply warrants careful study and consideration here, and should be included in the record of this proceeding.

[10] *See supra* note 1.

II. ACA RESPONSES TO QUESTIONS

We respond in this section to 21 of the questions posed in the Commission's Notice. For clarity, we follow the organization of the Notice, provide the responses in Q&A format, and number our responses for cross-referencing. We omit several questions that may not apply or for which we have insufficient information to answer at this time. We first address nondisclosure obligations imposed by programmers, and ACA member concerns about retaliation.

A. Nondisclosure obligations in programming contracts limit the information provided here.

Nearly all programming contracts contain strict nondisclosure terms. In attempting to answer the Commission's questions, ACA members fear the risk of retaliation by certain programming suppliers. Companies like CBS/Viacom, Disney/ABC and, News Corp./Fox have a range of ways to hurt smaller distributors, both overt and subtle.[11] No small cable operator can support a fight against any of these companies. Consequently, on several key issues – distribution restrictions, bundling, tying, and price discrimination – the responses provided here do not contain specific information from specific programming contracts. We must speak more generally.

What we can say is that for ACA members or their representatives, programming contract nondisclosure provisions are <u>always</u> a requirement of the programmer, not the cable operator. Many ACA members report that in recent negotiations, they requested removal of nondisclosure provisions. In each case, negotiators for the programmers rejected the request as "nonnegotiable".

Much of the specific information sought by the Commission is contained within specific programming contracts. One way for the Commission to get at this information is for the programmers to waive those restrictions for the purposes of this inquiry. If there are any takers among the programmers, and to the extent any of the

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[11] Mediacom Media Ownership Reply at 13-14 ("Mediacom is acutely aware of the awesome market power wielded by the six giant media companies and, based on direct experience, knows that those companies are willing and able to use that power against those who do not march to their beat.").

nondisclosure provisions are mutual, ACA will work to facilitate obtaining consents from the small cable sector as necessary to open those agreements for Commission and Congressional scrutiny.

Even if certain programmers resist disclosure, the Commission has authority under its Section 403 authority to investigate specific terms, conditions and prices contained in programming contracts.[12] To provide full and fair answers to the House Commerce Committee, the Commission should use that authority if all constituencies do not cooperate.

B. Historical matters

Question: Do MVPDs currently have the option to purchase channels from programmers on a stand-alone basis, such that they could, if they chose, offer programming to consumers on an *a la carte* or theme-tier basis? What are the limitations, if any, on their flexibility to do so?

ACA Response 1:

Due to nondisclosure provisions imposed by programmers and fear of retaliation, we base our response here on publicly-available information and general observations of smaller market cable operators.

Table 1 shows the top 50 satellite programming channels as reported by Kagan,[13] and the corporate affiliation of each service. We refer to this group as the "Top 50 Channels". Each of these channels is distributed to at least 51% of TV households.

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[12] 47 U.S.C. § 403 (1934) ("The Commission shall have full authority and power at any time to institute an inquiry, on its own motion, in any case and as to any matter or thing concerning which complaint is authorized to be made, to or before the Commission by any provision of this chapter, or concerning which any question may arise under any of the provisions of this chapter, or relating to the enforcement of any of the provisions of this chapter."). The Commission has relied on Section 403 to inquire into a range of improper conduct under its jurisdiction. *See, e.g., In the Matter of World Communications Satellite Systems, Inc.,* Notice of Apparent Liability for Forfeiture, 18 FCC Rcd. 18,545 (2003) at ¶ 6 ("The Commission has statutory authority to require its regulates to respond to Commission inquiries... This broad investigative authority… encompasses the authority to obtain from carriers information and documents.") (emphasis added); *In the Matter of SBC Communications, Inc.,* Forfeiture Order, FCC 02-112, 2002 WL 549714 (rel. April 15, 2002) at ¶ 8.

[13] *Network Census: April 30* (Kagan Cable Program Investor), May 19, 2004, at 11. The list ranks channels by number of households receiving the channel ("Kagan Newsletter").

Over 75% of the services are delivered to over 75% of TV households. Sixteen of the services are delivered to virtually every household served by cable or satellite.

Table 1. Top Fifty Channels[14]

Channel	Ownership	Channel	Ownership
MTV	Viacom / CBS	Animal Planet	Liberty Media
Nickelodeon	Viacom / CBS	Discovery	Liberty Media
Spike	Viacom / CBS	Travel	Liberty Media
TV Land	Viacom / CBS	TLC	Liberty Media
VH1	Viacom / CBS	Golf	Comcast Corp.
Comedy Central	Viacom / CBS	Outdoor Life	Comcast Corp.
BET	Viacom / CBS	E!	Comcast Corp.
CMT	Viacom / CBS	QVC	Comcast Corp.
Disney	Walt Disney Co. / ABC	HGTV	Scripps Company
ESPN	Walt Disney Co. / ABC	Food	Scripps Company
ESPN 2	Walt Disney Co. / ABC	AMC	Rainbow / Cablevision Systems
Lifetime	Walt Disney Co. / Hearst	C-Span	National Cable Satellite Corp.
ABC Family	Walt Disney Co./ ABC	C-Span II	National Cable Satellite Corp.
A&E	Hearst/ABC/NBC	WGN	Tribune Company
History	Hearst/ABC/NBC	Hallmark	Crown Media Holdings
CNBC	GE/NBC	Weather	Landmark Communications
MSNBC	GE/NBC	HSN	IAC/InterActiveCorp.
Sci-fi	GE/NBC		
USA	GE/NBC		
Bravo	GE/NBC		
Shop NBC	GE/NBC		
Fox News	News Corp.		
Fox Sports	News Corp.		
FX	News Corp.		
Speed	News Corp.		
TV Guide	News Corp.		
CNN	Time Warner / Turner		
Headline News	Time Warner / Turner		
TBS	Time Warner / Turner		
TCM	Time Warner / Turner		
TNT	Time Warner / Turner		
TOON	Time Warner / Turner		
Court TV	Time Warner / Liberty Group		

[14] Table 1 organizes the Top 50 channels by ownership and does not rank the channels by number of subscribing households.

Upon reviewing the Top 50 Channel list, ACA members report the following:

- Programming contracts for nearly all of the Top 50 Channels require that small cable companies distribute the channels to all basic or expanded basic customers.[15]

- Programming contracts for nearly all of the Top 50 Channels prohibit small cable companies from distributing channels a la carte.

- Programming contracts for several of the most popular Top 50 Channels obligate small cable companies to distribute affiliated services. In several cases, this involves multiple additional channels.

- Some of the channels became Top 50 Channels because of a tie-in with a more popular affiliated satellite channel or through retransmission consent.

It is also instructive to consider the next group of programming networks. Table 2 contains 34 channels ranked below the Top 50 Channels. We call these the "Second Tier Channels". In smaller market cable systems offering digital cable, digital packages contain many of the Second Tier Channels.

[15] Programming contracts generally do this either by expressly requiring carriage on basic or expanded basic, or by obligating the cable operator to distribute the service to at least 80- 90% of subscribers. Either technique reaches the same result – nearly all customers must receive, and pay for, the service.

Table 2. Second Tier Channels.

Channel	Ownership	Channel	Ownership
MTV2	Viacom / CBS	Discovery Home	Liberty Media
MTV Espanol	Viacom / CBS	Discovery Kids	Liberty Media
MTV Hits	Viacom / CBS	Discovery Wings	Liberty Media
VH1 Classic	Viacom / CBS	FitTV	Liberty Media
VH1 Country	Viacom / CBS	Disc.Espanol	Liberty Media
Nick GAS	Viacom / CBS	Discovery Health	Liberty Media
Nicktoons	Viacom / CBS	Discovery Times	Liberty Media
Noggin	Viacom / CBS	Science	Liberty Media
ESPN Classic	Walt Disney Co. / ABC	International	Liberty Media
ESPNEWS	Walt Disney Co. / ABC	style!	Comcast Corp.
Soapnet	Walt Disney Co. / ABC	techTV	Comcast Corp.
Toon Disney	Walt Disney Co. / ABC	Independent Film	Rainbow Media Holdings
LMN	Walt Disney Co. / Hearst	WE	Rainbow Media Holdings
National Geographic	News Corp.	GAC	Jones Media Networks
FMC	News Corp.	GSN	Sony Pictures/Liberty Media
		HITN	Hispanic Information & Telecommunications Network
		INSP	Inspiration Network
		Outdoor Channel	Outdoor Channel Holdings, Inc.
		Oxygen	Oxygen Media

Upon reviewing the list of Second Tier Channels, ACA members report:

- Almost all of the programming contracts for Second Tier Channels currently permit carriage on tiers other than basic or expanded basic.

