Before the
Federal Communications Commission
Washington, DC 20554

In the Matter of	)	
	)	
Comment Requested on A La Carte and	)	
Themed Tier Programming and Pricing	)	
Options for Programming Distribution	)	MB Docket No. 04-207
On Cable Television and Direct	)	
Broadcast Satellite Systems	)	
	)	
	)	

COMMENTS OF THE WALT DISNEY COMPANY

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Table of Contents

I. EXECUTIVE SUMMARY……………………………………………………………2

A. Under Any A La Carte or Tiered Programming System, Consumers Would Pay More But Get Less……………….……………………..2

B. There Is No Need For the Government to Revisit the Statutory or Regulatory Provisions Regarding Retransmission Consent…………..…..3

II. UNDER ANY A LA CARTE OR TIERED PROGRAMMING SYSTEM, CONSUMERS WOULD PAY MORE BUT GET LESS……………………..…4

A. There Is No Need For Government Intervention Into the Multichannel Video Programming Marketplace Because Consumers Enjoy A Wide Range Of Subscription Television Packaging And Pricing Options……..4

B. Fundamental Economics Support the Offering of Programming Via the Expanded Basic Tier and Altering This Method of Distribution Runs Counter to Those Principles……………………………………………...6

C. The FCC Does Not Have The Statutory Authority To Interfere With Private Contracts To Require "Voluntary" or Any Type of A La Carte Or Tiered Offerings……………………………………………………………..7

1. Congress Did Not Grant the FCC Express Jurisdiction to Require A La Carte………………………………………………………………..8
2. The FCC Does Not Have Ancillary Jurisdiction to Enact A La Carte Regulations…………………………………………………………9
3. Exercise of FCC Jurisdiction to Provide for Any Type of A La Carte Would Contradict Congress's Express Repeal of FCC Jurisdiction To Regulate Cable Rates……………………………………………...…11

D. The Expanded Basic Bundle Is The Most Attractive To Advertisers and Any Regulations Regarding A La Carte Offerings Would Have A Detrimental Impact on Advertising Revenues and the Ability of Networks to Sell Advertising…………………………………..………………...12

1. A La Carte Regulation Would Increase Consumer Costs Because It Would Decrease the Advertising Revenues Derived from the Expanded Basic Bundle That Currently Subsidize Consumer Rates………………………………………………………………….12
2. Advertisers Desire Programmers With Broad Subscribership and Thus A La Carte or Tiering Regulations Would Negatively Impact Both Advertising Revenues and Competition for Advertising…………….13

E. Any A La Carte Or Tiering Scenario Would Be Comparatively Less Efficient Than Expanded Basic And Would Cause Consumers To Pay More To Get Less…………………………………………………………..17

F. Disney Channel's Experience Migrating From An A La Carte Premium Channel To Expanded Basic Confirms The Pro-Consumer Efficiencies Of The Expanded Basic Bundle…………………………………………….18

G. Even Government Intervention Limited To Facilitating "Voluntary" A La Carte Would Cause Consumers To Pay More To Get Less – and All Consumers Would Bear the Costs………………………………………24

H. Government Mandated Tiers Would Create The Same Anti-Consumer Consequences As A La Carte……………………………………………25

I. Government Intervention Regarding A La Carte Would Return the Government to Rate Regulation…………………………………………27

J. Government Intervention In Favor Of A La Carte And Tiers Would Decrease Program Diversity……………………………………………28

K. Experience In Other Countries Provides No Basis To Believe That A La Carte Or Tiering Would Benefit Consumers In The United States……..29

1. Canada……..……………………………………………………..30
2. Other International Systems………………………………………...33

L. Disney's Contracting Practices Already Provide Significant Flexibility To MVPDs…………………………………………………………………35

M. Disney Accommodates Small Cable Operators Through Co-Op Buying Deals……………………………………………………………………36

N. A La Carte And Family Tiers Are Not The Way To Deal With Concerns About Programming Indecency………………………………………37

III. THERE IS NO REASON TO REVISE THE STATUTES OR REGULATIONS REGARDING RETRANSMISSION CONSENT………………………………37

A. Retransmission Consent was Enacted By Congress in Recognition that Broadcasters Have the Right To Require Consent Before Another Entity Distributes Its Product..………………………………………………..…37

B. Disney Offers MVPDs A Stand-Alone Cash Retransmission Deal For The ABC Owned Television Stations………………………………………..40

C. The Practice Of Granting Retransmission Consent For A Broadcast Station In Return For Carriage Of Commonly Owned Channels Is An Alternative And Was Developed In Conjunction With the MVPDs' Desire Not To Pay Cash……………………………………………………………41

D. Disney's Cash Retransmission Price for the ABC Owned Stations Is Completely Reasonable…………………………………………………….43

E. Disney Offers Flexibility In Its Retransmission Consent Negotiations….44

IV. CONCLUSION…………………………………………………………….46

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COMMENTS OF THE WALT DISNEY COMPANY

The Walt Disney Company submits these comments in response to the Public Notice issued by the FCC on May 25, 2004, in the captioned proceeding to gather information to respond to Congress on a variety of issues related to A La Carte and Tiered Subscription program offerings and Retransmission Consent. These Comments are submitted on behalf of The Walt Disney Company, ESPN (80% owned by Disney), ABC Cable Networks Group (The Disney Channel, ABC Family, Toon Disney and SoapNet), The ABC Television Network and the ABC Owned Television Stations (hereinafter collectively referred to as "Disney").

I. EXECUTIVE SUMMARY

A. Under Any A La Carte or Tiered Programming System, Consumers Would Pay More But Get Less

There is no need for government intervention into the subscription television marketplace. Consumers today enjoy a wide range of subscription television packages and pricing options.

Any government action to require or facilitate A La Carte or Tiered subscription television offerings would result in consumers paying more and receiving less. An economic study prepared by Economists Incorporated ("Economic Study"), attached to these comments as Exhibit 1, conclusively demonstrates that the perceived benefits of any A La Carte system are just that – only perceived – but that the costs would be real.

The Expanded Basic bundle of program services is the most efficient and cost effective way to deliver highly valued and diverse programming to consumers. As demonstrated by the statements from advertising executives attached to these comments, A La Carte or Tiered offerings would drain advertising revenues from the system and decrease competition for advertising. A La Carte or Tiered offerings also would precipitate increased equipment, marketing and transaction costs. Taken together, these decreased revenues and increased costs would result in sharply higher consumer rates even for drastically reduced programming packages. The Disney Channel's own actual experience in migrating from an A La Carte premium channel to Expanded Basic demonstrates the pro-consumer efficiencies of the Expanded Basic bundle.

Government intervention to facilitate "voluntary" A La Carte offerings would cause all the same anti-consumer problems as would mandated A La Carte. And, government mandated Tiers would create the same anti-consumer consequences as A La Carte. Government intervention in favor of A La Carte or Tiers would decrease program diversity and inevitably entail some form of government price control. The FCC does not have the requisite statutory authority to require A La Carte or Tiered offerings and programmers' experience in other countries provides no basis to believe that A La Carte or Tiers would benefit consumers.

B. There Is No Need For the Government to Revisit the Statutory or Regulatory Provisions Regarding Retransmission Consent

Disney negotiates Retransmission Consent only for the ten ABC Owned Television Stations. Disney offers cable and satellite operators a stand-alone cash Retransmission Consent deal, in addition to an offer to secure Retransmission Consent for one or more of the ABC Owned Television Stations in return for carriage of Disney ABC Cable program services. Disney's cash retransmission offer is completely reasonable and is supported by an economic analysis that is attached as Exhibit 2 to these comments ("Retransmission Consent Economic Analysis"). The Retransmission Consent Economic Analysis concludes that even an understated, average value for the ABC Owned Television stations falls within the range of $2.00 to $2.09 per subscriber (well in excess of the cash price offered by ABC). Disney's contracting practices also provide flexibility for multichannel video programming distributors ("MVPDs"). Moreover, the Retransmission Consent statutory provisions enacted by Congress in 1992 recognize the fundamental principle that a company that sells the product of another company should compensate that company. Nothing has changed in the marketplace since 1992 to alter this basic principle, as applied to Retransmission Consent. Therefore, there is no need for changes in the Retransmission Consent statute or its implementing regulations.

II. Under Any A La Carte or Tiered Programming System, Consumers Would Pay More But Get Less

A. There Is No Need For Government Intervention Into the Multichannel Video Programming Marketplace Because Consumers Enjoy A Wide Range Of Subscription Television Packaging And Pricing Options

Proposals for government action to mandate or facilitate A La Carte and/or Tiered program offerings seem to be based on the belief that today's subscription television marketplace does not provide consumers with a sufficient range of programming and pricing options. This is incorrect. The facts show that today consumers already enjoy a myriad of subscription television program packaging and pricing options.

