

**Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554**

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

**COMMENTS OF A&E TELEVISION NETWORKS**

Robert Corn-Revere  
Ronald G. London  
DAVIS WRIGHT TREMAINE, L.L.P.  
1500 K Street, N.W., Suite 450  
Washington, D.C. 20005-1272  
(202) 508-6600

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## EXECUTIVE SUMMARY

There is no such thing as a “voluntary” *à la carte* requirement. The Commission’s Public Notice seeks comment on what issues would be raised if Congress required video programmers to allow multichannel distributors to “voluntarily” offer channels to subscribers on an *à la carte* basis. But the very question reveals the tension underlying this proceeding. The Notice envisions some possible set of regulations in which consumers could “voluntarily” purchase channels *à la carte* that programmers would be *compelled* to market on that basis. Such proposals incorrectly assume that the general absence of *à la carte* options (beyond the availability of certain “premium” or pay-per-view channels) is evidence of a market failure, and simplistically suggest that regulation can create new economic choices without adverse consequences for the industry or for consumers. In response, A&E Television Networks (“AETN”) explores the economic and legal ramifications of the questions presented in the Public Notice.

The economic issues raised by the Public Notice have already been explored thoroughly in private economic analyses, investigations by the General Accounting Office, and by the Commission itself. Each of these previous studies confirmed that the current market structure, in which multichannel networks are offered on a “bundled” or tiered basis, exists because it is the optimal framework for networks that depend on subscriber fees and advertising revenue to launch and thrive. With bundling, multichannel video program distributors (“MVPDs”) intermingle established, familiar networks with new offerings so emerging networks can reach a “critical mass” of subscribers. This framework provides potential viewership every network needs to attract investment, gain advertisers, and pay for original programming. Networks maximize adver-

tising revenue by seeking the broadest possible dissemination on multichannel systems, thus making tier commitments by multichannel providers a saleable asset. Once that is secured, a bundled network can afford to develop unique, quality programming that drives the other component of ad sales, ratings share, while spending less on marketing by promoting programs rather than having to attract and retain subscribers.

Requiring programmers to abrogate existing contracts and allow their networks to be carried *à la carte* would scuttle the economic basis on which they were built. It would upset the expectations of programmers (and their investors) that invest billions of dollars every year developing content, marketing it, and negotiating for carriage under business plans based on bundling. Meanwhile, all analyses to date indicate that requiring *à la carte* provision of multichannel programming would lead to higher prices for consumers, loss of diversity as some networks fail and others vastly reduce program budgets, and interference with properly functioning multichannel video markets.

Current research and AETN's experience shows that even small losses from the subscriber base would cause a substantial decline in revenue and, correspondingly, drastic increases in per-channel and per-subscriber prices. The research also shows consumers are unwilling to pay much more than the low per-channel price they currently enjoy with tiered service – even for networks they highly value – and that increased costs, if passed on to consumers, would likely cause more subscriber defections. Faced with losses of subscribers, license fees, and advertising revenues, programmers will have no choice but to reduce spending on programming. This would harm program diversity as networks reduce the amount of original content they offer and some cease

operating altogether, with the most likely first victims being niche networks devoted to, *inter alia*, children, minorities and the arts.

These costs would not be offset by any meaningful benefits, and are wholly unnecessary. Government action is not needed to correct for any market failure – there is no bar to MVPDs bargaining with programmers to permit *à la carte* offerings if there were sufficient consumer demand for such an option. *À la carte* would not reduce cable prices for consumers, as those wishing to reduce what they pay would have to forego most networks they now receive, while the price for those wishing to continue receiving a multitude of tiered networks would face higher prices. Nor is government-mandated *à la carte* necessary for consumers to control the programming that enters their homes, to pay for only the programming they desire, or to facilitate “family-friendly” programming. Existing choices such as receiving solely broadcast or basic cable signals, and employing V-chip and channel-blocking technology, allow consumers to control exactly what programming they receive.

Requiring multichannel video programmers to alter their contracts to permit operators to offer “voluntary” *à la carte* channels would violate the First Amendment. As a threshold matter, programmers are not subject to any relaxed constitutional doctrine, unlike broadcasters and multichannel operators that rely on spectrum licenses or public rights-of-way. *À la carte* requirements would be subject to heightened First Amendment scrutiny because rules seeking to dictate how programming must be offered, or mandating the availability of “family-friendly” tiers, are inherently content-based. Such rules would fail strict scrutiny because there is no compelling interest in the government manipulating markets in this way, particularly where consumers have a choice of competing

providers. Moreover, having the government reshape the economic basis of the multi-channel market could never be considered the least restrictive means of achieving any interest the government might proffer.

Even if an *à la carte* regime were considered content-neutral and intermediate First Amendment scrutiny applied, it still would be unconstitutional. The government would not be able to prove that such rules served its purported interest in a direct and material way, as the case law requires. *À la carte* regulations would not lower prices for most consumers, would reduce consumer choice by driving some networks out of business, and would imperil much family programming that can exist only because it is part of a bundled package. *À la carte* advocates are uncertain about the impact of proposed rules, yet offer them as a kind of experiment to see how subscribers might react. Such an approach cannot possibly satisfy the government's burden to show – *before* adoption – that the rules would “directly and materially” advance its interests. The government cannot simply enact regulations and hope for the best. Enabling a few subscribers to reduce their bills also falls far short of the constitutional requirement that advancement of the government's interest be *material*, especially where a change as drastic as *à la carte* would harm programmers regardless of whether consumers flock to it. All told, *à la carte* regulations would be far more restrictive than the Constitution permits.

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**COMMENTS OF A&E TELEVISION NETWORKS**

A&E Television Networks (“AETN”), by its attorneys, hereby responds to the Public Notice in the above-captioned proceeding.<sup>1</sup> Though the Public Notice purports to seek answers to “factual questions regarding provision of *à la carte* and ‘themed-tier’ services” by cable and direct broadcast satellite (“DBS”) multichannel video program distributors (“MVPDs”), *id.* at 9291, it is predicated on various underlying policy proposals and extends beyond fact-gathering to the “legal and regulatory questions” the proposals raise. *Id.* at 9293-34. Thus, AETN responds to the Commission’s request for factual information, but at the same time comments on the policy proposals that underlie this proceeding.

In this regard, though some questions in the Public Notice are couched in terms of MVPDs offering *à la carte* and tiering options “voluntarily,” it makes little sense to discuss “voluntary” approaches when the apparent concern of this proceeding is the efficacy of government-mandated changes that will affect the way MVPDs offer programming to subscribers. The Public Notice recites, for example, that the “request

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<sup>1</sup> *Comment Requested on A La Carte and Themed Tier Programming and Pricing Options for Programming Distribution on Cable Television and Direct Broadcast Satellite Systems*, 19 FCC Rcd 9291 (Med. Bur. 2004) (“Public Notice”).

for comment is intended to assist in gathering information ... to respond to specific requests from ... Congress for a Report on this issue.”<sup>2</sup> In doing so, it at least implicates the Video Programming Choice and Decency Act of 2004, which Congressman Deal offered as an amendment to the Satellite Home Viewer Extension and Reauthorization Act of 2004, as an “attempt,” in part, “to deal with ... indecency in television,”<sup>3</sup> as well as Senator McCain’s frequent calls for exploration of *à la carte* options.<sup>4</sup> In addition, Commissioner Martin has advocated creation of “family-friendly” tiers on multichannel systems,<sup>5</sup> while groups interested in restricting programming they find objectionable, like Parents Television Council (“PTC”) and Concerned Women for America (“CWA”), have lobbied the FCC and Congress for measures to promote consumer purchases of video programming on an *à la carte* basis.<sup>6</sup>

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<sup>2</sup> *Id.* at 1 (citing Letter from Congressmen Barton, Dingell, Upton, Markey, and Deal, Committee on Energy and Commerce, to Michael K. Powell, Chairman, Federal Communications Commission, May 18, 2004 (“House Letter”); Letter from Senator McCain, Chairman, Committee on Commerce, Science and Transportation to Chairman Powell, May 19, 2004) (“McCain Letter”).

<sup>3</sup> See <http://www.house.gov/deal/press/pr-alcarte-programming.shtml>. Congressman Deal later withdrew the amendment, ostensibly to facilitate issuance of the House Letter which spurred initiation of the instant proceeding. *Commerce Committee Leaders Request À La Carte Feasibility Study*, SATELLITE WEEK, May 24, 2004. Indeed, the questions in the Public Notice are taken verbatim from the House Letter.