- Some ACA members have grouped Second Tier Channels into digital tiers, including themed tiers.

- The contractual flexibility to group Second Tier Channels on digital tiers initially made carriage of the services more attractive for some ACA members.

- Some of the Second Tier Channels are carried as a condition of access to affiliated Top 50 Channels.

- Some of the Second Tier Channels are carried as a condition of retransmission consent.

- For many of the Second Tier Channels, ACA members cannot carry the channel unless the affiliated Top 50 Channel is carried on basic or expanded basic.

- Certain Big Five companies are now demanding that smaller cable companies move certain Second Tier Channels from a digital tier to expanded basic.

- Certain Big Five companies are now demanding that smaller cable operators distribute Second Tier Channels to all digital subscribers, thereby undermining the ability to provide digital theme-tiers.

- There is evidence that programmers are targeting the small cable sector with increased distribution requirements for Second Tier Channels. Some ACA members have acquired digital cable systems from major MSOs. Under MSO ownership, those systems carried Second Tier Channels on a variety of discrete digital theme-tiers. ACA members report that after acquiring the systems, certain programmers now require them to distribute certain Second Tier Channels to all digital subscribers. This effectively eliminates the digital theme tiers previously offered under MSO ownership.

To fully understand the nature and scope of the distribution restrictions and price discrimination referenced above, the Commission will need to gain access to specific programming contracts. Still, from the more general information provided here, we believe the Commission can deduce the following:

- The Big Five control at least 75% of the news and entertainment services in the Top 50 Channels.[16]
- For nearly all of the Top 50 Channels, smaller market cable companies are prohibited by contract from offering the services on any tier besides basic or expanded basic.
- For nearly all of the Top 50 Channels, smaller market cable companies are prohibited by contract from offering the programming on tiers or a la carte.
- Contractual distribution restrictions, tie-ins and bundling are not necessary to support viable programming business models. Some programming services achieve distribution without such restrictions.
- Contractual distribution restrictions correlate with the market power possessed by the owner of the service. If a programming service is "must-have", then the owner of that programming will impose distribution restrictions, require carriage of other services, or both.

[16] We exclude C-Span, C-Span II, and home shopping channels from this ratio.

Question: What statutory or regulatory action would be needed to remove any such limitations?

ACA Response 2:

As suggested above, owners of "must have" programming use market power to impose a range of restrictions and carriage obligations on smaller cable operators. As a result, smaller cable companies lack the ability to adjust basic or expanded basic packages and to offer theme-tiers in response to their local marketplace. A variety of statutory or regulatory responses would address different aspects of the problem. We offer several proposals below. First, we address the possibility that *no* statutory or regulatory action would be needed.

Proposals for marketplace solutions.

ACA members would prefer mutually beneficial carriage arrangements with programmers rather than government mandates. For this to occur, certain media conglomerates would need to temper economic self-interest with a heightened concern for the public interest in localism, consumer choice, and reasonable cable rates. In response to small cable operator concerns, companies like Comcast and Time Warner have done just that.[17]

For example, the owners of certain high cost national and regional sports channels could permit smaller cable operators to migrate the channels to a sports tier. Similarly, the owners of certain music video services and "racier" entertainment channels could permit smaller cable operators to move those channels to a tier.

In many ACA member markets these two decisions alone would address customer dissatisfaction about choice, cost, and content. In markets where more consumers are price sensitive and do not desire to pay for sports programming, cable operators could offer a choice. Conversely, in markets where more consumers are content sensitive and do not desire to pay for the types of channels they consider indecent, cable operators could offer a choice. In markets where consumers prefer the current expanded basic line up, no change would occur.

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[17] *See supra* note 9.

The small cable sector offers an ideal laboratory for marketplace experiments of this kind. The companies and markets are extremely diverse. The number of customers served by the systems is relatively small, so the risk to a programmer of revenue changes should be correspondingly low. Similarly, the positive public interest impact would be substantial. Demographics in some rural systems include a higher percentage of senior citizens, those on fixed incomes, and lower income households, all of whom could benefit from a lower cost expanded basic package.

Possibly with greater scrutiny by the Commission and Congress, programmers may be more willing to adjust current wholesale practices. If not, the following legislative and regulatory action should be considered.

Proposals for legislative action.

Absent a marketplace solution, legislative action in at least three areas would remove several limitations on smaller cable companies' inability to tailor program offerings to local markets. These include: (i) changes to retransmission consent laws; (ii) changes to program access laws; and (iii) changes to antitrust laws.

Changes to retransmission consent laws. The retransmission consent laws provide network owners and major affiliate groups powerful leverage over smaller cable companies. We have provided the Commission with many examples of how this conduct reduces choice and increases costs for consumers in smaller markets.[18] In the *News Corp. Order*, the Commission expressly recognized how this conduct hurts consumers.[19]

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[18] *See* ACA Petition for Inquiry at 3-6, 12-13; ACA Petition for Inquiry Supplement at 1-4; ACA News Corp. Comments at iv-v, 8-16; ACA News Corp. Reply at 1-5.

[19] *News Corp. Order* at ¶ 209 ("If News Corp. uses withholding or threats of withholding in retransmission consent negotiations to obtain carriage of its affiliated cable networks that the MVPD, absent the threat of foreclosure, would not agree to carry, consumers are harmed because MVPDs are forced to make programming decisions based on News Corp.'s demands, rather than selecting the programming of their choice. In the long term, News Corp.'s use of market power to extract artificially high levels of compensation from MVPD rivals, or other carriage concessions, could make rival MVPDs less viable options for consumers, thus limiting consumer choice.").

Several statutory changes would begin to address the current imbalance. These include:

- Establish a streamlined procedure for resolving retransmission consent disputes. The arbitration procedures in the *News Corp. Order* provide one example.[20]

- Prohibit broadcasters from withholding access to a local broadcast signal pending resolution of a retransmission consent dispute. The *News Corp. Order* describes the importance to competition and consumers of continued carriage during a dispute.[21]

- Make the good faith negotiation obligation in Section 325 permanent, and direct the Commission to review and supplement periodically the good faith negotiation regulations. Broadcasters' statutory obligation to negotiate retransmission consent in good faith expires in less than 18 months. In light of continuing evidence of retransmission consent abuse against smaller cable companies,[22] and supported by the Commission's findings in the *News Corp. Order*,[23] no basis exists to relieve broadcasters of these obligations.

- Prohibit any network owners from restricting an affiliate's ability to grant retransmission consent. The Commission has evidence in other proceedings that network owners are restricting affiliate stations'

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[20] *Id.* at ¶¶ 172-77; 218-223 (MVPDS may demand commercial arbitration when they are unable to come to a negotiated "fair" price for News Corp. programming; MVPDs meeting the definition of "small cable company" may choose to appoint a bargaining agent to bargain collectively on its behalf in negotiating for carriage of regional sports networks with News Corp., and News Corp. may not refuse to negotiate carriage of RSN programming with such an entity).

[21] *Id.* at ¶ 209 ("If News Corp. uses withholding or threats of withholding in retransmission consent negotiations to obtain carriage of its affiliated cable networks that the MVPD, absent the threat of foreclosure, would not agree to carry, consumers are harmed because MVPDs are forced to make programming decisions based on News Corp.'s demands, rather than selecting the programming of their choice. In the long term, News Corp.'s use of market power to extract artificially high levels of compensation from MVPD rivals, or other carriage concessions, could make rival MVPDs less viable options for consumers, thus limiting consumer choice.").

[22] *See supra* notes 6-7.

[23] *News Corp. Order* at ¶ 219 (extending the good faith and exclusivity requirements "should help to temper increases in News Corp.'s market power arising from the transaction and protect the public interest in continued access to local broadcast stations carried by their MVPD as part of their package of video programming services").

retransmission consent rights.[24] This prevents the station from providing its signal to cable systems and consumers that desire it. Congress or the Commission should stop this anticompetitive, anticonsumer practice.