For starters, more than 95% percent of all U.S. television households currently are passed by cable[1] and enjoy access to a "Basic" cable service that costs an average of only about $14 per month.[2] Basic typically includes retransmission of local broadcast stations, public educational and governmental access channels, and selected other program services. Currently, approximately 10% of cable subscribers choose to receive only the Basic programming service.[3]

Many consumers also enjoy a wide range of program packaging and pricing options other than Basic cable, but at a cost at or less than the average $40 price range of the Expanded Basic cable and equipment bundle.[4] Most notably, virtually all consumers

[1] Tenth Annual Report, 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 (rel. Jan. 28, 2004) ("Tenth Competition Report"), at para. 21 and Table 1.
[2] Report on Cable Industry Prices, in the Matter of Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of 1992; Statistical Report on Average Rates for Basic Service, Cable Programming Service, and Equipment, MM Docket No. 92-266 (rel. July 8, 2003) ("2002 Cable Industry Prices Report"), at para. 4 and Attachment 2.
[3] *Id.* at para. 3.
[4] *Id.* at para. 4 and Attachment 2.

nationwide enjoy the program packaging and pricing options offered by direct broadcast satellite subscription television services. In fact, from a start-up industry in the 1990's, satellite distributors now have about 21% of the multi-channel market and represent its fastest growing segment.[5] For example, Dish Network (which just surpassed the 10 million subscriber mark) offers the "America's Top 60" package for only $25 per month providing a midpoint alternative between Lifeline Basic and larger, Expanded Basic bundles.[6] At $39 per month DirecTV provides its "Total Choice" package of 90 video channels.[7] New entrant VOOM has a package of 120 channels (35 in high definition) for $39.90.[8]

In addition to the satellite subscription services, a number of overbuilders offer competitively priced multichannel video services. These distributors, including RCN, Wide Open West and Knology, have a presence in 71 of the 210 television markets in America and in 9 of the top 10 DMAs. New technologies also are supporting new subscription offerings including USDTV, which provides 35 channels in Salt Lake City and 24 channels in Las Vegas and Albuquerque of cable and broadcast programming delivered digitally over-the-air for $20 per month (including ESPN, ESPN2, the Disney Channel and Toon Disney).[9] Finally, investments continue to be announced by the

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[5] Tenth Competition Report at para. 8 and Appendix B.

[6] *See* EchoStar Satellite L.L.C., *Basic Packages: America's Top 60, at* http://www.dishnetwork.com/content/programming/packages/at_50/index.asp?viewby=1&packid=10049&sortby=1 (last visited July 14, 2004).

[7] *See* The DirecTV Group, Inc. Companies, *TOTAL CHOICE® with Local Channels Package*, *at* http://www.directv.com/DTVAPP/learn/Packages_TotalChoice.dsp (last visited July 14, 2004).

[8] *See* Rainbow DBS Company LLC, *GET IT : Offers, at* http://www.voom.com/get_it/offers.jsp (last visited July 14, 2004).

[9] *See* U.S. Digital Television, Inc., *About USDTV!*, at http://www.usdtv.com/why_usdtv.php (last visited July 14, 2004).

regional phone companies in anticipation of new video services to be offered in conjunction with voice and data services to remain competitive with cable companies whose modem and phone offerings continue to grow.

As the foregoing demonstrates, today's marketplace provides consumers with a wide range of subscription television programming and pricing options. Contrary to the rhetoric of some critics, it simply is not true that consumers have no choice other than a single Expanded Basic bundle of cable services. The growth of satellite alone demonstrates that there is no marketplace failure that would necessitate or justify government intervention.

B. Fundamental Economics Support the Offering of Programming Via the Expanded Basic Tier and Altering This Method of Distribution Runs Counter to Those Principles

The Economic Study attached to these comments as Exhibit 1 makes clear that any A La Carte or Tiering regulation would be an unsound economic endeavor. As an initial matter, the Economic Study demonstrates that, even if there is any question of market power, the "[e]xploitation of market power is not a common reason for bundling" and that "a regulation requiring a firm with market power to unbundle would not diminish the firm's market power" because the firm could just charge the same price for the unbundled products (but then would add the additional transaction costs to sell the products unbundled). Economic Study at 2. The Economic Study goes on to describe the economic efficiencies of bundling, comparing the Expanded Basic tier to the practice of major newspapers selling a bundle of content in which not all readers likely are interested at all times. *Id.* at 1-2. Therefore, there is no competitive reason to interfere with the efficiencies of the Expanded Basic tier.

The Economic Study provides two models illustrating the potential for welfare losses from any A La Carte system, to consumers, distributors and programmers (at Appendix B and C). These models illustrate that A La Carte could reduce consumer welfare, even ignoring the additional costs that A La Carte creates, because operators and programmers would price programming at a level that would exclude some consumers who otherwise would have enjoyed the programming at a lower price. Indeed, under the assumption of the model at Appendix B unbundling makes everyone worse off. The second model, at Appendix C, depicts both mixed bundling and unbundling regimes and demonstrates that either regime may result in only a limited number customers faring better than under pure bundling, while the majority of customers would be worse off. As a general matter, the second model illustrates that the current Expanded Basic tier can produce greater consumer benefits than either mandatory or "voluntary" A La Carte – even ignoring costs. The Economic Study also reviews the relevant economic literature (at 11-13), which concludes that: (1) overall social welfare increases with bundling in cable television and there would be losses from unbundling; and (2) unbundling would clearly reduce advertising revenues and require uncertain increases in license fees to compensate.

C. The FCC Does Not Have The Statutory Authority To Interfere With Private Contracts To Require "Voluntary" or Any Type of A La Carte or Tiered Offerings

The FCC must demonstrate that Congress delegated it authority or jurisdiction before the FCC may issue any rule. As the United States Court of Appeals for the D.C. Circuit has stated, "An agency may not promulgate even reasonable regulations that claim a force of law without delegated authority from Congress."[10] In the instant case, the FCC must demonstrate that Congress has granted it the authority prior to adopting any regulations relating to A La Carte. The same threshold question of whether the FCC has jurisdiction applies whether the A La Carte regulations would be considered to be mandatory or "voluntary." As demonstrated below, the FCC cannot satisfy this burden. Therefore, legislative action would be necessary before the FCC could adopt any A La Carte regulations.

1. Congress Did Not Grant the FCC Express Jurisdiction to Require A La Carte

No statute, including the Communications Act of 1934, as amended, provides the FCC with express authority to enact regulations concerning A La Carte. Congress has delegated authority to the FCC concerning certain cable-related issues but authority regarding A La Carte is glaringly absent from these delegated matters. For example, Congress granted the FCC express jurisdiction to regulate carriage agreements, the scrambling or blocking of certain channels and the mandatory carriage of certain broadcast signals.[11] As these examples demonstrate, when Congress intended to give the FCC authority over a cable-related issue, Congress did so expressly. Thus, if Congress wanted to grant the Commission authority to require A La Carte, it would have done so expressly. The absence of such an express grant of authority to regulate A La Carte

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[10] *See* Motion Picture Ass'n of Am., Inc. v. FCC, 309 F.3d 796 (D.C. Cir. 2002) ("MPAA"). A court need not afford deference to an agency's interpretation of a statute unless the agency has acted pursuant to delegated authority. *See* United States v. Mead Corp., 533 U.S. 218, 226-27 (2001).

[11] *See* 47 U.S.C. § 536 (carriage agreements); 47 U.S.C. § 560 (scrambling); 47 U.S.C. § 534 (mandatory carriage).

indicates that Congress did not grant the FCC jurisdiction to impose A La Carte regulations.[12]

2. The FCC Does Not Have Ancillary Jurisdiction to Enact A La Carte <u>Regulations</u>

Absent express jurisdiction, the FCC may regulate in an area only if it is proper to exercise its limited ancillary jurisdiction in that area.[13] As an initial matter, exercise of ancillary jurisdiction with respect to cable matters is a particularly tenuous proposition given the express reservation of jurisdiction contained in Section 624(f) of the Act, which states that "[a]ny federal agency…may not impose requirements regarding the provision or content of cable services, except as expressly provided in Title VI."[14] In the instant case, Section 624(f) forbids the FCC from enacting A La Carte regulations because such regulations directly affect "the provision…of cable services."[15] For example, to require a cable operator to offer certain cable channels on an A La Carte basis is a "requirement regarding the provision or content of cable services."[16] Thus, Section 624(f) prevents the FCC from asserting its ancillary jurisdiction to require A La Carte.

Even if the FCC were to ignore the clear mandate of Section 624(f), it could exercise its ancillary jurisdiction to regulate A La Carte only if the Commission's Title I general jurisdictional grant covers the subject of the regulation and the assertion of

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[12] The common canon of statutory construction *expressio unius est exclusio alterius* (expression of one thing means exclusion of another) provides further support for this interpretation.

[13] *See generally* <u>United States v. Southwestern Cable Co.</u>, 392 U.S. 157 (1968) (determining standard for exercise of ancillary jurisdiction).

[14] 47 U.S.C. § 544.

[15] As discussed in further detail below, A La Carte regulations also affect "content of cable services."

[16] 47 U.S.C. § 544.

jurisdiction is "reasonably ancillary to the effective performance of [the FCC's] various responsibilities" under Title I.[17] In order to satisfy this ancillary jurisdiction burden, the FCC must rely upon § 1 of the Act, which states that the Commission's basic purpose is "to make available, so far as possible, to all the people of the United States . . . a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges."[18] Reliance upon § 1 for ancillary jurisdiction to regulate A La Carte would be misplaced, however, because "§ 1 merely authorizes the agency to ensure that all people of the United States, without discrimination, have access to wire and radio communication transmissions."[19] Any potential A La Carte regulations would govern the manner in which cable operators provide programming and the rates they charge for such programming; A La Carte regulations would not expand the reach of cable service to more Americans.[20] Because exercise of jurisdiction to require A La Carte would not be "reasonably ancillary" to the purposes of § 1, reliance upon ancillary jurisdiction would be improper in the instant case.