<sup>4</sup> See McCain Letter, *supra* note 2. See also Senator McCain, *Cable Consumers Shouldn’t Have to Pay for Programming that They Don’t Want*, Press Release, Mar. 14, 2003; Senator McCain, *McCain Requests GAO Review of Soaring Cable Rates*, Press Release, Apr. 16, 2002 (instructing the GAO to “research the feasibility of a la carte programming”).

<sup>5</sup> Written Statement of Kevin J. Martin, Commissioner, FCC, in *Protecting Children From Violent and Indecent Programming: Hearing Before the Senate Comm. on Commerce, Science and Transp.*, 108th Cong. (Feb. 11, 2004) (“Martin Statement”); Kevin J. Martin, *Family-Friendly Programming: Providing More Tools for Parents*, 55 FED. COM. L. J. 553 (May 2003).

<sup>6</sup> Letter from Brent Bozell, President, PTC, to Senator McCain, Concerning Cable Indecency, March 4, 2004 (“PTC Letter”); Martha Kleder, Policy Analyst, CWA, *The*

The Public Notice solicits comment on the historical, economic, and structural factors that both govern how MVPDs acquire programming and explain why they almost always offer bundled service tiers rather than on a stand-alone basis, though the only impediment to doing otherwise is market forces. The Commission seeks to understand how options would change with respect to how and what consumers pay for cable and DBS service, and the program choices available, were MVPDs compelled to depart from long-standing relationships and practices that have fostered unprecedented diversity in televised offerings. See Public Notice at 9292-93.

As explained below, government-mandated *à la carte* program offerings would fundamentally undermine the economic model responsible for providing consumers a plethora of ever-growing viewing options at reasonable prices, as well as substantial diversity among programming sources and choices. It also would be bad policy for the government to dictate how such programming is marketed. Moreover, to the extent the government issues mandates about the conditions under which programmers may sell content, and/or the way MVPDs package that content for subscribers, such rules would violate the First Amendment.

**I. BUNDLED AND TIERED SERVICE IS INSTRUMENTAL TO THE RICH TAPESTRY OF PROGRAM OPTIONS THAT CONSUMERS ENJOY, INCLUDING THOSE AETN OFFERS**

The bundling of multichannel offerings has played a vital role in establishing a trend toward “Americans enjoy[ing] more choice, more programming and more services

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*Case for À La Carte Cable Pricing*, Apr. 7, 2004, posted at <http://www.cwfa.org/articledisplay.asp?id=5468&department=CFI&categoryid=family>.

than any time in history”<sup>7</sup> that quickly would be reversed under any forced *à la carte* system. Consumers can select from multiple distribution platforms, including over-the-air broadcasting (which includes or will soon include multicast offerings), cable systems (and in some areas multiple systems) that offer basic, expanded, premium and on-demand services, similar choices from satellite services (including two DBS providers), and home-video alternatives (videotape, DVD). See *id.* at 1608-10; *2002 Biennial Regulatory Review – Review of the Commission’s Broadcast Ownership Rules*, 18 FCC Rcd 13620, 13648 (2003) (“*2003 Broadcast Review*”). Consumers have access to literally hundreds of national and regional networks and channels, as well as local offerings. *2003 Video Comp. Report* 1624-25 & App. C; *2003 Broadcast Review*, 18 FCC Rcd at 13648.

The explosion in program options has resulted primarily from the evolution of MVPDs (especially cable) offering bundled programming packages, and marketplace responses to them. Such bundling allows MVPDs to intermingle established, familiar networks with new offerings so that viewers drawn by the former gain exposure to the latter, thereby permitting new networks to “share” in access to existing substantial viewership and to build their own audience. This model facilitates the necessary “critical mass” of subscribers each new network requires to attract investment, gain advertisers, and pay for programming to get off the ground. See *Pitfalls of À La Carte: Fewer Choices, Less Diversity, Higher Prices*, National Cable & Telecommunications Association (“NCTA”), Policy Paper, May 2004 (“*À La Carte Pitfalls*”).

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<sup>7</sup> *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, 19 FCC Rcd 1606, 1608 (2004) (“*2003 Video Comp. Report*”).

Multichannel subscribers comprise about 88 percent of the video programming market, *2003 Video Comp. Report* ¶ 7, and they enjoy a richly diverse menu of programming that is both continually growing and reasonably priced. The FCC recently reported that the average cable customer receives a bundle of approximately 63 channels, at an average monthly cost of \$36.47 (\$40.11 including equipment), or \$0.664 per channel.<sup>8</sup> Conversely, the few stand-alone networks that currently exist, e.g., “premium” channels like HBO and Showtime, can cost as much as \$15 a month. The dichotomy between bundled networks that can share a common subscriber base, and offerings that choose to go it alone, is further illustrated by those that once were offered *à la carte* but are now part of a tier. For example, early *à la carte* offerings of the Disney Channel, the Golf Channel, and some regional sports networks cost \$8-\$15 a month, but now are part of bundled tiers and have a low per-channel cost similar to the rest of the channels on the tier. It also is notable that DBS services that provide all customers with addressable set-top boxes (that are a prerequisite to *à la carte* service) rely primarily on bundled service. Neither of the two established DBS providers offers programming on an *à la carte* basis as a means of attempting to attract away customers served by competing cable services or DBS providers. It is similarly noteworthy that as broadcasters prepare to become MVPDs by multicasting digital channels and/or using excess capacity to carry other programmers’ offerings, they, too, appear poised to do so on a bundled, rather than an *à la carte*, basis.<sup>9</sup>

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<sup>8</sup> *Implementation of Section 3 of the Cable Television Consumer Protection Act of 1992*, 18 FCC Rcd 13284, Att. 2 (2003) (“2002 Cable Pricing Report”).

<sup>9</sup> See, e.g., *Communications Daily*, June 4, 2004, at 9 (consortium of TV stations seeks to purchase over-air digital subscription TV service to sell programming consisting of local signals and “at least 30 cable channels” on excess digital channels).

Notwithstanding the benefits of and natural trend toward bundling multichannel networks, *à la carte* often is mentioned as a facile solution for whatever happens to be the perceived cable problem of the day. This is so whether the asserted problem is purportedly increasing rates or “indecent” programming. All information available to date, however, indicates that *à la carte* is anything but a panacea.

The Commission is well aware that the previously submitted authoritative economic analyses of channel tiering, the recent study by the General Accounting Office (“GAO”), and the NCTA’s policy paper, all demonstrate the ways in which a forced *à la carte* system would be counterproductive.<sup>10</sup> This includes higher prices for consumers, loss of programming diversity as some networks fail and others are forced to drastically reduce programming budgets, and interference with proper functioning of the MVPD market. The Commission already has had an opportunity to consider these findings in depth, and they need not be recounted at length here. It is notable, though, how the conclusion reached in the Economists Study in 1998 that “[f]orcing networks ... on to individual channels, far from benefiting viewers, would likely harm consumers, operators, and programmers,” *Economists Study* at 21, is remarkably consistent with more recent findings that “an a la carte pricing model would *reduce*

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<sup>10</sup> See *How Bundling Cable Networks Benefits Consumers*, Economists Incorporated, July 23, 1998, filed with Comments of ABC, Inc., CS Docket No. 98-102, July 31, 1998 at 2-9 (“*Economists Study*”); *À La Carte Pitfalls, passim; Issues Related to Competition and Subscriber Rates in the Cable Television Industry*, U.S. General Accounting Office, GAO-04-8, at 30-39 (Oct. 2003) (“*GAO Report*”). See also *Subscriber Rates and Competition in the Cable Television Industry*, Statement of Mark L. Goldstein, Director, Physical Infrastructure Issues, GAO, in *Escalating Cable Rates: Causes and Potential Solutions. Hearing Before the Senate Comm. on Commerce, Science and Transp.*, 108th Cong., at 13-16 (Mar. 25, 2004) (“*GAO Testimony*”).

program diversity and *increase* prices for consumers,” *À La Carte Pitfalls* at 22 (emphasis original).

The GAO Report, which reaches the same conclusions, is particularly telling. It found that “an à la carte approach” might “provide consumers with more individual choice” but that this would come at the expense of “requir[ing] additional technology and impos[ing] additional costs on both cable operators and subscribers.” See GAO Report at 30-37. The GAO found “most cable networks require cable operators to place their network on widely distributed tiers” out of necessity, as “cable networks obtain roughly half of their overall revenues from advertising,” and “an à la carte approach could result in reduced advertising revenues[,] ... higher per-channel rates and less diversity in program choice.” *Id.* Ultimately, the GAO stated, “the economics of the cable network industry could be altered” as a result of allowing “cable subscribers ... to choose networks on an à la carte basis,” *id.* at 34, and even simply shifting to “a greater number of smaller tiers could cause many of the same technological and economic concerns as an à la carte approach.” *Id.* at 30.