These statutory changes, along with Commission action to implement them, would help restrain the ability of media conglomerates to use retransmission consent as a means to force unwanted channels on consumers, reduce choice, and increase costs, especially in smaller markets.

Changes to program access laws. Enacted in 1992, the program access laws provide some protection against anti-competitive practices by vertically integrated satellite programmers.[25] But since 1992, the media landscape has fundamentally shifted. The market power of non-vertically integrated programmers has come to dominate most programming transactions. Certain Big Five programmers now use this market power to reduce choice and increase costs, especially in smaller markets.

Several adjustments to the program access laws would begin to address this aspect of the problem. These include:

- Bring all programmers within the scope of the program access laws.
- Expressly include as a prohibited practice non-cost-based price discrimination.
- Require programmers to disclose regularly to the Commission the prices, terms and conditions of all wholesale programming arrangements to facilitate compliance.
- Require the Commission to report periodically to Congress the status of prices, competition, and diversity in the wholesale programming market.

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[24] *See, e.g., In the Matter of Petition for Inquiry into Network Practices,* Network Affiliated Stations Alliance (filed March 8, 2001) at 29-35 (describing use of market power by network owners to unduly influence the operations of affiliates); *In the matter of Monroe, Georgia Water Light and Gas Commission v. Morris Network, Inc., owner of WMGT, Channel 41, Macon, Georgia,* File No. CSR-6237-C ("Monroe Proceeding"), Retransmission Consent Complaint and Petition for Declaratory Ruling (filed August 29, 2003) ("Monroe Complaint") (NBC uses its affiliation agreement to prohibit affiliate from granting retransmission consent outside of its DMA) and Consolidated Reply of Monroe, Georgia Water Light and Gas Commission (filed October 16, 2003) at 6-9.

[25] 47 U.S.C. § 548 (1996).

These changes, along with Commission action to implement them, would help restrain the use of market power by certain programming conglomerates and the resulting harm to consumers.

Changes to antitrust laws. The Clayton Act and the Robinson-Patman Act prohibit a range of anticompetitive conduct, including price discrimination[26] and tying arrangements.[27] When dealing with smaller cable companies, non-cost-based price discrimination and tie-ins of weak programming to strong programming are "business as usual" for many media conglomerates. This harms consumers and competition. To restrain this use of market power, Congress should amend the Clayton Act and the Robinson-Patman Act to bring "satellite and broadcast programming" expressly within the scope of the statutes. This will provide private parties and the federal government with clear anti-trust authority to challenge current programming practices.

Proposals for regulatory action.

Within the Commission's current authority, action in two areas will help address some of the public interest harms resulting from current exploitation of retransmission consent by certain network owners and major affiliate groups. These are: (i) enforcement of Section 310(d) in the context of retransmission consent; and (ii) review and amend outdated broadcast market protection regulations.

Enforce Section 310(d) when a non-licensee takes control of retransmission consent.

The retransmission consent practices of network owners implicate the prohibition on unauthorized transfers of control of broadcast licenses. Section 325 created retransmission consent rights for each commercial broadcast licensee, and no other

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[26] 15 U.S.C. § 13 (1936); 15 U.S.C. § 14 (1914).

[27] 15 U.S.C. § 15 (1982).

entity.[28] Consequently, determining the terms of cable carriage constitutes an essential station matter and a fundamental operating policy. It is well-settled under Section 310(d) that a broadcast licensee cannot delegate or assign responsibility for such matters without first obtaining the Commission's consent.[29]

The examples of retransmission consent practices provided by ACA show a consistent trend in how network owners or satellite programming affiliates are appropriating retransmission rights from broadcast licensees.[30] Most often, authority over retransmission consent is taken from the local station and assigned to a satellite programming affiliate. Network affiliate contracts are another means by which network owners restrict retransmission consent rights of non-owned stations. The Commission currently has pending a retransmission consent complaint in which NBC has admitted that it expressly prohibits its affiliates from granting retransmission consent outside of the affiliates' market.[31] Insofar as this practice constitutes an unauthorized transfer of

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[28] 47 USC § 325(b)(1)(A) ("no cable system or other multichannel video programming distributor shall retransmit the signal of a broadcast station, or any part thereof, except - with the <u>express consent of the originating station</u>…") (emphasis added).

[29] *Washington Broadcast Management Co., Inc., Licensee of KBRO (AM),* Letter, 13 FCC Rcd. 24,168 at 24,169 (1998) ("Although a licensee may delegate certain functions to an agent or employee on a day-to-day basis, ultimate responsibility for essential station matters, such as personnel, programming, and finances, cannot be delegated."); *In the Matter of Liability of Kenneth B. Ulbricht,* Memorandum and Opinion and Order and Forfeiture Order*,* 12 FCC Rcd. 11,362, ¶ 6 (1996) ("In ascertaining whether an unauthorized transfer of control has occurred, the Commission focuses on whether an individual or entity other than the licensee has obtained the right to determine the basic operating policies of the station.").

[30] *See, e.g.,* ACA Petition for Inquiry at 8-14 (explaining that as far as dealing with network owners and major affiliates, retransmission consent is anything but local as there is a consistent trend in how Disney, Fox, Hearst-Argyle, and NBC are appropriating retransmission rights from affiliated broadcast licensees); ACA Petition for Inquiry Supplement at 6-18 (providing examples of affiliated programming entities taking control of retransmission consent rights formerly exercised by local broadcasters); ACA Digital Must Carry Comments at 5-7 (describing the loss of control by local network stations over retransmission consent rights to affiliated cable networks).

[31] *Monroe Proceeding*, Opposition of National Broadcasting Company, Inc. (filed October 6, 2003) ("NBC Opposition") at 4 ("[I]n order to preserve the availability of free, over the air NBC programming, NBC must be able to limit an affiliate's right to consent to retransmission of that programming to a specific geographic area.").

control of a fundamental station function, the Commission should take appropriate enforcement action.

Reexamine and amend the Network Nonduplication and Syndicated Exclusivity Regulations.

Part 76 currently contains regulations that establish protected markets for cable carriage of local broadcast signals. Known as Network Non-duplication[32] and Syndicated Exclusivity,[33] the regulations entitle a broadcaster to prevent a cable operator from carrying a competing broadcast signal. The Commission first promulgated these regulations more than 20 years ago, when local broadcasters were truly local and needed some protection for their advertising revenue-based broadcast businesses.

In a nutshell, combined with retransmission consent these regulations now entitle a media conglomerate to withhold, or threaten to withhold, a local network signal from a cable operator *and* prevent that cable operator from bringing in a substitute network signal. Because these stations can block substitute network and syndicated programming, they are the only game in town. When a media conglomerate demands a "price" for retransmission consent, the same company can foreclose access to lower cost alternative sources of the same programming.

These regulations made sense when ad revenue and affiliate fees supported local broadcasters. These regulations still make sense today for many independent broadcasters that do not demand extra consideration for retransmission consent. But these regulations hurt competition and consumers where a media conglomerate seeks carriage of affiliated satellite programming, cash, or other substantial consideration for retransmission consent. In short, media conglomerates use the market protection regulations to avoid marketplace discipline on the "price" for retransmission consent.

The Commission should initiate a rulemaking to revise the market protection

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[32] 47 C.F.R. §§ 76.92-76.95.

[33] 47 C.F.R. §§ 76.101-76.110.

regulations so that when broadcasters impose a "price" on retransmission consent, cable operators and customers are free to obtain lower cost alternatives.

Other changes – Proposals of Mediacom Communications Corporation.

The Commission should also consider in this proceeding the proposals offered by Mediacom last year in the media ownership proceeding.[34] Mediacom asked the Commission to condition further consolidation among media conglomerates on the following requirements.

- The net effective rates for cable networks owned by affiliated companies should be the same for all MVPDs, regardless of distribution technology, size or market characteristics, unless the differentials are cost based.

- Cable systems should have the right to offer on an a la carte basis those networks for which the license fee is more than twice the average per-channel cost on the same tier of service.

- Broadcasters that are vertically integrated with owners of cable networks should be required to elect must-carry, rather than retransmission consent.

- Affiliated programmers should be prohibited from tying or bundling cable networks, either overtly or through pricing schemes that make individual carriage uneconomic.