FCC ancillary jurisdiction over A La Carte also would not be "reasonably ancillary" because any A La Carte regulations would impact content and the FCC must

[17] *See* United States v. Southwestern Cable Co., 392 U.S. 157, 177-78 (1968).

[18] *See* 47 U.S.C. § 151; 47 U.S.C. § 152.

[19] *See* MPAA at 804. The Court in MPAA further stated that "§ 1's mandate to serve 'all the people of the United States' is a reference to the geographic availability of service." *Id.*

[20] *See* MPAA at 804 ("Under § 1, Congress delegated authority to the FCC to expand radio and wire transmissions, so that they would be available to all U.S. citizens.") (citing United States v. Midwest Corp., 406 U.S. 649, 667-68 (1972); United States v. Southwestern Cable Co., 392 U.S. 157 (1968)).

have express jurisdiction to regulate content.[21] To require a cable system to sell its channels individually or package its programming into subject-specific tiers would affect the content on the cable system and thus run afoul of the D.C. Circuit's admonitions in MPAA v. FCC.

3. Exercise of FCC Jurisdiction to Provide for Any Type of A La Carte Would Contradict Congress's Express Repeal of FCC Jurisdiction To Regulate Cable Rates

To the extent that there is any lingering doubt regarding the FCC's lack of express or ancillary jurisdiction over A La Carte issues, the fact that Congress expressly repealed cable rate regulation soundly resolves any such doubt. In the Telecommunications Act of 1996, Congress ended its unsuccessful, short-lived experiment with FCC cable rate regulation by repealing the FCC's jurisdiction over cable service rates[22] and enacting a sunset of the FCC's jurisdiction over Expanded Basic rate regulation.[23] Congress's directive could not be more clear; the FCC no longer has jurisdiction to regulate cable rates.

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[21] *See* MPAA at 805 ("To avoid potential First Amendment issues, the very general provisions of § 1 have not been construed to go so far as to authorize the FCC to regulate program content. Rather, Congress has been scrupulously clear when it intends to delegate authority to the FCC to address areas significantly implicating program content.").

[22] *See* 47 U.S.C. § 543(a)(1) ("Regulation of Rates: No federal agency or State may regulate the rates for the provision of cable service except to the extent provided under this section and section 612"). In 47 U.S.C. § 543, Congress authorizes the Commission to assert jurisdiction and regulate rates only for the basic tier in the rare circumstance that it disapproves of a local franchising authority's certification to do so. Section 612 authorizes the FCC to regulate the price, terms and conditions under which cable operators provide access to unaffiliated programmers under certain defined circumstances; it does not address rates ultimately charged to consumers. 47 U.S.C. § 532(c)(1).

[23] *See* 47 U.S.C. § 543(c)(4) ("Sunset of upper tier rate regulation. – This subsection shall not apply to cable programming service provided after March 31, 1999.").

Absent a new grant of jurisdiction to regulate rates, the FCC may not impose A La Carte regulations because any A La Carte regulation would inescapably be a cable rate regulation – or its equivalent. Specifically, to require delivery of programming on an A La Carte or Tiered basis would be the equivalent of rate regulation because it would require an MVPD to charge a separate (and different) rate for that channel or small tier other than what it would charge for the channel as part of its preferred type of package or tier. The fact that the proponents of A La Carte regulations allege rising cable rates and the (misplaced) belief that consumers would pay less for certain combinations of channels among their motives for A La Carte provides further evidence that A La Carte regulations would be, at their core, rate regulation.[24]

Therefore, the FCC does not have express or ancillary jurisdiction over A La Carte carriage issues. Congress's express repeal of cable rate regulation authority further demonstrates the FCC's lack of jurisdiction in this area.

D. The Expanded Basic Bundle Is The Most Attractive To Advertisers and Any Regulations Regarding A La Carte Offerings Would Have a Detrimental Impact on Advertising Revenues and the Ability of Networks to Sell Advertising

1. A La Carte Regulation Would Increase Consumer Costs Because It Would Decrease the Advertising Revenues Derived from the Expanded Basic Bundle That Currently Subsidize Consumer Rates

The economics of the Expanded Basic bundle maximize the advertising revenues received by programming networks because, as described in detail below, advertisers are most interested in the broad subscriber reach of the Expanded Basic networks. The

[24] *See, e.g.*, Letter from The Honorable John McCain, Chairman, United States Senate Committee on Commerce, Science and Transportation, to The Honorable Michael Powell, Chairman, Federal Communications Commission (May 19, 2004) ("A La Carte pricing would enable consumers to pay for only those channels they want to watch . . . . It may also have the effect of disciplining cable rates overall.").

advertising revenues received by both the programming networks (as part of their dual revenue stream) and the distributors subsidize the retail cost of the networks to consumers. Every dollar in advertising revenue that comes into the system represents a dollar of cost that does not need to be recouped through retail charges to the consumer. Therefore, market structures that enhance advertising revenue help to reduce consumer cost.

By providing the opportunity for many different channels to enjoy wide circulation, the Expanded Basic bundle helps to maximize the advertising revenues that flow into the system. Conversely, any regulatory intervention (either A La Carte or Tiering), that reduces the number of channels that enjoy wide circulation would similarly reduce system-wide advertising revenues. Absent an equal reduction in program and operating costs, the advertising losses caused by government intervention would need to be recovered through increased retail costs to consumers.

2. Advertisers Desire Programmers With Broad Subscribership and Thus A La Carte or Tiering Regulations Would Negatively Impact Both Advertising Revenues and Competition for Advertising

The wide distribution of the Expanded Basic bundle of services is key to maximizing advertising revenue. Indeed, advertisers evaluate potential television advertising opportunities by looking at both the circulation and the ratings of a channel. If circulation decreases, revenues to the programmers and distributors will decrease. In addition, if there are fewer programmers with wide distribution, the market for advertising will become less competitive.

It is commonly-accepted that channels that enjoy wider circulation are deemed most desirable by advertisers. The Economic Study proves this (pages 6-10). The

Economic Study analyzes the relationship between advertising revenue and the subscriber base of cable networks and concludes that this relationship is roughly proportional (i.e., as reach increases, advertising revenues increase at roughly the same pace) only for networks that reach fewer than 50-60 million subscribers (see Figure 1). However, once a cable network's circulation reaches approximately 70-80 million subscribers, this proportionate relationship breaks down and there is a major jump in advertising revenues (see Figure 2). The Economic Study attributes this jump to several factors. The first factor is that as reach increases, the statistical reliability of ratings information (on which advertising purchases are based) increases significantly and therefore the advertising on these networks becomes more reliable and more valuable. Second, advertisers prefer (and will pay a premium for) broad reach and will pay more for an advertisement that will reach 1 million viewers at once than one that will reach 500,000 viewers at two different times (because of the potential for duplicated viewing in the latter example).

In addition to the Economic Study, any discussion with the people who actually purchase advertising will demonstrate that the reach of a channel is a crucial part of a national buying decision. As explained in the statements attached to these comments by advertising purchasers, both reach and rating are important considerations in advertising purchases. For example, Charlie Rutman, President of Carat USA, explains that "nationally distributed clients are interested in achieving the highest national reach and the highest national ratings on a given network." Exhibit 3; *see also* Exhibit 4 (Statement of Tim Spengler, Executive Vice President for National Broadcast for Initiative Media) and Exhibit 5 (Statement of Denise Weimann, Senior Vice President for MediaEdge).

For some advertisers, the reach of a programming network is uniquely relevant. For example, purchasers of advertising for national franchisors (e.g., quick serve restaurants, beverage companies, and car dealers) buy advertising with funds provided by the pool of *local* franchisees. As explained by Denise Weimann, a purchaser of national franchise advertising, "[b]ecause the advertising is funded by *local* franchisees, it is *critical* that the cable channels on which a franchisor buys advertising are distributed as widely as possibly and ideally in all the locations where local franchisees are located. This is a separate consideration from the aggregate national rating or share for any given channel or program because local franchisees want the advertising to reach viewers in their local area and a highly-watched program in one area of the country (e.g., in NY or Washington) is not of interest to them if the program is not even received by viewers in their franchise area (e.g., in Omaha)." *See* Exhibit 5.

Reductions in national reach would have a detrimental impact on the number of outlets available to advertisers. As explained by Denise Weimann, "[i]n the early years of cable, national advertisers had absolute requirements that they would only purchase advertising on channels with a certain level of national penetration. Since cable hit the 50-60% national penetration mark, national advertisers have had more flexibility and more options because they have been able to select from a wide variety of cable channels with wide national reach. If distribution were to be severely limited, I believe that national advertisers would most likely cut spending on those networks. Those networks would likely drop off the buy list (as in the early years of cable)." *See* Exhibit 5. The statements of Charlie Rutman and Tim Spengler are consistent with this assessment:

- Currently, because of the wide distribution of many cable channels, national advertisers have a variety of channels on which to buy advertising. If distribution of a cable were to become limited, national advertisers would most likely cut spending in accordance with these drops. In my view, the result would be that some networks would drop off buy lists. Tim Spengler, Exhibit 4.

- If the distribution of a channel were to be severely cut, ad spending would most likely be cut in accordance with those drops and some networks would drop off buy lists. This would have two effects. First, because there would be fewer places for national advertisers to buy, competition on the "buy side" of advertising would decrease. Second, and perhaps more importantly, it would [be] particularly hard for new networks to be launched." Charlie Rutman, Exhibit 3.