**A. Bundling MVPD Channels is a Proven Successful Business Model That Virtually All Multichannel Networks Rely on to Launch and Survive**

Since their inception with the advent of modern cable systems, MVPDs have relied on bundling to optimize the attractiveness of programming choices made possible by dual revenue streams of advertising sales and licensing fees paid by MVPDs.<sup>11</sup> The basis for this approach is as valid today as when the cable industry began. As the

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<sup>11</sup> See, e.g., GAO Testimony at 14 (“cable networks received nearly half of their revenue from advertising” and “the majority of the remaining revenue is derived from the license fees that cable operators pay”).

*Economists Study* reported, providers of goods and services in a variety of markets bundle them to lower transaction costs, take advantage of economies of scale, and enhance the value and/or convenience of the product to consumers. See *Economists Study* at 1.

For cable and DBS, bundling gives consumers that opt to subscribe to paid television service a broad array of content choices from a variety of programmers. In turn these programmers can focus on producing compelling content to build an audience among tier subscribers, rather than spending additional resources on marketing. In order to maximize advertising revenue, programming networks seek the broadest possible dissemination on multichannel systems because advertisers value most those networks that are viewed or have the potential to be viewed by the largest number of people. See, e.g., GAO Testimony at 15. The fact that a network is carried by an MVPD therefore is itself a saleable asset that program networks rely on to enter the video programming market and to survive once there. Channels offered on a bundled basis can utilize resources to develop unique, quality programming that drives the other component of ad sales, ratings share, while spending less on marketing by promoting its programs rather than seeking to attract and retain subscribers. Conversely, channels offered on an unbundled basis, such as “premium” channels like HBO, must employ marketing strategies that raise consumer awareness to the point that subscribers know enough about a network to make affirmative purchasing decisions to select and pay for it on a monthly basis. Such channels then must also heavily advertise individual programs to retain that subscriber base.

Programmers like AETN have invested hundreds of millions of dollars annually developing content, marketing it, and negotiating for carriage under business plans based on bundling service on expanded basic or other programming tiers. Requiring these programmers to change midstream and allow their networks to be carried *à la carte* would scuttle the economic premise on which they rely.<sup>12</sup> Most contracts between MVPDs and programmers – including each of the AETN networks – prohibit offering the programming service on an *à la carte* basis, and most specify the tier on which programming must appear. See GAO Report at 33. Moreover, every key economic term in such carriage contracts, including licensing fees, marketing support and other provisions, reflect and are conditioned on agreement to tiering provisions. Consequently, any regulatory change dictating modification of contracts to allow *à la carte* channel selection would frustrate programmers’ business expectations, and could not be implemented through simple amendments to existing agreements. Any such rule would require renegotiating every important economic term in all existing agreements.<sup>13</sup>

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<sup>12</sup> See *À La Carte Pitfalls* at 2 (a la carte pricing model “would ... destroy the economic underpinnings upon which companies have invested billions of dollars to build new infrastructure and develop new programming.”).

<sup>13</sup> Such a regulatory mandate would have other far-ranging business effects as well. For example, since AETN’s valuation is calculated based on several factors, including both subscriber base and cash flow (which is in significant part driven by advertising), *à la carte* could significantly reduce the company’s asset value. In addition, the rights AETN receives with respect to certain off-network, British, and other non-original programs, as well as the scores of third party elements included in original documentaries (such as film clips and stills), are limited in some cases to the manner in which AETN currently distributes or agrees to distribute programming. An *à la carte* system raises the possibility that AETN may be required either to forego such programming or negotiate (or renegotiate, as the case may be) for additional rights necessary for *à la carte* distribution and, most likely, pay extra for those rights.

## **B. AETN Exemplifies How MVPDs, Programmers and Consumers Benefit from the Current Structure**

The Public Notice finds AETN at an opportune point in its history to illustrate the importance of bundled multichannel service to not only both legacy and newer analog networks, but also to burgeoning digital networks and newly launched offerings. AETN was among the original programmers that populated early basic cable when it launched Arts & Entertainment Network, now known as A&E Network<sup>®</sup> (“A&E”), in 1984. Since then A&E has been carried on the basic and/or enhanced basic tier and seen subscribership grow to nearly 88 million households.<sup>14</sup> It provides a diverse mix of programming ranging from critically acclaimed original series and movies, to innovative documentaries – including the BIOGRAPHY<sup>®</sup> series – to dramatic specials and contemporary performances. A&E holds the record for the most Primetime Emmy nominations over the past five years for a basic cable network, and features a prime-time lineup in which at least 90 percent of the programming is original to the U.S. market.

On January 1, 1995, AETN was able to build on the value of A&E as a cornerstone basic cable network to launch The History Channel<sup>®</sup>, a unique, high-quality programming service featuring historical documentaries, movies and miniseries placed in historical perspective.<sup>15</sup> Its range and quality of programming has made the network, which like A&E appears on the enhanced basic tier, one of the quickest growing and most watched in cable, with over 86 million U.S. subscribers and 100 million subscribers

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<sup>14</sup> See *2003 Video Comp. Report*, Table C-6. Since the *2002 Video Competition Report*, A&E’s subscribership has grown to over 87.5 million.

<sup>15</sup> The History Channel<sup>®</sup> would have launched even more quickly, but was among dozens of proposed new cable networks that cable operators were unwilling to add due to the government’s attempt at rate regulation in the cable industry in the 1990s. See *Economists Study* at 19.

worldwide. Over 95 percent of the History Channel's primetime lineup is original programming, and the network has received awards ranging from the prestigious Academy of Television Arts & Sciences' Governor's Award to two Peabody Awards for outstanding documentary programming. Research data available to AETN (discussed in greater detail *infra* at 13-16) shows that The History Channel® is perceived among cable subscribers to be among the most important networks that contribute to their enjoyment of cable service.

The brand-recognition and success of A&E and The History Channel® has enabled AETN to be a pioneer on the digital tier as well, launching both The Biography Channel® and History International® in 1998. The Biography Channel® creates a unique, multidimensional view of individuals of cultural interest by intermingling the Biography® series with other documentaries, movies and original short features. History International® offers viewers an enriching mix of historical documentaries with a global focus, original short features, interviews with historians, and exclusive programs produced or acquired in conjunction with international partners. The Biography Channel® and History International® each have surpassed 30 million subscribers after only five years in existence. On June 7, 2004, AETN launched a new network, The History Channel en español™, which operates primarily as a digital service. The History Channel en español™ offers a wide range of Spanish-language programming focusing on history's great dramatic moments and events, as well as its pivotal figures, highlighting both world and Latin American history, and providing enriching entertainment about Hispanic roots and culture, and in many ways is intended to appeal to minority audiences, among others.

All of the AETN networks benefit from being bundled on a tier of multichannel services, for the cross-promotional and brand-awareness-building reasons set forth above. Each time AETN has launched a new network, it has been invaluable to enable viewers to discover the channel among familiar offerings already on the dial and to sample its programming without having to make a separate purchase.

Current research demonstrates the importance of such sampling. It shows that consumers have difficulty recalling even the best-known multichannel programmers without a reminder of their availability. Among subscribers to cable systems that carry A&E and The History Channel<sup>®</sup>, fewer than one in five, on average, are able to name either channel through unaided recall as a network available to them.<sup>16</sup> This is the case even though The History Channel<sup>®</sup> had the fourth-highest unaided recall score among major networks, and A&E was not far behind. *Id.* With aided awareness of the channels, however, nearly nine out of ten recognize A&E and The History Channel<sup>®</sup> as available programming choices. *Id.* This is a strong indicator that viewers “surfing” bundled channels and finding an AETN network are likely to recognize it and, if interested in the programming they encounter, tune in, whereas it is unlikely that viewers lacking access to an AETN network will think to seek it out, even if AETN were to substantially increase its marketing budget.<sup>17</sup>

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<sup>16</sup> Beta Research Corp., *2003 Beta Research Cable Subscriber Study Evaluation of Basic Cable Networks*, November 2003, Unaided Recall as Cable Channel-Persons in Systems Carrying Service (“*Beta Study*”).