- In the interest of assuring the availability of critical information that is essential to a "properly functioning market," affiliated programmers should be required to stop using confidentiality provisions to protect disclosure of rates and terms, waive existing confidentiality clauses and disclose the net effective rates that the various MSOs and the DBS companies actually pay, as well as other material contract terms.

ACA supports Commission consideration of these thoughtful proposals and asks the Commission to include them in its report from this proceeding.

[34] Mediacom Media Ownership Reply at 97-98.

C. Rates

Question: What would the impact be on retail rates to consumers if programmers, in addition to the currently offered packages, were required to allow MVPDs to offer their programming on an a la carte or themed-tier basis if the MVPD chose to do so?

ACA Response 3:

For ACA members, there is only one legitimate answer to this question: It depends. With additional flexibility in how smaller cable companies offer programming in local markets, some retail rates may not change, some retail rates may decrease, some retail rates may increase. The result will depend on several key variables, including how the cable operator packages programming, the programming purchased by the consumer, and, most importantly, the programmer's market power and wholesale pricing practices.

Sports tier example. ACA members report that sports channels are the most costly services they distribute, with annual wholesale rate increases well in excess of inflation.[35] Contractual distribution restrictions and tie-ins with weaker channels increase the aggregate cost of sports channels, both wholesale and retail. We consider here the potential effect on retail rates if smaller cable companies had more flexibility in how they offer sports channels.

Our example involves a 5,000 subscriber cable system that purchases programming through current wholesale practices. That system pays about $5.00 per customer per month for certain national and regional sports channels and the affiliated channels that are bundled with those channels. Generally, contractual distribution requirements obligate the cable operator to distribute the services to at least 90% of subscribers. Consequently, the cable operator must pay about $22,500 per month for those sports channels,[36] and substantially all customers must purchase and pay for those channels.

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[35] *The Telecom Future of Independent Cable: ACA Member Concerns and Issues* (The Carmel Group), June 30, 2003 ("Carmel Group Study") at 13.

[36] 5,000 customers x 90% x $5 = $22,500.

What happens if the same cable operator were permitted to move those services to a sports tier? Assume 30% of customers order the sports tier. Programmers might choose to charge substantially more for the channels if offered on a sports tier. If the programmers increased total fees to $15 from $5 per customer per month, the subscription revenue derived by the programmers from the system would not change – $22,500 per month.[37]

The retail rates paid by consumers would likely change, and in different directions. The key difference – <u>consumers would have more choice</u>. For sports tier customers, they would pay at least $15 per month, and probably more. For fans that value sports programming and purchase the sports tier, the additional fees would represent a reasonable price. On the other hand, retail rates paid by basic or expanded basic customers who did not desire costly sports programming would likely decrease.[38]

This example is more than a hypothetical. Many ACA members report that if they were permitted to move costly sports services to a tier, they would do so as soon as possible. In their markets, more customers would prefer a lower cost expanded basic package and less sports programming.

Other ACA members report that they would not launch a sports tier at this time even if they could. In their markets, more consumers are willing to pay for sports programming on expanded basic. In those markets, no change in retail rates should result.

Other theme-tiers. That same analysis applies to other channels. For example, in some ACA member markets, many customers find objectionable the content carried on certain music video channels and entertainment channels that carry mature programming. These channels carry partial nudity, sexually suggestive content, and profanity. In certain markets, ACA members would move these services to a "Contemporary Adult Tier" or similarly labeled tier. This would reduce wholesale costs for expanded basic, ease retail rate pressure, and address content concerns in markets

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[37] 5,000 customers x 30% x $15 = $22,500.

[38] Depending on the system, the decrease in expanded basic rates could result immediately through a rate reduction or over time through reduced rate increases.

where those concerns are pervasive. In other ACA member markets, the same services would remain on expanded basic.

The option to tier service may <u>lower</u> wholesale and retail rates. We emphasize another possibility – <u>the option of moving higher cost channels to a tier may result in lower retail rates for those channels</u>. This result would occur if a programmer considered wider distribution on expanded basic more valuable than more limited distribution on a tier, even at a much higher license fee. In this case, the programmer may offer the cable operator incentives through reduced license fees to distribute a service on expanded basic. This, in turn, would ease pressure on rates.

As shown in ACA Response 1, as a condition of access to services like sports channels, certain Big Five companies require smaller cable operators to distribute those channels to nearly all customers, with no other option.[39] In defending the status quo, some will argue that increased flexibility in how cable operators offer programming in local markets will inexorably lead to higher cable rates. The Commission should scrutinize those arguments and the underlying assumptions with care. As discussed here, <u>some ACA members are prepared to lower rates if they can achieve more flexibility in how they offer channels in local markets</u>.

[39] *See supra* pp. 9-14 and accompanying notes.

Question: Can MVPDs currently offer a la carte and themed-tier service in addition to the packages currently offered, such as basic and expanded basic?

ACA Response 4:

Carriage restrictions vary with the type of channel, the market power of the programmer, and the wholesale practices of the programmer. For a more detailed discussion see ACA Response 1.

Top 50 Channels. As a condition of access to nearly all of the Top 50 Channels, ACA members must distribute these channels to all basic or expanded basic subscribers. The Big Five companies control 75% of these channels.[40]

Second Tier Channels. Current programming contracts generally permit ACA members to distribute nearly all of the Second Tier Channels on tiers other than basic or expanded. ACA members report that certain programmers are increasingly demanding distribution of certain Second Tier channels to all digital subscribers, eroding the ability to offer theme-tiers.

For example, an ACA member reports carrying one of the Second Tier Channels on a digital theme-tier. The tier is distributed to 80% of the system's digital subscribers. The programmer has recently demanded that the company distribute the service to all digital subscribers or the rate for the service will double. The operator has little choice – either pay 100% more for the channel as currently carried, or pay the same per subscriber rate and distribute it to all customers.

Premium services. ACA members offer traditional premium services like HBO, Cinemax and Showtime on an a la carte basis.

Question: What effect would a la carte or themed-tier have on a network's per-subscriber license fees?

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[40] *See supra* p. 10.

ACA Response 5:

For ACA members, there is only one legitimate answer to this question: <u>It depends</u>. With additional flexibility in how programming is offered to consumers, many license fees will likely not change, some license fees will likely increase, and some may decrease. The result will depend on several variables, including the how the cable operator offers particular channels, the demand for channel offerings, and, most importantly, the programmer-owner market power and pricing practices.

Many license fees will not likely change. ACA members report that many customers desire a basic or expanded basic package with a variety of channels at a reasonable price. Even absent the current distribution requirements imposed by certain programmers, some ACA members would continue to offer an expanded basic much like they offer today. As a result, no basis would exist for programmers to change these rates solely because ACA members achieved a measure of flexibility in how they offer programming to local communities.

Some license fees may increase. For channels that are moved from expanded basic to a tier or to a la carte, a programmer may choose to increase the license fees for those channels. This business decision could allow the programmer to maintain subscription revenues even though fewer customers chose to subscribe to the tier. Consider the Sports Tier example from ACA Response 3.

Our example involves a 5,000 customer system with 90% penetration of expanded basic. Aggregate sports channel license fees total $5 per subscriber per month on expanded basic, and the sports programmers derives $22,500 per month in revenue. If higher cost sports services were moved from expanded basic to the Sports Tier, and 30% of customers subscribed to that tier, the programmer may decide to triple license fees to derive the same $22,500.

Programmers could also make different business decisions. For example, programmers might determine that demand elasticity exists for the Sports Tier (at the margin, very likely), and that they may increase subscribers and revenues by raising the tier license fee a lesser amount. Conversely, programmers might determine that demand inelasticity existed among core sports fans, thus allowing them to charge much higher licenses fees when channels are offered on a Sports Tier.

In either case, with additional flexibility in how channels are offered at retail, retail pricing would no longer be skewed by the current constraints imposed by media conglomerates.

Some license fees may decrease. Continuing with our Sports Tier example, the option to tier a high cost channel might also lead to lower license fees for that channel. A programmer might decide that wider distribution on expanded basic is more valuable than higher tier license fees. That programmer could offer an incentive to the cable operator to carry the channel on expanded basic by lowering license fees.