Thus, drops in the reach of the programming networks would result in decreased advertising revenues, decreased competition for advertising, and increased emphasis by advertisers on reach (with some channels dropping off the lists for national buys).

All these negative results – and others – are eloquently described in the statement of Thomas H. Winner, Global Media Buying Director for Wieden + Kennedy Advertising, attached as Exhibit 6. Mr. Winner has watched cable evolve and he is "convinced that the growth of [cable] is due to the bundling of disparate networks under a single pricing umbrella" and that A La Carte would stymie any further growth and make cable networks – including ESPN – a "much less attractive media vehicle for advertisers." In sum, Mr. Winner writes:

> By instituting a la carte pricing, legislators will be interfering with natural marketplace forces. To do this is to court disaster. Viewers will miss the variety of programming currently available. They will be upset by having to pay big numbers for their favorite networks. New and small networks will lie moribund, unable to be sampled or to grow. Advertisers will be hard pressed to find another means to effectively reach their target consumers. Cable systems will be forced to reduce their new technology offerings due to lower subscription revenue from viewers.

These harms are not counterbalanced by any of the perceived, limited benefits of the A La Carte proposals.

E. Any A La Carte or Tiering Scenario Would Be Comparatively Less Efficient Than Expanded Basic And Would Cause Consumers To Pay More To Get Less

Any regulation providing for A La Carte or Tiering would impose significant additional costs on the programmers and distributors. These costs would have to be borne by the consumer. These transaction costs are described below and at length in the Economic Study (pages 2-4).

For example, A La Carte and Tiering would cause a dramatic increase in consumer equipment costs. Both A La Carte and Tiering require some technical intervention between the distributor and the consumer's television set. In most cases, this technical intervention would take the form of an expensive individually-addressable set top box for each television set in the home. The cost of these set top boxes would need to be recouped in the form of higher consumer retail costs, far outstripping any hoped-for savings from A La Carte or Tiered service. Specifically, the National Cable Television Association estimates that the average monthly lease cost for addressable set top boxes is \$4.87.[25] Today, more than half of all consumer television sets connected to cable do not have set top boxes. The average American home has 2.5 television sets. Thus, moving to an A La Carte or Tiered system would immediately add an average of \$12.00 per month in cost for each home without set top boxes <u>before they even begin to make program selections</u>.

A La Carte and Tiering also would increase transaction costs. On the distributor side, cable and satellite subscription television operators would need to invest in expanded, more elaborate and more costly order taking and billing systems. All of these

[25] FCC, Report on Cable Industry Prices, MM Docket No. 92-226 (July 8, 2003) Table 10.

costs would need to be amortized across the subscriber base. Once again consumer costs would rise even before they made their first channel or tier selection.

A La Carte and Tiering also would dramatically increase marketing costs for both programmers and system operators. Programmers and operators would need to allocate substantial advertising dollars to sell and resell individual channels or tiers to customers on a monthly basis. All of these marketing expenditures would add dramatic new costs to the overall system costs that would be passed along to consumers.

The combined effect of reduced revenues and increased costs would require consumers to pay more for less under A La Carte and Tiered offering systems. An independent analysis conducted by the GAO concluded that "[b]ecause increased fees…are likely to be passed on to subscribers, it appears that subscribers' monthly cable bills would not necessarily decline under an A La Carte system."[26] Similarly, an independent analysis conducted by Bear Stearns concluded that A La Carte subscriptions to only five popular services (Disney Channel, ESPN, MTV, Fox News and TBS), would cost the customer more than the entire Expanded Basic bundle which includes the same five services plus many, many other channels. [27]

F. Disney Channel's Experience Migrating From An A La Carte Premium Channel To Expanded Basic Confirms The Pro-Consumer Efficiencies Of The Expanded Basic Bundle

Disney Channel originally launched in 1983 as a premium A La Carte service. As such, it was necessary for Disney Channel to constantly attract and retain new subscribers, requiring it to allocate a significant portion of its sales revenues toward

[26] "Issues Related to Competition and Subscriber Rates in the Cable Television Industry," U.S. General Accounting Office, GAO-04-8 (October 2003) ("GAO Report"), at page 36.
[27] Bear Stearns Equity Research Report, "A La Smart?" (March 29, 2004) ("Bear Stearns Report"), at 4.

marketing and promotion. In the mid to late 1990s, Disney Channel transitioned from a pay A La Carte channel to a service that was offered as part of a widely-distributed Basic or Expanded Basic package. This enabled Disney Channel to expand rapidly and to reach a significantly larger and more diverse audience that was not required to pay a premium fee. With this greater subscriber penetration, Disney Channel was able to redirect funds previously committed to marketing and subscriber retention and spend them instead for high quality family programming. Such programming is a hallmark of Disney Channel today, and in addition to industry recognition for artistic excellence, Disney Channel has garnered many philanthropic honors for its positive contributions in support of diversity and children's development. Had Disney Channel remained a premium A La Carte service, it is unlikely that it would contain as much original and vibrant kid and family-friendly programming that it does today.

Disney Channel currently is offered on MVPDs' first or second most highly penetrated level or tier of television service and as such is widely available to kids and families across the country. However, this was not always the case. Originally offered as a premium service, Disney Channel's availability was limited to only those kids and families who could afford and agreed to pay the additional $10 to $16 monthly fee[28] – that is, consumers who could afford to pay $120 to $192 more per year for it. Notwithstanding the strength of the Disney brand, penetration hovered on average in the 9-10% range (representing approximately 5 million subscribers).

Unfortunately, limited availability was not the only problem. Like all other premium services, Disney Channel had to contend with high subscriber turnover, also

[28] Retail prices are estimates.

known as churn, which typically runs approximately 5% to 6.5% per month, or roughly 60% to 78% per year for premium services. This meant that each year in order to simply maintain the prior year's distribution Disney Channel had to replace 60% to 78% of the subscribers with which it began in any given year. This also increased churn and operating expenses for MVPDs.

Accordingly, when Disney Channel was a premium service, its resources were focused on telemarketing, subscriber acquisition programs (such as free previews of the service supported by direct-mail advertising, bill inserts, and consumer premiums), and retention programs like the production and distribution of Disney Channel Magazine, all in an effort to counteract churn and to grow subscribers on a transaction by transaction basis.

During the late 1980s, Disney Channel encountered increased competition from growing programming offerings on Expanded Basic. In response and in order to combat the effects of churn in the premium service business, Disney Channel began to provide more subscriber incentives and promotional offers. This eventually eroded the original base subscriber revenues. Without higher penetration levels, it became clear that Disney Channel's business as an A La Carte premium service would decline in the long-term. To remain viable, Disney Channel began to experiment with pricing and packaging models to test other distribution strategies.

Through 1998, Disney Channel was offered in a hybrid fashion. On some cable systems it was a premium service, on others it was part of a premium package or part of tiers, and on others it was on Expanded Basic. Aggressive marketing of Disney Channel as part of a package of premium services with HBO and Showtime showed some gains;

however, these proved to be short-lived. When Disney Channel was offered either as part of a new product tier or third tier with three to four newer cable networks (like Court TV and Sci-Fi) for between $3.95 and $5.95 per month, there was initial success. However, after the initial lift, penetration began to drop. Even at their peak, these tiers reached only 40% penetration and then only for a brief period. These strategies continued to require heavy investment in transactional costs associated with marketing and retention programs for the various methods of distribution, which, in turn, unavoidably diverted funds from programming. From 1990 through 1997, Disney Channel annually invested on average approximately 10% of its total revenue from A La Carte sales on telemarketing, subscriber acquisition programs, and retention programs. In the late 1990s, it became clear that the hybrid approach was inefficient and too costly to sustain long-term. Ultimately, by the end of 2000, a distribution strategy change was made to offer Disney Channel only as an Expanded Basic service. After Disney Channel's transition from A La Carte to Expanded Basic, telemarketing, subscriber acquisition, and retention costs were *de minimis*, and Disney Channel could thus spend more of its total revenues on diverse, quality programming for kids and families.[29]

The adoption of the Expanded Basic strategy by Disney Channel was beneficial from a public interest perspective. Some local officials praised participating cable providers and Disney Channel for making a quality, commercial-free cable network dedicated to kids and families available to their communities (*see* Exhibits 7 and 8, proclamations from the cities of Las Vegas and Honolulu designating a "Disney Channel

[29] Notwithstanding the fact that Disney Channel is offered only as an Expanded Basic service after 2000, as a legacy of the hybrid distribution strategy, a few cable systems still carry Disney Channel A La Carte or as part of a tier.

Day" to welcome Disney Channel to Expanded Basic). Some cable operators informed Disney that carriage of Disney Channel on Expanded Basic may have been a beneficial factor during franchise renewal negotiations, as a broad distribution of Disney Channel was perceived as beneficial to consumers. Further, cable operators who were early adopters of Disney Channel on Expanded Basic saw an increase in their Expanded Basic penetration. Between 1992 through 1996, the growth in Expanded Basic subscriptions for cable systems with Disney Channel on Expanded Basic ranged from between 0.7% to 2.4% higher than the growth in cable systems that did not carry Disney Channel on Expanded Basic.