<sup>17</sup> This phenomenon reflects the way in which most television viewers make programming choices. See Research Alert, *How TV Viewers View TV*, Cable and Telecommunications Association for Marketing (Dec. 6, 2002) (approximately 50 percent of cable and satellite TV viewers scroll across the dial until they find something to watch, while only slightly more than one third make it a regular practice to watch particular

Another strong indicator of the value of enabling subscribers to “sample” new programming options is the impact such viewing has on the perceived value of the channels. The perceived value of A&E, for example, is approximately double for subscribers who have viewed the network at least nominally within the past year compared to those who merely have access to it from their MVPD but have not watched. The difference for The History Channel<sup>®</sup>, although it is among networks having the highest perceived value, is still nearly sixty percent. *Beta Study – Average Perceived Value*. It is evident that the majority of subscribers who might value a network highly given the opportunity to sample its programming likely would not value it sufficiently to select it affirmatively *before* having an opportunity (other than on a limited basis as a free preview) to experience its programming, as would be necessary in an *à la carte* system. See GAO Testimony at 16 (“subscribers place value in having the opportunity to watch networks they typically do not watch”); *Economists Study* at 4 (“subscribers are buying certain services that they know and understand, as well as an option to sample all the remaining services”).

The importance of bundling in amassing sufficient potential viewers to launch or sustain a multichannel network cannot be overstated. In AETN’s experience, distribution fees alone are insufficient as a revenue stream, but rather must be complemented by advertising dollars, for a multichannel network to pay for high-quality programming, the lifeblood of its existence. A multichannel network must be able to

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shows). See also *Confessions of a Nielsen Household – The Drawbacks of the Paper Diary Method for Recording Television Viewing*, AMERICAN DEMOGRAPHICS, May 1, 2001 (requirement that households record viewing habits in diaries separated into 15-minute intervals does not correspond with actual “twitchy, channel-surfing habits”).

show it reaches at least forty million subscribers before it can reasonably expect to attract significant advertising revenue. In order to attract sufficient advertising revenue to afford to pay for and provide a meaningful quantity of *original* programming, the network must reach approximately sixty million subscribers. Thus, a network has to reach tens of millions of subscribers before it attains a level where it can pay for unique programming, which helps increase the viewership, which in turn leads to advertising dollars that allow the network to bring something new to the market.

It is doubtful very many networks would be able to achieve (or sustain) this level of subscriber- and viewership without being bundled on a multichannel tier. Using A&E and The History Channel<sup>®</sup> as examples, each network reaches on average around 87 million subscribers, but it is still unclear they would survive if forced off tiers into an *à la carte* model. If, as noted, only one in five subscribers has sufficient recall of the channels to “ask for them by name,” their penetration under an *à la carte* model could quickly and easily drop below that necessary to offer significant quantities of original programming. They may be at risk of even dropping below the 60 million needed to garner significant advertising revenue. A&E and The History Channel<sup>®</sup> are greatly concerned about this possibility even though they are among the top ten for unaided recall. It is unlikely this concern would be much different for other major networks, given that the top twenty networks (based on subscribership) are separated by only about four million subscribers each, and none has more than 90 million subscribers. *2003 Video Comp. Report*, Table C-6.

**II. GOVERNMENT-MANDATED À LA CARTE WOULD DEVASTATE BASIC CABLE SERVICES LIKE A&E NETWORK<sup>®</sup> AND THE HISTORY CHANNEL<sup>®</sup> AND DIGITAL OFFERINGS SUCH AS THE BIOGRAPHY CHANNEL<sup>®</sup>, HISTORY INTERNATIONAL<sup>®</sup>, AND THE HISTORY CHANNEL EN ESPAÑOL<sup>™</sup>, WHILE DIMINISHING PROGRAM DIVERSITY**

The detrimental impact of forcing multichannel networks that grew based on bundled business models to being offered *à la carte* would be devastating. As a threshold matter, there is a general disconnect between the value consumers place on networks and what they are willing to pay to receive them as stand-alone channels. Industry data made available to AETN shows that, among viewers of the average enhanced basic network, the average perceived value was \$1.30 per network, but fewer than half the viewers would be willing to pay as much as a dollar per month for the programming if it were offered separately, and forty percent were either unwilling to pay *anything* or would not pay as much as 50 cents a month. Notwithstanding these results, nearly two-thirds of viewers indicated that the average network was important to their enjoyment of cable. This dynamic is a significant factor in why an *à la carte* system would harm a great number of multichannel networks and thus diminish viewer choice.

**A. À La Carte Would Erode AETN's Subscriber Base, Substantially Reduce Its Revenues, and Directly Affect the Quantity and Quality of Its Original Programming**

Given the disconnect between perceived value and willingness to pay a separate fee, any enhanced basic network would expect a significant reduction in the number of subscribers they reach as those who are unwilling to pay more than a nominal price for most cable channels – even those they value – elect not to receive some networks. Because AETN's advertising revenues are dependent upon both the number of subscribers its networks reach and the ratings they draw, any substantial

loss of subscribers would have to be countered by either a significant increase in per-channel fees or significant ratings increases, or both.

The History Channel<sup>®</sup> is a perfect case in point. It would experience a substantial adverse impact in an *à la carte* environment.<sup>18</sup> This would be the case even though, as previously mentioned, The History Channel<sup>®</sup> is one of the most successful multichannel networks, enjoying a high perceived value among subscribers and a penetration rate just behind that of top-ten sister channel A&E. *See supra* at 13. AETN's analysis, set forth below, yields a sobering set of projections. It is based on the *Beta Study*; AETN's experience with the effect of distribution levels on advertising and subscriber revenues during the evolution of The History Channel<sup>®</sup> (as well as that of The Biography Channel<sup>®</sup> and History International<sup>®</sup>); and AETN's estimate of additional marketing expenditures it would be forced to make. *See supra* at 12-14.

Despite the level of success The History Channel<sup>®</sup> has attained, AETN projects that it would lose money if forced to transition to *à la carte*. AETN could not continue programming The History Channel<sup>®</sup> at its current standard of quality under these circumstances. The network's entire existence would be placed in immediate peril, even though The History Channel<sup>®</sup> is among the most widely available and highest-valued networks.<sup>19</sup> If under an *à la carte* system AETN charged \$1.65 (the

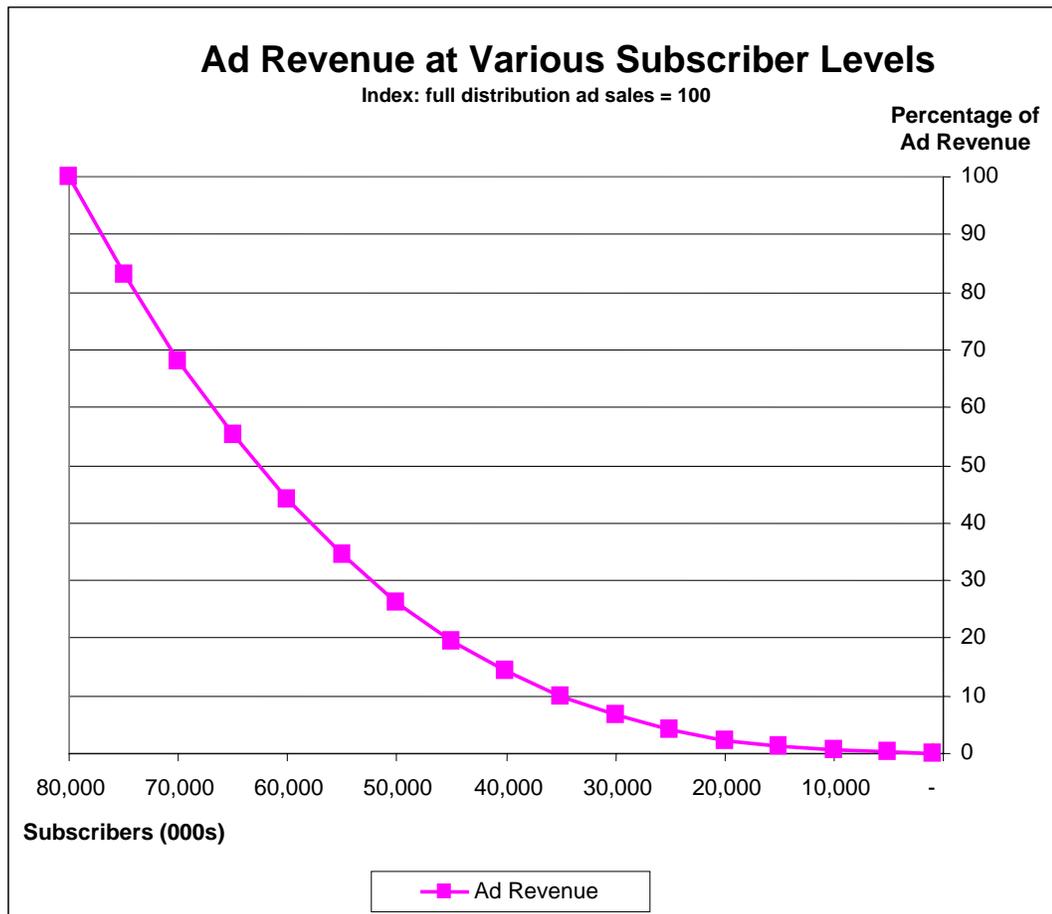
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<sup>18</sup> The same holds true for AETN's other networks as well; however, for present purposes the example provided by The History Channel<sup>®</sup> suffices to illustrate the point.