In summary, providing smaller cable operators with more flexibility in how they offer programming in local markets could have a range of effects on license fees.

Some will argue that a measure of increased flexibility in how smaller cable companies offer programming in their local markets will inexorably lead to higher license fees. Careful examination should lead to a much different answer.

Question: Are there networks that have migrated from being offered on a tiered basis to an a la carte basis, or vice versa?

ACA Response 6:

ACA members report that programmers are demanding two different types of migration – migration of certain channels from theme tiers to "digital basic," and migration of certain channels from digital to analog expanded basic.

Migration from Digital Theme-Tiers to Digital Basic. Programmers are increasingly restricting smaller operators' ability to offer channels on digital theme tiers. Either by expressly requiring carriage on "digital basic" or requiring distribution to all digital subscribers, certain programmers are reducing choice and increasing cost for digital customers.

There are indications that this programming practice is targeted at smaller operators. Some ACA members have acquired systems from major MSOs, and those systems offered digital theme-tiers, like a sports tier, a family tier, and a movie tier. Post-acquisition, the same programmers now require the small cable company owners to distribute formerly theme-tier channels to all digital customers, under the threat of higher rates or contract penalties.

Migration from Digital Tiers to Analog Expanded Basic. ACA members also report that certain Big Five programmers are demanding migration of affiliated channels from digital tiers to analog expanded basic. The channels are usually tied toTop 50 Channels, and the programmers use that as a lever to expand their affiliated channels on expanded basic. As a result, more channels controlled by Big Five companies increasingly dominate scarce analog channel capacity. As discussed in ACA Response 10, this conduct is hurting independent programmers' ability to gain distribution.[41]

[41] *See infra* pp. 37-38.

D. Retransmission consent.

The record here should incorporate retransmission consent filings and orders from other proceedings. In answering retransmission consent questions, the Commission can draw upon its extensive experience and detailed records developed in other proceedings. In other filings, ACA has described the smaller cable sector's increasing concern about the use of retransmission consent by network owners and affiliate groups.[42] The principal tactic – requiring carriage of affiliated satellite programming as a condition of access to local broadcast signals. As a result, smaller cable companies and their customers must pay for programming that they would not otherwise choose, solely to receive a free, over-the-air local broadcast station. This practice reduces choice and increases costs in smaller markets. Others have expressed similar concerns.[43]

The Commission too has begun to question this conduct. In 2001, the Commission expressly recognized small cable's "important concerns" over retransmission consent tying.[44] The Commission committed to "continue to monitor the situation with respect to potential anticompetitive conduct by broadcasters in this context."[45] Upon a showing that tying arrangements harm small cable operators and their subscribers, the Commission would "consider appropriate courses of action".[46]

Early this year, the Commission took specific action to restrain the use of

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[42] *See infra* notes 5-6, 29 and accompanying text; *See also In re Application for Transfer of Control of CBS Corporation and Its Licensee Subsidiaries from Shareholders of CBS Corporation to Viacom, Inc.,* Petition to Deny of ACA (filed December 31, 1999); *In re Applications of Capital Cites/ABC, Inc. and the Walt Disney Company for Consent to the Transfer of Control of Broadcast and Television Station Licenses,* Petition to Deny of the SCBA (filed September 27, 1995).

[43] *See, e.g.,* Mediacom Media Ownership Reply at 12-14.

[44] *In the Matter of Carriage of Digital Television Broadcast Signals*, First Report and Order and Further Notice of Proposed Rulemaking, 17 FCC Rcd. 6441 (2001) ("*Digital Must Carry Order*") at ¶ 35 (referencing comments of the Small Cable Business Association, the former name of ACA), ¶ 121, and *Final Regulatory Flexibility Analysis*, ¶ 20.

[45] *Id.*

[46] *Id.*

retransmission consent by News. Corp. In the *News Corp. Order,* the Commission analyzed the incentive and ability of networks owners to use retransmission consent to gain distribution of affiliated programming and to increase the prices paid for that programming.[47] The Commission expressly recognized the harm to competition and consumers that can result from this conduct.[48] To mitigate these harms, the Commission imposed a range of retransmission consent conditions on News Corp., including special conditions for dealing with small cable companies.[49]

Correcting the problems that have developed in the retransmission consent process will ultimately require changes to the retransmission consent laws. The Commission's input on retransmission consent will be critical for developing a fair and balanced record for Congress to consider. To that end, the Commission's report here should build upon and include the extensive knowledge base already developed at the Commission through the filings of ACA and others, and through the Commission's analyses in other proceedings.

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[47] *News Corp. Order* at ¶ 203 ("News Corp.'s existing control of MVPDs' access to a large number of local broadcast stations airing highly popular Fox network programming, when combined with ownership of a nationwide DBS platform, will likely increase News Corp.'s incentive and ability engage in temporary foreclosure strategies aimed at increasing its programming fees thereby having the effect of raising rival MVPDs' costs by lowering the costs to News Corp. of engaging in such behavior.").

[48] *Id.* at ¶ 109 ("News Corp.'s use of market power to extract artificially high levels of compensation from MVPD rivals, or other carriage concessions, could make rival MVPDs less viable options for consumers, thus limiting consumer choice.").

[49] *Id.* at ¶¶ 169-79, 213-26 (imposing conditions on how News Corp. and its affiliates deal with smaller cable companies for retransmission consent and access to regional sports networks).

Question: How have broadcast networks and affiliate groups used the retransmission consent process to expand carriage of affiliated programming?

ACA Response 7:

In several filings, ACA has described how network owners and affiliate groups have used retransmission consent to obtain carriage of affiliate programming on smaller market cable systems.[50] Examples include:

- Tying of retransmission consent for ABC in one market to carriage of affiliated Disney programming in other markets.[51]
- Tying of retransmission consent for ABC in one market to carriage of the Disney Channel on basic in other markets.[52]
- Tying of retransmission consent for Fox Network in one market to carriage of Fox Sports, Fox News, FX, National Geographic Channel, and Fox Health Channel in other markets.[53]
- Tying of retransmission consent for NBC in one market to carriage of MSNBC, CNBC, and payment of Olympics surcharge in other markets.[54]

In this way, network owners have turned retransmission consent into another means to force affiliated programming on smaller cable companies' basic or expanded basic tiers. Many retransmission consent "negotiations" have become one-way conversations, driven by corporate owners of broadcast licenses.[55]

Table 3 contains examples of retransmission consent tying from previous retransmission consent rounds as reported by ACA members.

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[50] *See infra* notes 5-6, 29, 41 and accompanying text.

[51] ACA Petition for Inquiry at 3-4; ACA Digital Must Carry Comments at 4-15.

[52] *Id.*

[53] *Id.*

[54] *Id.*

[55] ACA Petition for Inquiry at ii, 2, 4; ACA Petition for Inquiry Supplement at 4.

Table 3 Channels carried because of retransmission consent tie-ins.

Program Service	Ownership
FX	News Corp.
Fox News	News Corp.
Speed	News Corp.
National Geographic	News Corp.
Fox Movie Network	News Corp.
Fox Sports World	News Corp.
Fuel	News Corp.
ESPN2	Walt Disney Co. / ABC
ESPN Classic	Walt Disney Co. / ABC
ESPNews	Walt Disney Co. / ABC
Disney from premium to basic	Walt Disney Co. / ABC
Toon Disney	Walt Disney Co. / ABC
SoapNet	Walt Disney Co. / ABC
Lifetime Movie Network	Walt Disney Co. / Hearst
Lifetime Real Women	Walt Disney Co. / Hearst
MSNBC	GE / NBC
CNBC	GE / NBC
Shop NBC	GE / NBC
Olympic Surcharges for MSNBC/CNBC	GE / NBC
Comedy Central	Viacom / CBS
MTV Espanol	Viacom / CBS
MTV Hits	Viacom / CBS
MTV2	Viacom / CBS
Nick GAS	Viacom / CBS
Nicktoons	Viacom / CBS
Noggin	Viacom / CBS
VH1 Classic	Viacom / CBS
VH1 Country	Viacom / CBS

Comparing this with the Top Fifty Channels in Table 1 and the Second Tier Channels in Table 2 demonstrates how certain members of the Big Five have used retransmission consent to control a significant portion of analog and digital channel capacity.