Expanded Basic distribution allowed Disney Channel the ability to reallocate funds previously used for marketing and subscriber retention programs to original and acquired programming. Disney Channel's average yearly programming expenses increased by over 38% from the period 1990 - 1997 to the period 2000 - 2003. Furthermore, Disney Channel's average yearly *original* programming expenses increased by over 109% from the period 1990 - 1997 to the period 2000 - 2003. This investment in programming has resonated with Disney Channel's audience in the form of higher ratings as Disney Channel has tripled its ratings for kids 6-11 since it was a premium service in 1995.

Moreover, Disney Channel's investment in high-quality kid and family programming in the Disney tradition also has been recognized in the industry and by viewers as reflected by Disney Channel's numerous nominations and awards for Humanitas Prizes for original programming, NATAS Daytime Emmy Awards for preschool programming, Parents' Choice Foundation awards for children's programming, and Nickelodeon's Kid's Choice Awards.

Furthermore, as an Expanded Basic service, Disney Channel has been able to reach a broader audience and provide far-reaching support of various public affairs initiatives through programs like Cable in the Classroom, PremEars in the Park, Learning Together, and numerous public service announcements during the September 11th national crisis to address children's fears and anxieties. It has also been able to address the interests of a growing and diverse audience. Disney Channel has more than doubled its ratings for African American kids 6-11 over the past 3 years. Indeed, in May 2004, approximately 15% of Disney Channel's programming hours included programs with an African American lead actor (19% if you include programs with a diverse cast).[30] Disney Channel's diverse programming has also been recognized by minority groups for its positive contribution in support of diversity, with Disney Channel and Disney Channel programming such as "That's So Raven," "The Cheetah Girls," and "The Proud Family" receiving nominations and awards like the NAACP Image Award, the Imagen Foundation Award, and the NAMIC Vision Award.

Based on the experience and history of Disney Channel, it is clear that Disney Channel's move from A La Carte to Expanded Basic has resulted in a far more robust network that is more reflective of the growing and diverse audience it serves. If Disney Channel were mandated to return to its A La Carte beginnings, it could be forced to retreat from its current position as a leader in high quality and trusted, kid and family television programming that is responsive to and representative of its audience.

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[30] Percentages were calculated based on sample programming schedules in October 2000 and May 2004.

G. Even Government Intervention Limited To Facilitating "Voluntary" A La Carte Would Cause Consumers To Pay More To Get Less – and All <u>Consumers Would Bear the Costs</u>

Some have tried to characterize as a modest compromise government intervention limited to facilitating "voluntary" A La Carte as distinguished from government intervention to mandate A La Carte. Unfortunately, as detailed below and in the Economic Study (at 20-21), the anti-consumer results would be the same.

First, any "voluntary" A La Carte would not be "voluntary" for the programmers. Under such a regime, programmers would be legally prevented from following a business plan for a widely distributed channel and for negotiating in the marketplace for such distribution. Absent some clear market failure (which does not exist here), the government should not limit the contracting options of free market participants.

Even under a system of "voluntary" A La Carte, program networks would lose circulation and advertising revenue. These losses would be passed along to consumers in the form of higher subscription fees. In addition, program networks would face the <u>same</u> increased marketing and transaction costs they would face under a mandated A La Carte system. However, these increased costs would be passed along to all consumers, regardless of who received the network on a tier or not.

"Voluntary" A La Carte also would lead to uncertainty regarding programming investments. Programmers would face great difficulty in predicting how many MVPDs would offer their channels on an A La Carte basis and how many customers would subscribe. This uncertainty would create a disincentive to make the long-term programming investments that are critical to ultimate consumer satisfaction. Programmers need certainty in making programming <u>purchases</u>. As described in the

Economic Study, with respect to ESPN, even "voluntary" A La Carte would result in an ESPN that would be less able to offer niche sports programming. Moreover, because sellers of programming – such as college and professional sports leagues – will only consider selling programming to programmers with a certain broad reach, ESPN could lose the ability to keep high profile sports and sports events. Basically, without certainty, programmers under a "voluntary" A La Carte scheme would be unable to purchase produce the highly-desirable programming that makes them successful today. Economic Study at 18-19.

Finally, even a "voluntary" A La Carte system would necessitate increased customer equipment costs as described above. An A La Carte customer would face a monthly equipment bill of $12.00 before she even makes her first programming selection.

In sum, a mixed system would impose all the same costs as a forced A La Carte system and thus is not a modest middle ground proposal at all. Like government mandated A La Carte, "voluntary" A La Carte would cause consumers to pay more to get less.

H. Government Mandated Tiers Would Create the Same Anti-Consumer Consequences As A La Carte

Government intervention to segregate the Expanded Basic bundle into separate Tiers of service (e.g. a "Family Tier" or "Sports Tier") is sometimes suggested as another moderate middle ground that would avoid the problems associated with mandating A La Carte. As an initial matter, establishing such tiers clearly would place the government in the role of making content-based decisions. As discussed above, any regulation implicating content in such a manner would be subjected to the highest level of judicial review. In addition, the practical difficulty of the FCC sorting through programming networks to determine which "tier" on which they should be placed would be imprudent and impossible.

Moreover, even assuming the government could practically or legally establish the basis for placing a service in such a defined category, as discussed above with respect to "voluntary" A La Carte, government-mandated Tiering would create the same anti-consumer effects as A La Carte. Government mandated Tiers would undermine advertising revenues because of reduced circulation for each channel. And, dividing the Expanded Basic bundle into government mandated Tiers would require the same expensive set top boxes as A La Carte. Tiering also would lead to increased marketing and transactional costs.

Further, as the GAO pointed out in its recent report on A La Carte, major sports rights sellers will begin to move away from services consigned by the government to A La Carte distribution. For example, if ESPN were relegated to a "sports tier" it would find its distribution dramatically decreased. In response, the rights selling community, in consideration of its own interests in maintaining large exposure for its products, will move to services whose potential to reach a mass audience is not so constrained. To be clear, the result would be that "sports programming" would in fact migrate away from the so-called "sports tier" to the general interest widely-distributed channels (which likely would increase the rates charged by these channels), a truly perverse result. Thus, under the guise of helping consumers, the government would decrease the quality of programming on ESPN without achieving the intended (but misguided) result of taking highly-priced (and highly valued) sports programming out of the Expanded Basic bundle. This would be an ironic but highly predictable outcome of mandatory "sports tiers."

In short, government mandated Tiers would suffer from all the same anti-consumer defects as A La Carte.

I. Government Intervention Regarding A La Carte Would Return the Government to Rate Regulation

Government intervention to require (or to encourage "voluntary") A La Carte would be very dangerous because it would create consumer expectations that the government would be unable to satisfy. Specifically, consumers would expect that they could enjoy substantial savings by canceling the Expanded Basic bundle and subscribing to only a limited number of A La Carte channels.

However, because A La Carte would decrease revenues and add increased costs, the retail price for individual A La Carte channels would be very high. The reality that even a few A La Carte channels would cost the customer as much or more than the Expanded Basic bundle, would create a backlash against programmers, MVPDs and the government. The result would be inevitable pressure on the government to intervene even further in the form of attempted price controls.

As discussed above, given the repeal of rate regulation, the FCC no longer has the authority to regulate rates. Moreover, even if the government had the authority to attempt such regulation, it is clear from even a moment's contemplation that any such effort to set retail prices for different programming networks with widely varying content, cost, and distribution structures would fail. Recent history shows that even less ambitious attempts by the federal government to regulate subscription television prices ended in failure. In 1996 the Congress repealed a cable television price control scheme that it had adopted only four years earlier.[31] Adopting an A La Carte scheme would only return the government to another ill-fated attempt at rate regulation.

J. Government Intervention In Favor Of A La Carte And Tiers Would Decrease Program Diversity

In addition to the negative economic consequences (to programmers, advertisers, consumers, and operators) described above, government intervention in favor of A La Carte or Tiering also would reduce program diversity to the detriment of consumers. The existence of the Expanded Basic bundle has enabled the launch of numerous innovative and worthwhile channels. Some of these channels feature programming of broad appeal while others appeal to niche tastes, minority groups or previously unrepresented viewpoints. It is clear that these new channels could not have been launched in an A La Carte or Tiered environment. In this respect, these channels are analogous to specialty shops that rely upon the structure of a shopping mall and the anchor department store tenants to create the environment and the traffic necessary for their survival.

The independent GAO study confirmed that A La Carte would lead to a reduction in program diversity. Specifically the GAO concluded that "some cable networks, especially small and independent networks, would not be able to gain enough subscribers to support the network." [32] Bear Sterns reached a similar conclusion stating "[w]e believe many of the smaller, nascent networks would find it difficult to survive in an A La Carte environment, reducing consumer choice."[33] The likely loss of program diversity would include channels with the potential for broad appeal such as History Channel and

[31] 47 U.S.C. Section 543(a)(1) & (c)(4).
[32] GAO Report at 36.
[33] Bear Stearns Report at 5.

Discovery Channel (which would not have thrived in an A La Carte system), as well as channels that appeal to minority or niche audiences such as TV One.[34]

All consumers benefit from access to the broad range of channels present in the Expanded Basic bundle – even those channels that are not regular favorites of a particular consumer. It is a critical consumer benefit to have access to a wide range of channels for infrequent, but intensely important viewing. The Economic Study details at length numerous concrete examples of "spikes in viewership" during which subscribers of the Expanded Basic tier enjoyed the ability to view a particular network. Economic Study at 4-5 and Appendix A. A few of these examples include:

(1) The Weather Channel during periods of dangerous weather;
(2) CNN's and MSNBC's viewership during major news events;
(3) The Fox News Channel's viewership during the 2000 Presidential election;
(4) TNT and Lifetime major original movies; and
(5) Discovery Channel documentaries.