<sup>19</sup> The History Channel<sup>®</sup> has a perceived value of approximately \$1.65 per month among those who view the network even occasionally. *Beta Study – Average Perceived Value*. This \$1.65 value persists notwithstanding that, in a recent "omnibus study of TV viewers," The History Channel<sup>®</sup> ranked first for viewer loyalty and relevance among men 18 to 34, a figure the report called "especially impressive for a network that just a few years ago was considered to be targeted primarily to older men." Jack Myers,

perceived value) for The History Channel®, its projections indicate the number of subscribers would fall to only about half as many as AETN requires to operate the network at current levels of programming and profitability.

The adverse impact owes in significant part to how rapidly advertising revenues would drop due to loss of the channel’s current reach. Using data in the *Beta Study* and based on AETN’s experience, AETN has projected the effect on advertising revenues resulting from lost subscribers in an *à la carte* environment. This projection is reflected in the graph below:



LLC, *History Channel Ranks #1 for Viewer Loyalty & Relevance Among Men 18-34*, JACK MYERS REPORT, June 21, 2004, available (to subscribers) at <http://www.jackmyers.com>.

As the graph indicates, The History Channel<sup>®</sup> would experience a precipitous drop in advertising revenue from even the initial loss of a disproportionately small number of subscribers. Specifically, advertising revenue shrinks by more than thirty percent from the loss of even ten million (12.5%) subscribers. Losing even only a quarter of the network's subscribers (down to 60 million) results in a *fifty-six percent loss* of advertising revenue. And even if as many as one of every two MVPD households elects to pay to continue receiving The History Channel<sup>®</sup> its advertising revenue would be practically nonexistent, falling to only fourteen percent of its present level. The adverse economic impact, which would arise from any mandatory transition to an *à la carte* model, would be similar for AETN's other networks and would be compounded by the fact that AETN would lose distribution fees for every subscriber below the number it currently reaches who elects not to make the network(s) part of his *à la carte* package.

At the same time, each network would be forced to spend significantly more on promotion costs to obtain and retain viewers. The fragmentation of subscribers would make marketing inherently more expensive; efficiencies would be lost. The combination of these losses would force AETN to devote materially more resources to marketing to its subscribers. Under a forced *à la carte* system, AETN estimates that its promotion costs would be 250 percent of its current costs – a 150 percent increase. AETN estimates that it would be required to spend an additional 50 percent of current spending on acquiring subscribers, and an additional 50 percent retaining them. In addition, even after acquiring and retaining subscribers, AETN would have to increase by half the marketing dollars it spends persuading those subscribers it has to view AETN's programming in an increasingly fractured ratings market. Unlike a "premium"

network model, AETN still would rely on advertising revenue for support. The only way to obtain or retain significant advertising would be if those who subscribe were to watch more AETN programming, and encouraging viewership would require substantial marketing support.

All of the foregoing would have a drastic adverse impact on AETN's programming. Increased marketing costs necessarily would force a reduction in other expenditures, the most immediate of which would be programming (though significant personnel cuts inevitably would follow as AETN looked for ways to reduce costs). Ironically, AETN would be forced to divert a significant portion of the millions of dollars it now spends producing compelling programming to expanded marketing efforts, and it would not be able to continue investing in any significant amount of original programming. As AETN's ability to produce original programming is diminished, it would have little choice but to rely on pre-existing programming, thereby reducing the amount of diverse content available to subscribers. Ultimately, these conditions could threaten the very existence of the AETN networks – including two of the most successful and most popular MVPD offerings – with subscribership further reduced due to drop-offs in program originality and quality.

**B. An À La Carte Requirement Would Harm Programming Diversity**

AETN's uncertain future in an *à la carte* environment is hardly unique. Overall, *à la carte* requirements would have a drastic impact on the diversity of programming available to consumers. Some networks would fail altogether, taking with them not only their contribution to diverse programming but diversity among programmers as well.

See generally GAO Report at 36-37. The impact on “niche” networks, which by definition serve only a relatively small portion of the market, would be the most drastic.

The *GAO Report* noted that cable operators and financial analysts agreed “smaller networks or those providing specialty programming would be hurt the most by an à la carte system.” *Id.* at 36. Such networks focus on particular demographics or interests with programming that may not have broad appeal. This includes gender-targeted programming that by design expects to forego approximately half the viewing audience, programming for children that make up only about 25 percent of viewers,<sup>20</sup> and programming that is in foreign languages or otherwise targeted to serve minority viewers (such as The History Channel en español<sup>TM</sup>), as well as arts programming, religious programming and other niche-oriented programming.<sup>21</sup> Many such networks already have relatively small audiences. The loss of even a small portion of these subscribers due to a transition to à la carte – particularly those able to “sample” and discover the network – could be fatal. See GAO Testimony at 16 (“programming diversity would suffer under an à la carte system because some cable networks, especially small and independent networks, would not be able to gain enough subscribers to support the network”). Though some of the most popular may be able to

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<sup>20</sup> United States Census Bureau, *Statistical Abstract of the United States*, <http://www.census.gov/prod/2004pubs/03statab/pop.pdf>, Table 13 (accessed June 22, 2004).

<sup>21</sup> It is notable that the ability of MVPDs to support niche networks in the current bundling environment allows them to offer what Commissioner Martin calls “family-friendly” programming, not to mention programming aimed at minority segments of the population, to an extent that may not be possible on broadcast channels, which must concentrate most of their efforts on programs of mass appeal. See *Family-friendly Programming* at 556-57 (Commissioner Martin article noting that “primetime viewing options as a family” on broadcast “may be few and shrinking” while “cable and satellite ... offer” a wealth of family fare that is “great programming”).

survive by raising prices, it would not be feasible for most to continue as advertiser-supported networks or to exist as a subscription “premium” service.

In this scenario, the ability to launch new networks would all but disappear. As the *Economists Study* noted, “[i]n many respects, bundling enables the launch of new and previously unsampled services” that “benefit greatly from their association on the bundled tier with established networks,” as it gives “new services ... the greatest opportunity to be sampled and ... find an audience.” *Economists Study* at 4. Since new networks do not already have viewers, or ratings that go with them, the key asset they have to encourage investment is not the viewers themselves, but the *potential* to reach them through meaningful subscriber penetration commitments. That asset would be lost in an *à la carte* system – whether it is required for all channels or merely “voluntary.”

*À la carte*, conversely, requires that consumers must affirmatively request a new network – sight unseen – for it to be added to their multichannel lineup. Given the millions of subscribers necessary to sustain even the most unambitious of networks, building a critical mass of subscribers needed to launch would be exceedingly difficult. Projecting future advertising revenue would be virtually impossible, as programmers and MVPDs would be unable to estimate the number of subscribers or the amount of viewing that advertisers could expect. And the uncertainty surrounding a launch under these circumstances would make it virtually impossible to attract investment capital to support a new network. See *À La Carte Pitfalls* at 1 (bundling new and well-established networks to allow sampling and sharing of large subscription base is “dynamic that creates the investment incentives that produce the rich diversity of programming consumers enjoy today”).

### C. Experience Outside the U.S. Does Not Support À La Carte as a Viable Framework

Limited experience with *à la carte* offerings outside the U.S. do not show that *à la carte* is a viable business model or that *à la carte* mandates would serve the purposes of its current advocates. Some proponents of regulation have cited “testimony regarding the availability of a la carte pricing for digital cable consumers in Canada” as support for the proposition that such options should be available in the U.S. McCain Letter at 2. Notably, however, one of the key qualifiers of this observation is that *à la carte* is available “for *digital* cable in Canada.” *Id.* In other words, *à la carte* service in Canada is an adjunct to *bundled* service north of the border. Consequently, to the extent *à la carte* advocates cite Canadian experience as a reason such a system should be adopted here, it is clear the total *à la carte* system they propose “is not exactly how the system works in Canada.” Ted Hearn, *À La Carte Lives, Up North*, MULTICHANNEL NEWS, June 14, 2004, at 1.