Question: How has this affected rates for MVPD offerings for consumers?

ACA Response 8:

ACA members report that retransmission consent tie-ins have affected rates in several ways —

- Retransmission consent tie-ins have directly led to rate increases for basic or expanded basic service;
- Retransmission consent tie-ins have increased the amount of rate increases for basic or expanded basic service; and
- Retransmission consent tie-ins have decreased operating margins for basic or expanded basic service.

Specific wholesale rates for most channels tied to retransmission consent remain subject to nondisclosure restrictions. By obtaining programming contracts and rate information from programmers, the Commission should be able to determine how retransmission consent tie-ins have increased the cost of basic or expanded basic tiers.

Question: Do the rules governing retransmission consent and must-carry limit consumers' ability to select their own programming? If so, how?

ACA Response 9:

In at least four ways, broadcast signal carriage laws and regulations enable network owners and major affiliate groups to restrict how smaller cable companies offer programming and how consumers can choose programming in local markets.

The ability to withdraw a broadcast signal during retransmission consent negotiations gives broadcasters powerful leverage over local cable systems. Retransmission consent laws and regulations currently entitle broadcast license owners to withhold retransmission consent and demand immediate withdrawal of a local broadcast signal from a cable system. The Commission has concluded that the threat of even temporary withdrawal of a signal gives the broadcaster powerful leverage in negotiations, and that broadcasters can use that leverage to reduce choice and increase costs to consumers.[56] Currently, only stations controlled by News Corp. must continue to make signals available pending resolution of a retransmission consent dispute.[57]

The ability to condition retransmission consent on carriage of affiliated programming results in carriage of, and payment for, unwanted programming. Retransmission consent laws and regulations currently entitle owners of broadcast licenses to require carriage of affiliated programming as a condition of access to a local broadcast signal. As mentioned above, this practice has expanded to where some members of the Big Five have required smaller cable companies to carry affiliated satellite programming in systems outside of the local broadcast market, in some cases several states away. In this way, ownership of a broadcast license has been used to force carriage of, and payment for, affiliated programming by consumers that do not even receive the broadcast signal.

Market protection regulations allow broadcasters to increase the "price" of retransmission consent and exclude lower cost alternatives. The market protection regulations known as network nonduplication and syndicated exclusivity entitle a local broadcaster to require a cable system to block certain programming on a competing out-of-market channel. These rules were promulgated years ago to protect ad-revenue supported local broadcasters. Network owners and affiliate groups are now using these

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[56] *News Corp. Order* at ¶ 209 ("If News Corp. uses withholding or threats of withholding in retransmission consent negotiations to obtain carriage of its affiliated cable networks that the MVPD, absent the threat of foreclosure, would not agree to carry, consumers are harmed because MVPDs are forced to make programming decisions based on News Corp.'s demands, rather than selecting the programming of their choice. In the long term, News Corp.'s use of market power to extract artificially high levels of compensation from MVPD rivals, or other carriage concessions, could make rival MVPDs less viable options for consumers, thus limiting consumer choice.").

[57] *Id.* at ¶ 221 ("Upon receiving notice of the intention to submit the dispute to arbitration, pursuant to the procedures described in the following paragraph, News Corp. must immediately allow continued retransmission of the broadcast station signal under the same terms and conditions of the expired contract, unless the dispute is a first time request for local broadcast station signal carriage by an MVPD.").

regulations to foreclose lower cost choices for smaller cable companies and consumers in order to raise the “price” of retransmission consent.

Network owners use affiliate contracts to restrict consumer access to broadcast signals. Network owners are using affiliate agreements to restrict affiliated stations’ retransmission consent rights.[58] In some cases, this results in network owners having the power by contract to prevent an affiliated station from delivering its signal to a cable system and consumers that desire the signal. As discussed above, this represents a transfer of control of an essential station function that requires prior Commission consent under Section 301(d).[59] To date, the Commission has not enforced Section 301(d) in this context.

In these ways, the current broadcast signal carriage regime, much of it established years ago, is now exploited by media conglomerates to reduce choice and increase costs, especially in smaller markets.

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[58] *See* Monroe Complaint at 3-5 (NBC uses its affiliation agreement to prohibit affiliate from granting retransmission consent to Monroe outside of its DMA).

[59] *See supra* pp. 19 - 20.

E. Programming diversity

Question: What effect, if any, would the voluntary offering of a la carte or themed-tier service have on the ability of independent, niche, religious, and ethnic programming to continue to be carried or launched?

ACA Response 10:

In smaller markets, more flexibility at the retail level would promote programming diversity. Conversely, current practices of the Big Five hurt programming diversity, impeding the ability of smaller cable companies to carry independent niche, religious, and ethnic channels. As described in ACA Responses 1, 6, 7, and 8, media conglomerates use market power over popular channels and local broadcast stations to require carriage of many additional affiliate channels on basic or expanded basic. This eliminates "shelf space" where the cable operator could carry independent programming, programming that could compete with Big Five controlled channels for viewers and advertising revenue.

ACA members report several examples of this. The Outdoor Channel is one channel that has been affected. The independently owned Outdoor Channel "promotes the traditional outdoor activities that are a vital part of our national heritage including fishing, hunting and shooting sports."[60] Most ACA members serve rural markets, and the Outdoor Channel carries programming that aligns with the interests of many consumers in those markets.

ACA members report difficulties in launching the Outdoor Channel in many rural systems for one reason – programming affiliated with the Big Five has absorbed available analog channel capacity, regardless of consumer demand for the channels. This prevents some systems from responding to consumer preferences and launching independent services like the Outdoor Channel.

Other ACA members report the same problem in local markets where niche Spanish-language channels would serve a significant portion of the customer base. Again, because Big Five programming has locked up available channels, Spanish-language channels must wait until the systems are further upgraded.

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[60] http://www.outdoorchannel.com.

One ACA member reports that programming practices of certain Big Five members are resulting in systems decreasing the distribution of existing religious channels. Big Five companies continue to increase the number of affiliated channels required to be carried on basic or expanded basic. To avoid contract penalties, withdrawal of "must-have programming," or a costly dispute, the cable operator must move independent religious channels from expanded basic to a lower penetrated digital tier.

In these ways, current wholesale programming practices serve to reduce choice, increase costs, and disadvantage independent programmers seeking distribution on smaller market cable systems.

F. Rural and smaller markets

Question: Describe the programming cost differential for the largest cable and satellite companies and the smallest independent MVPDs in smaller markets and rural areas. What is the "volume discount" to the larger companies?

ACA Response 11:

Our response to this question is limited by nondisclosure provisions in most programming contracts and lack of access to major MSO programming cost information. The Commission should be able to obtain this information directly from the programmers.

We can offer more generalized information from cable companies that have acquired systems from major MSOs. These companies estimate that programming costs increased up to 30%, solely because a smaller company acquired ownership. While programming costs increased on the day of closing, it is important to understand what did not change. Delivery costs did not change – the same headends received the same satellite signals as before. Administration costs did not change – the smaller operator continued to pay monthly programming fees through the National Cable Television Cooperative and programmers were paid directly, and on time, by NCTC. The only discernable change was the lack of market power of the smaller cable company compared to its major MSO predecessor. And for this reason, wholesale rates increased up to an estimated 30%.

These differences of 30% are estimates based on extrapolations. A recent statement from Liberty Media suggests that difference could be even greater.[61] In discussing the financial results of Liberty Cablevision of Puerto Rico, the report states:

> When we were split off from AT&T in August 2001, Liberty Cablevision of Puerto Rico lost the benefit of AT&T's programming rates, which were based on AT&T's total subscriber base. In response to a resulting 55% increase in programming costs in late 2001 and early 2002, Liberty Cablevision of Puerto Rico raised its subscriber rates.[62]

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[61] Liberty Media International, Inc., Information Statement (May 28, 2004).

We are familiar of no changes to Liberty's Puerto Rico systems that would justify this increase in programming costs, except for the divesture by AT&T Broadband.

Question: What percent of total expenses do smaller MVPDs in smaller markets and rural areas attribute to programming, and how does this compare to the largest cable and satellite companies?