These programming choices would not be available to viewers in an A La Carte regime.

K. Experience In Other Countries Provides No Basis To Believe That A La Carte Or Tiering Would Benefit Consumers In The United States

Proponents of A La Carte regulation have suggested that non-U.S. MVPDs, and in particular the Canadian model, offer consumers broader access to popular program services on an A La Carte basis, to the benefit of the international consumer. An examination of the international experience with A La Carte, however, reveals that the perceived benefits are highly overstated or, in some instances, non-existent. If anything,

[34] *See, e.g.*, Alfred Liggins, *Destroying Diversity*, THE WASHINGTON TIMES, Apr. 12, 2004 (stating that to require A La Carte would erode advertising support for niche channels like TV One, triggering a dramatic increase in per-subscriber fees, and resulting in ultimate failure of programming services that otherwise would thrive if carried as part of "Expanded Basic" tier).

the international experiences, as discussed in more detail below, provide further evidence that A La Carte regulations will not benefit consumers and are not the solution to a perceived lack of consumer choice or potentially increasing cable rates.

1. Canada

The most often cited example of an A La Carte model to emulate is the alleged A La Carte system in Canada. It has been suggested the Canadian distribution system offers consumers broader access to popular program services on an A La Carte basis and that these A La Carte offerings result in lower costs for consumers and are economically viable for the programmers. In fact, as demonstrated below, the opposite is true for both the analog and digital platforms in Canada.

Exhibit 9 is a letter submitted by Bart Yabsley, Executive Vice President of CTV Specialty Television Inc. ("CTV Specialty"), a company that manages one of the largest and most successful stables of programming services in Canada. ESPN, Inc. is a 30% minority shareholder in CTV Specialty. Mr. Yabsley's letter describes the Canadian distribution systems and the detrimental impact of Canada's limited A La Carte system on programmers and consumers.

As set forth in more detail in Mr. Yabsley's letter, the Canadian system does not generally offer the most popular services on an A La Carte basis. Instead, programming services are generally offered by MVPDs in packages, beginning with the entry level basic service (which subscribers must purchase in order to gain access to discretionary programming tiers). The "basic" tier of service in Canada for both cable and satellite distributors generally consists of local broadcast stations, the CBC (Canada's public broadcaster), and various public affairs channels as well as a limited number of specialty channels. From there, just as in the United States, consumers have access to large "Expanded Basic" bundles of the most popular programming services in Canada. Thus, from the perspective of the consumer, cable and satellite programming in Canada is available in a manner that is very similar to the U.S. distribution model.

In Canada, there are three categories of programming services: analog, Category 1 digital services and Category 2 digital services. Analog programming services are generally distributed by cable systems in broad packages (either as part of the basic or Expanded Basic tier) and are rarely, if ever, offered on an A La Carte basis. Category 1 digital services are also generally offered as part of a package of programming services, and may not be offered on a purely A La Carte basis. In fact, the CRTC recently imposed a prohibition on cable and satellite distributors offering Category 1 digital services on an A La Carte basis unless those services also are offered as part of a package of programming services. It is noteworthy that this prohibition was put in place because of the CRTC's recognition of the substantial economic risks to programmers of A La Carte distribution.[35]

As described in Exhibit 9, the only digital services in Canada on a "pure" A La Carte basis are Category 2 digital programming services. However, only those Category 2 services that are offered in a package as well as A La Carte are showing significant growth. An example is Animal Planet, one of the most successful Category 2 digital services with approximately 1 million subscribers. Animal Planet is offered both as part of a tier and A La Carte, but the reason it is successful is because virtually all of its

[35] *See* Public Notice CRTC 2000-6, Licensing Framework Policy for New Digital Pay and Specialty Services (Jan. 13, 2000) at para. 22, *available at* http://www.crtc.gc.ca/archive/ENG/Notices/2000/PB2000-6.htm.

distribution comes from carriage in a package. Thus, generally speaking neither the regulatory environment nor the current business model has proven hospitable to the growth of A La Carte services in Canada. Purchase rates of A La Carte services are very low and no service that is offered purely on an A La Carte basis is achieving high penetration on the digital platform.

Canadian consumers also are not benefiting from Canada's limited A La Carte system. For example, a cable subscriber in Toronto can purchase a 70-plus channel package of basic and Expanded Basic services for about $45 per month (Canadian dollars, pre-tax).[36] The basic tier alone costs the consumer $24/month.[37] If a consumer declines to purchase the Expanded Basic tier, but she wants to purchase additional services A La Carte, she first much purchase the basic tier (again, for $24/month) and then also obtain a digital box (for an additional $9/month). Only after already spending this $33/month can she have the ability to purchase premium services, digital tiers, A La Carte services (about $2 to $4 each), HD tiers, or multi-cultural channels. Apart from the fact that the consumer is therefore unlikely to save much money, the consumer in this scenario also is unlikely to get the channels she wants because none of the services available in the cable system on the basic or Expanded Basic analog tiers – i.e., the most popular channels – is separately available on an A La Carte basis. Therefore, in comparison to their American counterparts, the Canadian consumer does not benefit from the perceived A La Carte system.

[36] *See, e.g.*, Rogers Communications Inc., *Cable Package Pricing (Toronto), at* http://www.shoprogers.com/store/cable/cablecontent/pricing.asp?shopperID=6S0QTVRKNBL9J2JK7STWW9GBLQN8ND5&cityName=%7C9%2A107 (last visited July 14, 2004).
[37] *Id.*

2. Other International Systems

A review of the use of A La Carte program offerings in countries outside the U.S. and Canada also provides no support for enacting A La Carte regulations in the United States.

In Japan, SkyPerfect, a direct to home ("DTH") satellite provider which launched in 1996, offers A La Carte channels in addition to channel packages. SkyPerfect uses this model because the Japanese government requires it. As of the end of 2003, approximately 3.1 million Japanese households, or only six percent of television households in Japan, subscribed to SkyPerfect.[38] DTH penetration in Japan has grown at a significantly slower rate than in the U.S., due in part to the mandatory A La Carte requirement. In its first nine years of availability, DTH penetration in the U.S. reached 18% of television households.[39] Over the first nine years of availability in Japan, that number is projected to reach only 7% by the end of 2004, and there is some evidence that growth has flatlined.[40] SkyPerfect also reportedly is having some difficulties competing with its cable counterparts, which are not subject to the mandatory A La Carte requirement. Specifically, from the first quarter of 2002 to the fourth quarter of 2003, ARPU[41] declined 8%, from ¥ 3,956 per month ($35.32) to ¥ 3,649/month ($32.58), while

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[38] SkyPerfect data from SkyPerfect website and TV household data from Jumin Kihon Daicho Jinko Yoran, March 2004.

[39] US historical data based on averages from: Eighth Annual Report, in the Matter of Assessment of the Status of Competition in the Market for the Delivery of Video Programming, CS Docket No. 01-129 (rel. Jan. 14, 2002) at para. 57; Veronis Suhler Industry Forecasts, 2003 Kagan Industry Forecast, and analyst reports from Salomon Smith Barney, Morgan Stanley, and CSFB.

[40] 2004 Japan DTH subscriber projection based on Merrill Lynch report May 10, 2004. Also see Chart, attached as Exhibit 10.

[41] Average revenue per unit (or subscriber).

the ARPU for cable remained the same.[42] Additionally, as a result of the mandatory A La Carte offering and lack of a consistent "basic" package, most individual channels continue to achieve less than 35% penetration of SkyPerfect's total subscriber base.[43] Moreover, Japanese consumers do not appear to be embracing the A La Carte option as is evidenced by the fact that A La Carte subscriptions comprise, on average, less than 10% of a channel's total DTH subscriber base. Only a few channels achieve more from A La Carte, but even these channels still only garner approximately 15-25% of their total DTH subscriber base from A La Carte subscriptions. Thus, it is clear that at least in Japan, the A La Carte model has proven both difficult to maintain from a business perspective and relatively unpopular with the subscribing public. Overall, the Japanese experience illustrates that the perceived benefits of A La Carte are not real but illusory.

A La Carte models in countries other than Japan are so limited in their scope that they have little relevance or utility as a model for the U.S.[44] Therefore, international A La Carte offerings provide no basis to support imposition of A La Carte requirements in the U.S. and it would be misguided for the Commission to consider potential A La Carte regulations in the United States based on any international experiences. Indeed, the fact that so few countries have attempted A La Carte indicates that it would be imprudent for

[42] ARPU data from SkyPerfect website.

[43] CS-TV Advertising Bureau Japan website.

[44] For example, Hong Kong's largest utility, PCCW, launched a digital subscriber line ("DSL") programming service in 2003, through which it offers approximately twenty-five channels on an A La Carte basis. PCCW's choice to offer channels A La Carte reportedly was based on PCCW's initial research, which indicated that the A La Carte model was preferred over a basic bundling model. Notably, despite the short time since PCCW launched its service, PCCW already is exploring potential packaging strategies. The distribution business models in France are similar to those in the United States, although several years ago a French cable operator (Noos) experimented briefly and unsuccessfully with offering consumers a pure A La Carte service.

the United States to restructure its entire MVPD distribution model in search of non-existent consumer benefits.