As an initial matter, the Canadian market is not analogous to the U.S. market, for a variety of reasons. First, the Canadian market is much smaller, and is fragmented as well, in that thirty percent of the population is French-speaking.<sup>22</sup> Canada also is a secondary market for U.S. networks. They offer programming there as an adjunct to their provision of programming to the U.S. market. Without the base of the U.S. market, Canadian *à la carte* would not be possible given the inability of programming offered under that construct to be self-supporting. The economics of the multichannel video

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<sup>22</sup> Remarks by Michael Hennessy, President and CEO, Canadian Cable Television Association, to Washington Metropolitan Cable Club, June 29, 2004, at 2, (“Hennessy Speech”), filed with Letter from Daniel S. Brenner, Senior Vice President, Law & Regulatory Policy, NCTA, to Marlene H. Dortch, Secretary, FCC, June 30, 2004, MB Docket No. 04-207 (notice of *ex parte* meeting).

market in Canada also differ, given the significantly dissimilar regulatory environment in that country, particularly the extent to which Canadian programming requirements are imposed. See *id.* at 4 (“the Canadian Radio-television and Telecommunications Commission – CRTC – has created an intricate web of carriage rules to promote Canadian culture and diversity”). All told, the way that programmers build viewership in Canada, and the business structures they are forced and/or willing to accept to participate in that market, create different incentives and obligations that bear on the availability of *à la carte* programming there. But see *id.* at 5 (“The most popular cable services are available on analog tiers and by regulation cannot be moved to digital without [a network’s] consent” which “would not be provided because [they] fear *à la carte* or pick packs would fragment their market and undermine revenue required to contribute to the production of Canadian content.”).

In any event, the Canadian *à la carte* option exists only because networks offered on that basis are provided alongside – and only after subscription to – bundled and/or tiered networks. Subscribers to Canada’s Rogers Cable, for example, must first purchase a basic package that consists of about 30 channels and includes basic cable networks like A&E, The Discovery Channel, The Learning Channel, and Country Music Television, then must further subscribe to digital to acquire *à la carte* rights, plus rent the requisite cable box at an investment of C\$8.95 per month (for each television on which *à la carte* service is to be received). Once they do, the first *à la carte* channel costs C\$2.49 a month – well more than current data shows American consumers willing to pay for the average basic channel on a stand-alone basis. See *supra* at 15. Each of the next four *à la carte* channels appears to cost C\$2.49 as well, with a bundle of five *à*

*la carte* channels costing C\$9.95, and each additional group of five channels costing around an additional C\$5.00 each. However, individual channels not purchased in groups of five still appear to cost C\$2.49 each, so even under Rogers' *à la carte* structure, bundling, albeit in smaller bundles, still provides the best value.

Given the necessary pricing structure, it should come as no surprise that *à la carte* "is not that popular in Canada." *À La Carte Lives, Up North* at 57. Rogers Cable reports that "very few customers actually buy one or two channels a la carte," and "[v]ery few take between one in five channels as well." *Id.* Just how unpopular *à la carte* in Canada may be, however, is difficult to know, because "although a la carte is widely available," so few customers purchase *à la carte* that Rogers "doesn't even keep track of the number" of those who do so. *Id.* It is significant, though, that "only one provider in Canada actually put *à la carte* at the centre of its business plan" and "[i]t went into receivership." Hennessy Speech at 12.

Moreover, the "[l]ack of marketplace enthusiasm for the Canadian a la carte system has held digital-cable penetration ... to 22 percent - which lags the 30-plus percent ... in the U.S."<sup>23</sup> This is so even though one would expect "digital cable penetration would be much higher in Canada" if "the a la carte approach was truly successful." *Id.* Rogers concludes that, though it began offering *à la carte* in 1999 with the rollout of digital with the idea that "it was a good marketing opportunity to offer that kind of choice to ... customers," in practice people "haven't exercised [it] a great deal." *À La Carte Lives, Up North* at 57.

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<sup>23</sup> Rob Stoddard, Senior Vice President, Communications & Public Affairs, NCTA, *Letters: Cable Packaging Isn't All That Different in the Great White North*, MULTICHANNEL NEWS, June 21, 2004, at 64.

AETN's experience in Canada further illustrates the limitations of *à la carte* options. The Canadian version of The Biography Channel (of which AETN owns a minority interest (30 percent) as required by Canadian law) is a Category 1 digital channel offered on the digital tier. As such, it must be sold in at least one digital package, and cannot be sold exclusively on an *à la carte* basis. Where it is offered *à la carte* (in addition to being part of a package, as Canadian regulations require), few subscribers take advantage of this option. The low take rate is anticipated because the per-channel price is higher to the subscriber. The Canadian version of The Biography Channel is paid the greater of a specified percentage of what systems operators charge at retail for it, and the amount the network would receive for carriage on a tier. Even under these circumstances, the Canadian version of The Biography Channel is not profitable and its continued existence is threatened, due to the lack of distribution. Thus, in most respects, the Canadian structure that offers *à la carte* options after basic and digital service are purchased (a choice that only a notably small percentage of subscribers actually exercise) is similar, all told, to the bundling and tiering approach in the U.S., as well as that found elsewhere.<sup>24</sup>

### **III. CONSUMERS ALREADY HAVE AMPLE CHOICES AND CONTROL WITH RESPECT TO VIDEO PROGRAMMING**

There is no overriding economic or policy justification for subjecting programmers like AETN, and the MVPD market generally, to the substantial downside of forced *à la carte* described above. The existing system of bundling networks that has been in

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<sup>24</sup> In the United Kingdom, there is no single-channel *à la carte* selection on cable systems, and The History Channel<sup>®</sup>, for example, is tiered on both cable and satellite as part of an "extended basic" tier. There also is no *à la carte* single-channel selection in Japan for basic channels, which in AETN's case includes The History Channel<sup>®</sup>.

place since cable's inception has, as noted, fostered both an unprecedented number and variety program choices and continued growth, and there is no market failure that prevents *à la carte* from flourishing if market forces warrant it. A forced *à la carte* regime also would result in increased prices for multichannel service for most consumers. Those who might experience any reduction in price would see only marginal savings while foregoing most of the channels they currently receive. Nor is mandating *à la carte* necessary to give consumers more control over the programming that comes into their homes. In sum, while AETN has noted that "à la carte channel carriage is a solution in search of a problem,"<sup>25</sup> it is, in truth, not much of a "solution" at all.

**A. No Market Failure Warrants Government Intrusion in the Form of Mandated *À La Carte***

Government action to require or facilitate the provision of multichannel networks on an *à la carte* basis is unnecessary and unwarranted. The fact that market forces limit *à la carte* options to a handful of certain specialized market segments does not mean that government intervention is warranted. As a threshold matter, the FCC long ago set out to foster competition in the video programming market, and to ensure that the goods and services offered reflect market forces and not regulatory fiat. *Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992*, 16 FCC Rcd 17312, 17316 (2001) (citing "principal objective ... to foster competition in the acquisition and delivery of multi-channel video programming"). This has proven to be a sound course. The Commission has reported that the MVPD

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<sup>25</sup> Letter from Robert Corn-Revere & James S. Blitz, Counsel, AETN and Courtroom Television Network LLC, to House of Representatives Committee on Commerce, Science and Transportation, Subcommittee on Telecommunications, Trade, & Consumer Protection, May 11, 2004 (copy attached).

market is more competitive than it has ever been. *2003 Video Comp. Report* ¶¶ 4, 6-7. Consumers have more choices among video programming providers and a wider variety of content available to them than ever before, and the range of options continues to grow. *Id.* at 1608-10; *2003 Broadcast Review*, 18 FCC Rcd at 13648.

It should be first noted that no consumer is required to subscribe to cable or DBS, and for those finding such service necessary to receive non-MVPD programming, such as good reception of local broadcast signals, “basic” service already exists. See 47 U.S.C. § 543(b)(7)(A). For consumers electing to subscribe to an MVPD, and to purchase more than basic service, the robust market for video programming demonstrates that MVPDs and programmers respond to market forces to deliver value. All MVPDs offer a range of service packages at a variety of price points. If there were more of a demand to support more widespread *à la carte* offerings, they would be available.