ACA Response 12:

Based on a study of the small cable sector issued by the Carmel Group in 2003, ACA members reported the following:

- 53% of respondents allocated between 35% and 49% of total expenses to programming costs.[63]
- 20% of respondents allocated more than 50% to programming costs.[64]

Question: What would be the impact on the programming costs of smaller MVPDs if they were to purchase programming on a stand-alone basis rather than in bundles?

ACA Response 13:

If smaller cable companies could purchase certain programming on a stand-alone basis, the impact on programming costs would vary depending on the programming purchased, and the programmer owner's market power and pricing practices. The most likely impact is that programming costs would remain the same or increase. Consistent with current wholesale programming practices, programmers with market power will likely increase programming rates for stand-alone services to the point where it becomes unreasonable to purchase the service except in a package.

A review of current Big Five programming contracts will uncover several examples of how smaller cable companies are effectively forced to buy bundles. In several cases owners of "must have" programming set stand-alone fees for a single popular channel far above the fees for a bundle that includes the popular channel and

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[62] *Id*. at 36 (emphasis added).

[63] Carmel Group Study at 13.

[64] *Id.*

several weaker channels. The Commission can readily conclude that this pricing practice is aimed at preventing carriage of “must have” channels unless the cable operator carries weaker affiliated channels.

Still, the ability to *purchase* programming on a stand-alone basis does not address the two principal problems in the smaller cable sector – restrictions on distribution and non-cost-based price discrimination.

ACA Responses 3 and 14 show that a measure of flexibility in how smaller cable companies can package channels to serve local markets would benefit competition, choice, alleviate upward pressure on rates, and, in some cases, result in reduced rates for basic or expanded basic.

Question: What would be the impact on the programming cost of smaller MVPDs if they were allowed to offer a la carte or themed-tier service in addition to bundled packages?

ACA Response 14:

For ACA members, there is only one legitimate answer to this question: <u>It depends</u>. With additional flexibility in how smaller cable companies offer programming in local markets, programming costs may not change, may decrease, or may increase. The result will depend on several key variables, most importantly, the programmer’s market power and wholesale pricing practices.

Sports Tier example. We return to our Sports Tier example.

Our example involves a 5,000 customer cable system that purchases programming through current wholesale practices. That system pays about $5.00 per customer per month for certain national and regional sports channels and the affiliated channels that are bundled with those channels, and must distribute the channels to at least 90% of subscribers. Consequently, the cable operator pays about $22,500 per month for those sports channels, and substantially all customers must purchase and pay for those channels.

What happens if the same cable operator were permitted to move those services to a sports tier? Assume 30% of customers order the sports tier. It is likely that the programmer would charge substantially more for the service if offered on a sports tier.

If the programmers increased fees to $15 per customer per month, the subscription revenue derived by the programmers from the system would not change – $22,500 per month. On the other hand, a programmer with market power might increase fees even more. In that case, aggregate programming costs would increase, even though the service is distributed to fewer customers.

Programmers could also make different business decisions. For example, programmers may determine that demand elasticity exists for the Sports Tier, and that they may increase subscribers and revenues by raising the tier license fee a lesser amount.

Similarly, ensuring that smaller cable companies had the option to tier a high cost sports channel might also lead to <u>lower</u> license fees for that channel. A programmer might decide that wider distribution on expanded basic is more valuable than higher tier license fees. That programmer could incent the cable operator to carry the channel on expanded basic by lowering license fees.

G. Set top boxes

Question: Is an addressable converter box required for every television set on which a consumer might wish to view programming offered on an a la carte or themed-tier basis?

ACA Response 15:

Nearly all ACA member systems currently offer premium channels like HBO, Cinemax and Showtime on an a la carte basis. In some systems, this requires an addressable converter box. Some systems can deliver these services a la carte without a converter box through the use of traps. Traps are filters installed outside the customer's home that block or pass designated channels to that customer. As systems are upgraded to provide digital services, digital set top boxes have generally replaced the use of traps. Plug and Play televisions will enable consumers to obtain unidirectional digital services without set top boxes, including in smaller cable systems.

Question: Is it true that a la carte or themed-tier services can only be offered on a digital basis?

ACA Response 16:

No. Analog-only systems can offer a limited number of a la carte services and at least one theme-tier through use of traps or analog scrambling techniques.

Question: What percent of cable and satellite distributors offer digital programming to their subscribers?

ACA Response 17:

According to the Carmel Group Study, as of December 2002, 51% of ACA member respondents offered digital programming to their customers, with an additional 16% planning to roll out the services by December 2003, and another 14% of responding companies planning to offer digital cable within the next three years.[65]

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[65] Carmel Group Study at 16.

H. Legal and regulatory matters

Question: Would MVPDs be in compliance with the must carry rules so long as they offered all local broadcast stations on an a la carte or themed-tier basis, or would the must-carry rules prohibit MVPDs from offering local broadcast stations on an a la carte or themed-tier basis?

ACA Response 18:

Section 623(b)(7) of the Cable Act obligates cable operators to deliver a basic tier to all subscribers.[66] By statute, the basic tier must contain all broadcast signals carried by the cable operator, except for out-of-market superstations.[67]

Question: What, if any, Constitutional or other legal questions are raised by programmers' ability to bundle services through retransmission consent, regional sports contracts, and national programming contracts for marquee programming?

ACA Response 19:

Two excellent sources for legal and policy concerns arising from current wholesale programming practices are the *News Corp. Order* and the Commission's orders implementing the retransmission consent laws.

The *News Corp. Order*. In the *News Corp. Order*, the Commission analyzed the ability of a media conglomerate to leverage retransmission consent and marquee programming to require carriage of affiliated programming and raise costs for smaller cable companies and consumers. The Commission concluded:

- An owner of "must have" programming like a regional sports channel possesses significant market power over distributors.[68]
- An owner of a network broadcast station controls "must have" broadcast programming and possesses significant market power over distributors.[69]

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[66] 47 U.S.C. § 543(b)(7) (1996).

[67] 47 U.S.C. § 543(b)(7)(A)(i) and (iii) (1996).

[68] *News Corp. Order* at ¶ 148 ("At the outset, we agree with commenters that there are no reasonable available substitutes for News Corp.'s RSN programming and that News Corp. thus currently possesses significant market power in the geographic markets in which its RSNs are distributed.").

[69] *Id.* at ¶ 201 ("We find the News Corp. currently possesses significant market power in

- An owner of “must have” broadcast and satellite programming has the incentive and ability to raise the price for its channels by temporary withdrawal, or threatening temporary withdrawal.[70]

- Consumers are harmed by increased prices for “must have” satellite and broadcast programming and by temporary withdrawal of that programming.[71]

- Small cable companies are especially vulnerable to this conduct.[72]

These conclusions established the foundation for the Commission to impose conditions on retransmission consent transactions and regional sports network transactions involving News Corp.-controlled channels. Other media conglomerates engage in similar conduct, with the same harm to consumer choice, competition, and costs. As discussed in ACA Response 2, the conditions contained in the *News Corp. Order* offer models for addressing several current wholesale programming practices on a broader scale.

Retransmission consent orders.

A review of the Commission’s interpretation and implementation of Section 325 shows how current retransmission consent practices conflict with the intent of the statute. Those orders reflect the following analysis and conclusions emphasizing

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the DMAs in which it has the ability to negotiate retransmission consent agreements on behalf of local broadcast television stations. Local broadcast station programming is highly valued by consumers, and entry into the broadcast station market is difficult.”)

[70] *Id.* at ¶ 366 ("[T]he increased profits accruing to DirecTV and News Corp. as a result of the temporary withdrawal of regional sports programming and broadcast signals will give News Corp. an increased incentive to adopt a strategy of temporary foreclosure in order to uniformly raise the price of its broadcast television and regional sports programming and/or obtain other carriage concessions.").

[71] *Id.* ("[I]ncreased ability and incentive to seek and obtain higher programming prices and/or obtain other carriage concessions through temporary foreclosure would likely lead to higher prices to MVPD consumers and thereby harm the public interest.").