L. Disney's Contracting Practices Already Provide Significant Flexibility To MVPDs

Disney permits MVPDs to license its most popular individual channels without being obligated to also license any other Disney owned service. For example, an MVPD may elect to license the Disney Channel but not license Toon Disney. Cable and satellite distributors also may enter into standalone license agreements for SOAPnet or ABC Family. A distribution license for ESPN does not obligate the cable or satellite operator to carry ESPN2, ESPN Classic or ESPNEWS.[45]

In terms of retail flexibility, Disney negotiates to permit MVPDs to offer the primary ESPN channel on either the first or second most widely penetrated tier of service. The operator in turn determines the content of the tier and its retail price. The negotiated contracts for ESPN2 and ESPN Classic provide that they may be offered on the first, second or third most widely penetrated tier and even, under certain circumstances, on an A La Carte basis. ESPNEWS can be offered in any service package or on an A La Carte basis. Disney Channel and ABC Family may be carried on the first

[45] While ESPN offers the original "ESPN" channel on a standalone basis, it distributes the complementary ESPN-branded services (ESPN2, ESPNEWS and ESPN Classic) only to those distributors who have licensed the original basic "ESPN," and those distributors may then choose to license – or not to license – any one or more of the complementary ESPN-branded channels. Similarly, when Toon Disney was first launched, it was made available as a complementary service only to those distributors who licensed Disney Channel. Since that time, Disney's policy has changed, and as a more mature service, Toon Disney is now offered to new licensees of the service on a standalone basis. Certain Toon Disney agreements that were executed under the original distribution policy are still in effect, but as they are renewed, the new policy is applied.

or second most widely distributed tier. Toon Disney and SOAPnet may be carried on any tier. In sum, Disney's contracting practices provide significant flexibility for MVPDs.

M. Disney Accommodates Small Cable Operators Through Co-Op Buying Deals

Many of the arguments concerning A La Carte are based on the misplaced notion that smaller cable operators are disadvantaged in striking distribution deals with companies like Disney/ESPN. However, as an accommodation to the smaller operators, Disney has entered into carriage agreements for each of its programming services with the National Cable Television Cooperative. The NCTC deals allow small cable operators to earn volume discounts to which they would not be entitled on their own.

Just recently, ESPN entered into a new carriage deal with the NCTC. More than 95% of the NCTC's members opted to participate in this deal (including Cable One Inc., Cebridge Connections, Buckeye CableSystem, and Massillon Cable TV).[46] This comprehensive deal is similar to affiliation deals that ESPN struck earlier with Cox, Charter, and Cablevision.[47] Indeed, as the following quotes demonstrate, the NCTC's members themselves were pleased with the deal:

- "We just felt the economics of it were reasonable … The risk is that it's a long-term deal. We're putting faith in ESPN that the programming's going to remain top-quality." Brad Mefferd, Buckeye executive vice president.[48]
- "It was a classic case of both sides meeting as close as they could in the middle." Jerry McKenna, vice president of strategic marketing for Cable One, Inc.[49]

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[46] Linda Moss, *95% Opt In To Co-Op's ESPN Deal*, MULTICHANNEL NEWS, June 21, 2004.
[47] Linda Moss, *Majority of NCTC's Members Ink ESPN Deal*, MULTICHANNEL NEWS, June 15, 2004.
[48] Linda Moss, *Small Ops Face Deadline to Opt Into ESPN Deal*, MULTICHANNEL NEWS, June 14, 2004.
[49] Linda Moss, *What a Year It's Been for Affiliates*, MULTICHANNEL NEWS, May 3, 2004.

Therefore, it can hardly be said that the smaller cable operators – all of whom are eligible to become part of NCTC – are disadvantaged.

N. A La Carte And Family Tiers Are Not The Way To Deal With Concerns About Programming Indecency

Some government officials and public advocates have expressed interest in A La Carte or Family Tiers as a response to concerns regarding perceived program indecency. The creation of tiers is not an appropriate approach to achieve that end. As outlined above, A La Carte and Family Tiers would create significant industry disruptions and anti-consumer effects. As important as concerns about program indecency may be, imposing regulations to address those concerns is not an appropriately tailored approach given the business disruption and anti-consumer effects of A La Carte and Tiering. Nor is it necessary. There is no reason why cable should be subjected to different standards in this area than are applied to broadcast.

III. THERE IS NO REASON TO REVISE THE STATUTES OR REGULATIONS REGARDING RETRANSMISSION CONSENT

A. Retransmission Consent was Enacted by Congress in Recognition that Broadcasters Have the Right to Require Consent Before Another Entity Distributes Its Product

Nothing has happened since enactment of retransmission consent in 1992 to justify any changes to the statute – or its implementing regulations. Nonetheless, over the last few years, a limited number of cable operators (mostly smaller cable operators now competing with satellite) have made various allegations of "abuses" of retransmission consent.

In order to put these allegations in the proper context, some history is helpful. Prior to 1992, cable operators were of course required to negotiate with and compensate the owners of cable programming channels. However, prior to 1992, cable operators were able to obtain broadcast stations off air and distribute them to consumers and keep the proceeds. Congress changed that through the passage of The Cable Television Consumer Protection Act of 1992.[50] In passing that legislation, Congress concluded that "a very substantial portion of the fees which consumers pay to cable systems is attributable to the value they receive from watching broadcast signals" and public policy should not support a system "under which broadcasters in effect subsidize the establishment of their chief competitors."[51] At the time, Congress noted that due to a 1959 FCC interpretation, "[C]able systems use these signals without having to seek the permission of the originating broadcaster or have to compensate the broadcaster for the value its product creates for the cable operator."[52]

In the 1992 Act, Congress changed this practice to require cable systems to obtain the consent of, and to compensate the owner of, a broadcast channel before distributing that channel to consumers. By way of explanation, Congress stated, "[c]able operators pay for the cable programming services they offer to their customers; the Committee believes that programming services which originate on a broadcast channel should not be treated differently."[53] Further, Congress specifically anticipated that the compensation paid by the cable operator to the broadcast station could take the form of "the right to program an additional channel on a cable system."[54]

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[50] Public Law 102-385, 106 Stat. 1460, approved Oct. 5, 1992.
[51] Senate Report 102-92, Cable Television Consumer Protection Act of 1991 (June 28, 1991), at 35.
[52] *Id*.
[53] *Id*.
[54] *Id*. at 36.

Since that time, the FCC has several times affirmed the practice of bundling. Here are a few examples:

- In March 2000, the FCC ruled that – in the SHVIA context – proposals for carriage of a broadcast signal contingent on "carriage of any other programming, such as … an affiliated cable programming service" are "consistent with competitive marketplace considerations."[55]

- In 2001, the FCC stated that "offering retransmission consent in exchange for the carriage of other programming such as a cable channel" is "consistent with competitive marketplace considerations" and that "[g]ood faith negotiation requires only that the broadcaster at least consider some other form of consideration if the MVPD cannot accommodate such carriage."[56]

Any departure from this established precedent would have to be supported by the Commission by a well-founded reason for the change and, given that Disney offers a cash stand-alone option as well flexible carriage offers, there is no such reason for a departure from this line of cases.

The essence of the various allegations concerning retransmission consent is the desire of a few distributors to return to a pre-1992 regime. But, the fundamental notion behind retransmission consent is fundamental: broadcasters – like any business – should be compensated for their product if distributed and sold by another entity. Broadcasters still invest billions of dollars annually to create the most valuable and most desired television channels in the industry and should have the right to be compensated for that product.

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[55] Order, Implementation of the Satellite Home Viewer Improvement Act of 1999, (Retransmission Consent Issues: Good Faith Negotiation and Exclusivity) at para. 56 (rel. Mar. 16, 2000).

[56] <u>EchoStar Satellite Corporation v. Young Broadcasting</u>, 16 FCC Rcd 15070, 15079 (Aug. 6, 2001).

B. Disney Offers MVPDs A Stand-Alone Cash Retransmission Deal For The <u>ABC Owned Television Stations</u>

Disney negotiates Retransmission Consent only for its ten ABC owned television stations (which have a 24% national reach). Disney does not require MVPDs to carry any ABC/Disney/ESPN cable networks in order to secure the right to retransmit the signals of the ten ABC Owned Television Stations. Instead, Disney offers MVPDs a stand-alone cash Retransmission Consent proposal, in addition to an alternative that involves a combination of channels that varies with the MVPD. If the MVPD agrees to a cash ABC retransmission deal, that MVPD is under no obligation to carry any other ABC/Disney/ESPN channel.

If there is any doubt about Disney's cash offer, Disney is again attaching the affidavit executed by Ben Pyne, Executive Vice President, Disney and ESPN Networks Affiliate Sales and Marketing. Mr. Pyne is the individual who is responsible for working with the ABC Owned Stations to negotiation retransmission agreements. In his affidavit, Mr. Pyne certifies that, "in negotiating for retransmission consent, ABC offers MVPDs a cash stand-alone price for retransmission consent for the ABC owned stations. If the cable operator accepts that offer, that decision results in no additional obligation to carry any Disney/ABC programming. To the extent that any given MVPD decides not to accept ABC's stand-alone cash offer, and instead elects the alternative to negotiate to carry programming, that decision is made by the individual MVPD. We attempt to work with the MVPD to customize a reasonable offer to address their particular needs." *See* Affidavit attached as Exhibit 11. Thus, there is no question that ABC offers MVPDs a cash stand-alone offer.