Programmers like AETN that condition sale of their programming to MVPDs on carriage on a bundled programming tiers do so for the reasons set forth above. Market forces preclude programmers from offering most networks on an *à la carte* basis. Where there is sufficient demand for a network at a price that supports its programming and operational costs, it *is* offered on an *à la carte* basis, as is the case with “premium” networks like HBO and Showtime, or sports packages like NFL Season Ticket and NBA League Pass. It is notable in this regard that even where there is head-to-head competition between providers on the same platform, such as that between the two existing DBS providers or cases of cable overbuild, or on different platforms, *i.e.*, DBS competing with cable, MVPDs have not found *à la carte* to be a draw that attracts their competitor’s subscribers. Consequently, it is not the case, as some suggest, that

cable monopoly power precludes widespread *à la carte* from taking root.<sup>26</sup> Government intrusion into a properly functioning market is an inappropriate response. *Economists Study* at 18 (“regulation tends to introduce distortions and disincentives that outweigh the problems [it] was intended to remedy”).

Some may suggest that a mandatory *à la carte* policy can be made to “work” by using rate regulation to ensure that individual channels are an attractive option to consumers. But when the government ignores economic forces and tries to compel markets to conform to policymakers’ preconceived notions of how they should behave, disaster often follows. The Commission’s previous experiment with cable rate regulation provides an important example of how unintended adverse consequences can overwhelm the anticipated positive effects of a policy choice. The rate regulations wreaked havoc on the programming market, *Economist’s Study* at 18-21, leading the Commission to adopt a series of mitigating remedial measures,<sup>27</sup> until it ultimately abandoned the policy altogether.<sup>28</sup> An *à la carte* proposal should not become the vehicle by which the Commission repeats this unfortunate history.

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<sup>26</sup> E.g., Martha Kleder, Policy Analyst, CWA, *Monopoly is More Than a Game: U.S. Senate Hearing on Cable Hears Calls for Competition and Choice*, May 24, 2004, posted at <http://www.cwfa.org/articledisplay.asp?id=5702-CFI&categoryid=papers>.

<sup>27</sup> E.g., *Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation*, 10 FCC Rcd 1226, 1231 (1995); *Cox Communications, Inc. Social Contract*, 11 FCC Rcd 1972, 1985 (1996). See Thomas W. Hazlett, *Prices and Outputs Under Cable TV Reregulation*, 12 J. OF REGULATORY ECON. 173 (1997) (The growth rate of basic cable television subscribership fell sharply during the period of rate reductions. Only after rate controls were relaxed in response to concerns about their impact on programming networks did industry output measures return to the pre-regulation growth trends.”).

<sup>28</sup> *Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996*, 14 FCC Rcd 5296 (1999).

## B. À La Carte Will Not Lower Prices for Consumers

The notion that *à la carte* requirements “that ‘unbundl[e]’ some or all cable programming services would lower the rates paid by subscribers reveals a misunderstanding of the economics of cable programming.” *Economists Study* at i. Forced distribution of cable networks *à la carte* would result in lost subscribers and reduced subscriber fees and advertising revenues needed to recover the costs of producing and distributing programming, which remain constant. Such programs are “public goods,” in that “once a program exists, it costs nothing to let one additional viewer to enjoy it.” *Id.* at 6. The more subscribers that view it, however, the more widely its costs can be distributed, lowering per-subscriber prices. *Id.* Conversely, the fewer subscribers that receive a program, the more they must be charged to cover its costs. See, e.g., GAO Testimony at 15-16. See also *Economists Study* at 7; *À La Carte Pitfalls* at 3.

In this regard it is essentially advertising revenue – and by extension bundling, because it helps maximize advertising revenue – that keeps the cost of programming to consumers at a reasonable level. Once even initial subscriber reductions occur upon initiation of *à la carte*, the per-channel cost of multichannel programming to the remaining subscribers must increase. This effect is not only demonstrable for the economic reasons above, but is observable in practice as well. It can be seen in the prices of existing “premium” subscription networks, the pre-tiering prices of formerly “premium” networks, and the price of *à la carte* offerings in Canada.<sup>29</sup> If forced to transition to *à la carte*, AETN estimates that it may have to charge as much

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<sup>29</sup> With respect to Canadian *à la carte* offerings, if they are purchased in quantities less than ten (the average size of “program packs” in which per-channel costs drop significantly), they cannot be acquired for less than C\$2.00 a channel. See *supra* at 23-24.

as \$2.00-\$3.00 (U.S.) for each of its networks. This would not be uncommon – the GAO Report noted that “one cable network ... estimated that to compensate for the loss of advertising revenue in an à la carte scenario, [it] would have to raise its monthly license fee from the current ... rate of \$0.25 per subscriber to a level several fold higher – possible as much as a few dollars per subscriber per month,” *i.e.*, an approximately *tenfold* increase. GAO Report at 36.

Thus, for consumers to experience a significant price reduction, they would have to subscribe to far fewer channels than they presently receive. The Commission has reported that at present the average MVPD monthly bill is \$36.47 for 62.7 channels (\$40.11 including equipment costs), or \$0.664 per channel. *2002 Cable Pricing Report*, 18 FCC Rcd 13284, Att. 2. Assuming even an unrealistically low *à la carte* per-channel price of \$1.50 per month,<sup>30</sup> subscribers would have to *forego approximately two thirds of the channels* they currently receive to experience *even a ten percent savings*. And that ten percent savings is illusory, because it does not include the cost of the digital box subscribers would need to purchase for each television for which they desire *à la carte* service.<sup>31</sup> Moreover, it is highly unlikely the quality of programming on the few channels they retain would remain at its present high level.

Even those staunchly favoring *la carte* requirements tacitly admit the system would fail to benefit most consumers. In disputing portions of the *GAO Report*,

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<sup>30</sup> This is a fraction of the cost of “premium” *à la carte* channels, well shy of what AETN expects would be a more realistic price, and below the Canadian price for *à la carte* channels.

<sup>31</sup> The GAO estimates that the average monthly price of an addressable converter is \$4.39. GAO Testimony at 14. For homes that have multiple television sets, GAO estimated that the average cost could amount to \$13.17. GAO Report at 32 (anticipated cost of equipping three TVs).

Consumers Union complained that “GAO understates how many subscribers would benefit from an à la carte approach,” and it estimates that “a substantial percentage ... perhaps as many as 40 percent ... could see their monthly bill decline.” *GAO Report* at 81. Even taking Consumers Union’s prediction a face value (though the GAO Report does not provide sufficient information to assess its reliability), *sixty percent or more of subscribers would not see their bills decline* as a result of à la carte options. Moreover, the “as many as” forty percent that *could* see their bills decline likely would do so only to a marginal degree, and at the expense of foregoing many – if not virtually all – of the channels they currently receive. Meanwhile, the sixty percent of subscribers who would see either no change or increased prices under the Consumers Union’s assumptions would likely experience a loss of programming, because the defection of the forty percent of “savers” would drastically diminish the quantity and quality of programming multichannel networks may be reasonably expected to produce and/or sustain. Moreover, it may be the case that not even forty percent of consumers would see a price reduction, given Consumer Union’s acknowledgement that “fundamentally there is tremendous uncertainty regarding ... an à la carte regime.” *Id.*

**C. Consumers Already Possess Ultimate Control Over the Multichannel Programming That Enters Their Homes**

Government regulation is not needed to provide consumers à la carte rights to purchase multichannel programming on grounds that they require such pick-and-choose options to control content that enters their homes. Consumers already enjoy multiple, overlapping options to block reception of television programming they do not wish to receive. These options, which can be deployed independently or in combination, range from relying solely on over-the-air broadcasting or basic cable, to MVPD-

provided options to block unwanted channels, to use of the “V-chip” to block select programs. Both the government and the MVPD industry have promoted these alternatives,<sup>32</sup> and even proponents of *à la carte* as a means of content control do not seriously contend that these mechanisms are not readily employed.<sup>33</sup>

Government-mandated *à la carte* as a content-control device poses serious concerns. Most glaringly, as content-based regulation it faces significant First Amendment problems, the breadth of which are discussed below. Its economic impact also means that, even limited to *à la carte* proponents’ core claim – that they should not pay for programming they do not wish to receive and may seek to block – there still is no basis for government intervention.

As a threshold matter, due to disparities between the per-channel price in a bundled environment and projected per-channel prices under an *à la carte* system, see *supra* at 29-30, it is likely that costs to consumers would be the same or even higher for them to receive only the channels they want via *à la carte* pick-and-choose than for them to do so by simply blocking unwanted channels in the bundled tiers they receive. Thus, consumers in effect are paying little, and in some cases nothing, for any channels they do not want. Conversely, the impact of *à la carte* would be to increase prices for most if not all subscribers. The demands of the relatively small (albeit vocal) minority of

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<sup>32</sup> See <http://ftp.fcc.gov/cgb/consumerfacts/vchip.html>; <http://www.fcc.gov/vchip/Welcome.html>; <http://www.fcc.gov/parents/channelblocking.html>; <http://controlyourtv.org>; [http://www.ncta.com/pdf\\_files/whitepapers/TVControl.pdf](http://www.ncta.com/pdf_files/whitepapers/TVControl.pdf).