[72] *Id.* at ¶ 176 (“[W]e agree with ACA to the extent that it argues that small and medium-sized MVPDs may be at particular risk of temporary foreclosure strategies aimed at securing supra-competitive programming rate increases for “must have” programming such as RSNs…”).

localism and mutually beneficial retransmission consent agreements:

- "[T]he statutory goals at the heart of Sections 614 and 325 [are] to place <u>local broadcasters</u> on a more even competitive level and thus <u>help preserve local broadcast service to the public</u>."[73]
- "<u>Local broadcast stations</u> are an important part of the service that cable operators offer and broadcasters rely on cable as a means to distribute their signals."[74]
- The retransmission consent framework provides "incentives for both parties to come to <u>mutually-beneficial arrangements</u>."[75]

Against this backdrop, ACA members must today deal with national media conglomerates for permission to distribute local broadcast signals. For smaller cable companies, retransmission consent has become anything but "local" and anything but "mutually beneficial." Corporate parents have shifted retransmission consent authority away from local broadcast licensees to advance national strategies of expanded carriage of affiliated satellite programming. Often, the resulting tying arrangements require the small cable operator to carry the affiliated satellite programming on cable systems that do not carry the broadcast signal. This conduct has nothing to do with localism and consumer choice, and everything to do with revenue goals of corporate parents and satellite programming affiliates.

Section 325 also reflects Congress' concern over the interplay between retransmission consent and basic rates. Section 325(b)(3)(A) expressly directs the Commission to consider the impact of its retransmission consent regulations on basic rates.[76] In 1993, when the Commission first considered this question, it found little

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[73] *In the Matter of Implementation of the Cable Television Consumer Protection and Competition Act of 1992; Broadcast Signal Carriage Issues*, Memorandum Opinion and Order, 9 FCC Rcd. 6723 (1994) ("1994 Broadcast Signal Carriage Order") ¶ 104 (emphasis added).

[74] *Id.* at ¶ 115 (emphasis added).

[75] *Id.* (emphasis added); *see also id.* at ¶ 107 (interpretation of Section 325 guided by maintaining ability of broadcasters and cable operators to negotiate mutually advantageous arrangements).

[76] 47 U.S.C. § 325(b)(3)(A) (1999).

evidence of rate impact and declined to regulate retransmission consent rates at that time.[77] Much has changed since 1993.

As discussed in ACA Responses 2, 7, 8 and 9 the retransmission consent practices of media conglomerates have both directly and indirectly increased the costs of cable, especially in smaller markets.

These developments show that current retransmission consent practices do not align with the goals of "preserving local broadcast stations for the public," and maintaining reasonable rates for basic cable service.

Question: What, if any, Constitutional or other legal questions would be raised if, in addition to currently offered packages, Congress required programmers to allow MVPDs to voluntarily offer their channels on an a la carte or themed-tier basis?

ACA Response 20:

Congress has ample authority to impose content neutral regulations on wholesale programming transactions. The program access laws provide a model and a legislative vehicle to address several aspects of the problem. The current program access laws have withstood First Amendment scrutiny.[78] The Commission findings in the *News Corp. Order* and in this proceeding will give Congress a solid record to consider expanding the program access laws in light of the "unique power"[79] that media conglomerates have gained in the cable market and how that power is being used to impede the important government interests of promoting competition, choice, and diversity, especially in smaller markets.

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[77] *In the Matter of Implementation of the Cable Television Consumer Protection and Competition Act of 1992 Broadcast Signal Carriage Issues,* Report and Order, 8 FCC Rcd. 2965 (1993) at ¶¶ 173, 178.

[78] *Time Warner Entertainment, L.P. v. FCC*, 93 F.3d 957, 977-979 (D.C. Cir. 1996).

[79] *Id*. at 978 (citing S. Rep. No. 92, 102d Cong., 2d Sess. 4 (1991)).

F. Other matters

Question: We seek comment on these issues and any other issues that will inform the Report on the provision of a la carte or themed-tier programming by MVPDs.

ACA Response 21:

A final point – a pure a la carte regime is impossible for thousands of cable systems in rural America due to the cost.

This inquiry has emerged from growing dissatisfaction among consumers and policymakers with: (i) the lack of choice and control over many of the channels delivered on cable; and (ii) the increased rates for those channel packages. As we have described here, in smaller markets, two changes will go far in addressing this dissatisfaction.

First, smaller cable companies need flexibility in how they can package and offer channels in local markets. Among ACA's 1,000 member companies and the many thousands of local markets they serve, a "one-size-fits-all basic" or expanded basic package does not fit all. Yet the wholesale programming practices of Big Five companies require that most smaller cable companies distribute the same costly bundles of programming to nearly all customers. Second, smaller cable companies should not be subject to non-cost-based price discrimination in wholesale programming rates. This results in rural customers subsidizing programming costs of larger distributors, including the DBS companies. This is anticonsumer, anticompetition, and should be stopped.

One solution we cannot propose is a pure a la carte regime. We acknowledge the appeal of consumers being able to select what they want from a menu of channels. But for smaller cable companies, the problem is cost. Based on an analysis by Alan Tschirner, Vice President of Engineering, National Cable Television Co-op, the technology cost alone for any cable system to offer convert an analog line up to digital and offer a la carte exceeds $285,000.[80] Additional costs will come from set top boxes,

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[80] Exhibit 1, Letter from Alan Tschirner, Vice President – Engineering, National Cable Television Cooperative, to Christopher C. Cinnamon, Cinnamon Mueller (July 9, 2004) (on file

billing system changes, and other sources. As stated by Mr. Tschirner, “For NCTC and ACA member systems, hundreds of which are under 1,000 subscribers, it would seem self-evident that the systems could not support these costs.”[81]

The Commission has ample familiarity with the economics of smaller market cable systems to verify that technology costs of this magnitude are a financial impossibility for those systems.

By communicating that message, the Commission’s report will help eliminate current misconceptions concerning pure a la carte in smaller markets.

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with author).

[81] *Id.*

III. CONCLUSION

ACA appreciates the Commission undertaking this important inquiry and will make all Association resources available to assist.

Respectfully submitted,

AMERICAN CABLE ASSOCIATION

By: ________/s/_______________

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July 12, 2004

ACA Comments MB Docket No 04-207.doc

Exhibit 1

Letter from Alan Tschirner
Vice President – Engineering
National Cable Television Cooperative, Inc.

NATIONAL CABLE TELEVISION COOPERATIVE, INC.

July 9, 2004

Christopher C. Cinnamon
Cinnamon Mueller
307 North Michigan Avenue
Suite 1020
Chicago, IL 60601

Re: Small cable a la carte; technology and estimated headend costs

Dear Chris:

Within the context of the industry discussion concerning proposals for a la carte programming, I have studied the necessary technology and related costs for a typical smaller cable system to provide true a la carte. After reviewing the available technologies, I have concluded that offering a la carte channels will require digitizing each channel at the cable headend, then providing customers with set top boxes that permit individual channel choices. While the technology appears to be available today, it is clear that small cable systems cannot now, or in the foreseeable future, support the cost of that technology. I explain further below.

Headend equipment necessary to offer true a la carte.

To offer a la carte, a small cable system would first need to digitize all channel inputs. For analog channels, this requires encoding of the analog signal into digital format. This requires a separate encoder for each analog input. Encoder costs are currently averaging $7,850 per channel.

Networks that are delivered digitally do not need a separate encoder. These networks do need to be "muxed", or groomed into QAM payloads for transmission on the system. QAM (quadrature amplitude modulation) is the signal modulation technique used by digital cable systems. The equipment necessary for muxing is called a multiplexer. Multiplexer prices are averaging $1,000 per channel input, or $10,000 for a 10 channel multiplexer. In addition, each channel group must be processed through a QAM modulator. QAM modulator prices average $1,000 per channel.

11200 Corporate Avenue
Lenexa, KS 66219

913/599-5900
FAX 866/628-2774

Technology costs for offering true a la carte for a typical smaller cable system.

Using current technology costs, I have estimated headend costs for a typical small cable system. I have assumed a system that offers 58 channels, 32 in analog and 26 in digital. Technology costs are:

32 encoders x $7,850	$251,200
3 10 channel multiplexers x $10,000	$ 30,000
6 10 channel QAM modulators	$ 6,000
	$287,200

Please keep in mind that this figure does not include settop box costs, billing system costs, administrative costs, and many other costs that a small system would need to incur in a true a la carte regime.

For NCTC and ACA member systems, hundreds of which are under 1,000 subscribers, it would seem self-evident that the systems could not support these costs.

Sincerely,

/s/
Alan Tschirner
Vice President - Engineering