C. The Practice Of Granting Retransmission Consent For A Broadcast Station In Return For Carriage Of Commonly Owned Channels Is An Alternative and Was Developed In Conjunction With the MVPDs' Desire Not to Pay Cash

As noted in Section A above, prior to 1992 cable operators distributed local broadcast signals without the consent of the owners of these stations. After the 1992 change in the law, many leading cable operators announced that they would never pay cash to a broadcaster for Retransmission Consent.[57] As the statutory deadline approached for completion of Retransmission Consent deals, a standoff ensued between the broadcasters and the cable operators.[58] This standoff threatened the continued cable carriage of many local broadcast stations.[59] This standoff was resolved when three of the then four major broadcast networks agreed to proposals to grant Retransmission Consent for network-owned stations in return for cable carriage of, and payment for, new

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[57] *See* Mark Robichaux, *Tele-Communications Says It Will Fail to Meet Deadline on TV Stations' Fees*, THE WALL STREET JOURNAL, Aug. 18, 1993, at B8 ("Nearly all of the nation's largest cable operators have vowed to forgo paying cash to local TV stations."). The cable operators' prospective refusal to pay for retransmission rights was so uniform that Senator Daniel Inouye of Hawaii asked the Justice Department and the Federal Trade Commission to investigate whether the cable companies violated antitrust laws by improperly colluding with each other. *Id.*; *see also* Rachel W. Thompson, *Inouye to Cable: Why No Cash?*, MULTICHANNEL NEWS, Aug. 16, 1993.

[58] *See, e.g.*, Ted Sherman, *Consumers Loom as Losers in Battle Between Cable, Broadcast Firms*, THE NEWARK STAR-LEDGER, Sept. 13, 1993 (noting that after 1992 Cable Act established retransmission consent requirements, "[a]lmost every broadcaster initially demanded the cash [and] at the same time, nearly all cable operators said no, threatening to dump the on-air broadcast stations come Oct. 6, when the [retransmission consent] provision takes hold"); Robichaux, *supra* note 27 ("Delays in meeting the October deadline have been caused in part by the face-off between TV stations demanding new cash fees and cable systems steadfastly refusing to pay.").

[59] *See, e.g.*, Jeannine Aversa, Rachel W. Thompson & Rod Granger, *Storm Still Brews in Conn. as FCC Readies Final Must-Carry Rules*, MULTICHANNEL NEWS, Mar. 8, 1993 (noting Cablevision's threat to drop several broadcast stations, including those in Boston and Hartford/ New Haven "if they don't forgo payment for carriage"). Some cable operators, including Cablevision, said they would offer subscribers switches to easily obtain broadcast programming over the air rather than pay broadcasters for their signals. *See* Sherman, *supra* note 28.

network-owned cable channels.[60] In return for granting broadcast Retransmission Consent, Fox was able to launch the cable network FX, ABC was able to launch ESPN2 and NBC was able to launch "America's Talking" (which later became MSNBC).[61]

There are two critical points to make regarding these deals which established the pattern of granting broadcast Retransmission Consent in return for carriage of commonly owned cable channels. First, these alternatives were conceived after cable operators[62] – notwithstanding the 1992 Act – refused to pay cash for broadcast Retransmission Consent and were an accommodation to this refusal.[63] Second, as discussed above, these

[60] *See* Sherman, *supra* note 28 ("Instead [of cash], the cable operators have been offering to swap spare channel capacity to the broadcasters for new cable programming that all networks are developing, in return for the right to retransmit regular, over-the-air programming.").

[61] *See* Sherman, *supra* note 28 (describing cable channels for which ABC, Fox, NBC and CBS negotiated carriage).

[62] *See, e.g.*, Sherman, *supra* note 28 ("In a nearly united front…cable operators refused to negotiate with the networks, making it a possibility that cable subscribers would be forced to rely on conventional television reception to tune in to top rated shows…"); Rachel W. Thompson, *TCI Cuts 14 'Zero Pay' Carriage Agreements*, MULTICHANNEL NEWS, June 21, 1993 ("Cablevision Systems announced last Friday that it would offer broadcasters a single free cable channel in each of the markets where it operates that they can use" and "a package of free advertising time…in exchange for retransmission consent"); Jeannine Aversa, *Effros: Offer Broadcasters Leased Access*, MULTICHANNEL NEWS, May 3, 1993, at 18 ("At least one cable executive has an idea of how to deal with failed retransmission consent negotiations: Offer the broadcaster a leased access channel on the cable system's basic tier and let the station collect a fee directly from subscribers."); Mark Robichaux, CABLE COWBOY: JOHN MALONE AND THE RISE OF THE MODERN CABLE BUSINESS (John Wiley & Sons, Inc. 2002) ("TCI, for one, refused to pay cash to any of the big networks but it indicated it might be willing to make room on its systems for a new cable channel a broadcaster might like to start.")

[63] *See, e.g.*, *Inouye Poses Antitrust Question on Retransmission Consent Decisions*, COMMUNICATIONS DAILY, Aug. 11, 1993 ("14 of top-20 cable MSOs said they wouldn't pay cash for retransmission consent"). MSOs that stated they would not pay for retransmission consent included TCI, Continental, Cablevision Industries, Coaxial, Colony, Comcast Crown, Harron, Jones, KBLCom, Newhouse, TeleCable, Time Warner and Viacom. *Id*.

alternatives had been specifically anticipated and approved in the Senate Report to the 1992 Act.

D. Disney's Cash Retransmission Price for the ABC Owned Stations Is Completely Reasonable

In earlier pleadings at the FCC, the ACA has argued that somehow ABC's cash stand-alone Retransmission Consent offers are a "sham."[64] This argument is wholly without merit. First, as described above, this offer was made – in writing – to each MVPD that was part of the last round of ABC's retransmission consent negotiations (and the offer was in the range of $.70 - .80 per subscriber per month). Second, ABC's stand-alone Retransmission Consent price is completely reasonable. To demonstrate this, Disney recently commissioned an economic study to determine the fair market value of three of the ABC owned stations. The Retransmission Consent Economic Analysis is attached as Exhibit 2.

The Retransmission Consent Economic Analysis focuses on three ABC owned stations, including one of ABC's owned stations in a large market (WPVI in Philadelphia) and the two ABC owned stations located in the smallest of the markets in which ABC owns stations (Flint and Toledo).[65] Notably, the economic study concluded that the value – on average – of the ABC owned stations ranges between $2.00 to $2.09 per subscriber per month, well in excess of the $.70-.80 per subscriber per month that ABC offers MVPDs.

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[64] *See* American Cable Association Petition for Inquiry into Retransmission Consent Practices, First Supplement, at 9, 11 (December 2002) (This petition makes clear that ACA's objection is not that the cash option is not offered to small cable operators, but they do not want to pay it.).

[65] The smaller markets were chosen given that the ACA's members are largely from smaller markets.

The Retransmission Consent Economic Analysis used three different approaches to assess the value of the ABC Owned Stations, all of which resulted in a figure in excess of Disney's cash offer and all of which, according to the economists, likely understate the real value. The first method was to determine the value of the stations based on the retail price for the stations as sold by DBS (with results ranging from $.97 to $1.23). Similarly, the second method was to determine the value of the stations based on the retail price for the stations as sold by cable (with results ranging from $1.90 to $3.06). The third method was based on the amount spent by the ABC Network for programming (and discounting for the lack of advertising availabilities on broadcast networks) and determining a comparable license fee to a cable network. The third method notably included only the amounts spent by The ABC Television Network, and not the vast amounts spend by the local stations themselves (for news, public affairs, syndicated programming). Nonetheless, the result for this method was $2.27. Therefore, ABC's cash offer is unquestionably reasonable.

E. Disney Offers Flexibility in Its Retransmission Consent Negotiations

When negotiating with MVPDs – including the smaller rural carriers that may not be able to upgrade their plant in the face of competition from advanced digital satellite services, Disney offers flexibility in striking a retransmission consent deal. Disney's flexibility is reflected in part by the volume discount deals that ESPN has reached with the NCTC. Disney also has volume discount deals through the NCTC for the cable networks that are part of the Disney family (e.g., Disney Channel, Toon Disney, ABC Family, and SoapNet).

Disney has offered alternatives in negotiating Retransmission Consent terms. For example, some small cable operators wish to retransmit an ABC owned station (but do not want to pay cash for the carriage), and yet they lack sufficient capacity on the same cable system to carry commonly-owned cable channels. In these instances, ABC has agreed to allow carriage of its station in market A in return for cable carriage of a commonly owned channel in market B where the cable operator <u>does</u> have sufficient channel capacity.[66] And, ABC will continue to work in good faith to accommodate the needs of smaller cable system operators. These practices are accommodations – not abuses - and in no way argue in favor of changes in retransmission consent.

[66] Ironically, this good faith accommodation by Disney has been twisted by a few operators into an allegation of bad faith. Specifically, the ACA has included this as one of its alleged "abuses" of retransmission consent. In fact, the flexibility to allow the Retransmission Consent compensation to occur in a different market is an accommodation to capacity constraints of the cable system owner.

IV. CONCLUSION

As demonstrated in these comments and the exhibits, there is no need for government intervention to create any type of A La Carte or Tiered offerings because sound economic analysis demonstrates that such attempts would only result in consumers paying more – for less.

Respectfully Submitted,

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