<sup>33</sup> See *Family-Friendly Programming* at 561 (“Digital and satellite systems offer [a] tool for parents to protect their children from certain content” in the form of “technology that enables a parent to limit access to whole channels through use of a password” that “appears easier to use than the [FCC-mandated] V-chip.”); Letter Regarding the Video Programming Choice and Decency Act of 2004 (“cable companies have begun making it possible for customers to block offensive channels”), posted at <http://www.cwfa.org/articledisplay.asp?id=5581&department=CWA&categoryid=>.

viewers for *à la carte* options to pick and choose the channels they want (as opposed to exercising existing controls) should not be permitted to serve as a basis for raising prices and reducing diversity for everyone else.

The analogy touted by some *à la carte* advocates, that bundling networks on multichannel tiers is “like a grocery store telling you that in order to buy a gallon of milk, you also have to buy a six-pack of beer and a carton of cigarettes”<sup>34</sup> is absurd, because it presents a false metaphor: Cable tiering cannot reasonably be compared to a grocery store offering bundled products bearing no relation to one another for the simple reason that no such grocery stores exist in reality. Nor can cable tiering legitimately be compared to a magazine stand that requires a *Sports Illustrated* fan to buy all the magazines on the rack, for the same reason – no such newsstands exist. Bundled products are offered in the market where it is efficient to do so and consumers derive a benefit. Thus, encyclopedias are sold in sets, and newspapers are sold in bundled sections, because such methods of distribution are more efficient and supported by the market.<sup>35</sup> The same is true of bundled tiers of video programming.

Nor is forced *à la carte* necessary to ensure sufficient “family” programming. *Compare*, Martin Statement at 6. Putting aside that the prospect of the government specifying which programming is “family-friendly” and requiring MVPDs to offer it on a special tier raises definitional issues and compounds *à la carte*’s constitutional

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<sup>34</sup> *PTC Promotes Benefits of À La Carte Cable Television Programming*, Press Release, May 5, 2004, available at <http://www.parentstv.org/ptc/publications/release/2004/0505.asp>.

<sup>35</sup> *Economists Study* at 1-2 (providers of goods and services bundle them where it is efficient to do so, where it creates economies of scope, where it delivers value to simply have the opportunity to access all the items in the bundle even if that option is under- or unused, and/or where synergies are created).

infirmities,<sup>36</sup> the market already more than meets the demand for “family” fare. Even PTC admits “basic cable” alone “opens up a whole universe of family-friendly programming.”<sup>37</sup> Commissioner Martin agrees that “you can get a significant selection of high-quality, family-friendly programming” under the current system. *Family-Friendly Programming* at 556. Should any subscribers wish to limit the multichannel signals they receive to only those fitting their own definitions of “family” channels (which incidentally is the only appropriate way to resolve such definitional issues), the bundling and channel-blocking tools MVPDs already offer permit the construction of such individualized family tiers. *À la carte* choices are thus unnecessary to accomplish that objective.

To the extent the question is whether MVPDs should be forced to offer a discrete, pre-packaged family tier, the answer here is the same as that for *à la carte* generally – if market forces warrant such a package, MVPDs will provide it. Cable and DBS providers have no incentive not to package programs in this manner if doing so can be profitable and/or gives them a competitive edge. In this regard it is notable that DirecTV once offered a “family pack” option to its subscribers but it no longer does so,<sup>38</sup> on grounds, one can only assume, that DirecTV found there was insufficient interest to

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<sup>36</sup> Indeed, Commissioner Martin endorses a definition of “family-friendly” programs that “contain no elements the average viewer would find offensive,” “that the average viewer is [not] embarrassed to see with children in the room,” and that “ideally embod[ies] an uplifting message.” *Family-Friendly Programming* at 557 n.18. However, no one has suggested a methodology for choosing which channels would qualify under these patently subjective criteria.

<sup>37</sup> PTC Letter, *supra* note 6, at 1.

<sup>38</sup> Compare Andrea Figler & Mavis Scanlon, *Cable's Direct Threat Satellite Provider Boosts Subs as News Corp. Merger Looms*, CABLE WORLD, Oct. 22, 2001, at 1 (discussing, *inter alia*, provision of, and promotional offer permitting four free months access to, “Family Pack”), with <http://www.directv.com/DTVAPP/packages/Landing.dsp> (DirecTV website showing current packages, but no “Family Pack”).

sustain it. The government should not view *à la carte* as a mechanism for requiring MVPDs to offer what the market will not support.

#### **IV. REQUIRING CABLE PROGRAMMERS AND OPERATORS TO OFFER “VOLUNTARY” À LA CARTE PROGRAM OFFERINGS VIOLATES THE FIRST AMENDMENT**

Consideration of the issues raised in the Public Notice must confront not only the deleterious economic and public policy effects an *à la carte* system would have, but also that *à la carte* and tiering proposals necessarily implicate the First Amendment, and inexorably lead to a conclusion that it would be unconstitutional for the government to compel in any way *à la carte* options. As noted, the Public Notice must be viewed against the backdrop of policy proposals that motivated its issuance, all of which are based on the government dictating or at least influencing the way MVPD subscribers purchase programming. See *supra* notes 2-6 and accompanying text. That the Public Notice is directed specifically toward responding to the House Letter and to the McCain Letter is especially notable. The notion that legislative or regulatory action would result in “voluntary” steps by MVPDs or programmers is a non sequitur, and there is thus no basis for analyzing this issue as a voluntary measure.

The Public Notice seems to acknowledge as much. It specifically raises legal and regulatory questions, and in particular asks what constitutional issues would arise if Congress required programmers to offer their channels to operators on a stand-alone basis and prohibited them from requiring carriage on specified tiers. Public Notice at 9293-94. It also asks what issues would be raised if Congress required programmers to allow MVPDs to “voluntarily” offer their channels *à la carte* in addition to bundling them. *Id.* Notably, though the question is couched in terms of “voluntariness” with respect to

MVPDs, it still necessarily would impose requirements on how non-integrated programmers like AETN may or may not provide content.<sup>39</sup>

The fact that an *à la carte* system ultimately would place restrictions on *programmers* makes the prospect of such a system particularly vulnerable to First Amendment scrutiny. This is so because, unlike broadcasters and MVPDs that rely on spectrum licenses and/or use public rights-of-way, programmers are not subject to any kind of relaxed constitutional doctrine. See, e.g., *United States v. Playboy Entmt. Group, Inc.*, 529 U.S. 803, 813-15 (2001).

A government-inspired *à la carte* system regulating the distribution of video programming consequently would face the same constitutional rules as any other non-video speech regulation and would not survive First Amendment review. In this regard, there can be no doubt that *à la carte* requirements would be subject to heightened First Amendment scrutiny. This is so because virtually any system requiring or encouraging the provision of *à la carte* options to MVPD subscribers necessarily would be content-based and thus subject to strict scrutiny, *Turner Broad. Sys. v. FCC*, 512 U.S. 622, 644-46 (1994) (“*Turner I*”); *Time Warner Entmt. Co. L.P. v. FCC*, 211 F.3d 1313, 1316 (D.C. Cir. 2000), and at the very minimum would be subject to intermediate scrutiny as economic regulation that affects programming. *Turner I*, 512 U.S. at 661-62; *Time*

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<sup>39</sup> Indeed, the Video Programming Choice and Decency Act of 2004, see *supra* note 3 and accompanying text, would have permitted MVPDs to “voluntarily” offer programming to subscribers on an *à la carte* basis, but to facilitate their doing so would impose *requirements* – not voluntary options – for how programmers make content available to MVPDs. It would have authorized FCC rules “prohibit[ing] any MVPD from entering into any contract with any video programming producer, or from complying with any provision of any such contract, that would preclude the MVPD from voluntarily offering *à la carte* programming,” as well as rules suspending for at least 12 months any contract provision in affiliation agreements from being enforced if it “preclude[s] the MVPD from voluntarily offering *à la carte* programming.” *Id.* §§ 209(b), (d).

*Warner Entmt. Co. L.P. v. FCC*, 240 F.3d 1126, 1129-30 (D.C. Cir. 2001); *Time Warner Entmt. Co. L.P. v. FCC*, 56 F.3d 151, 181-82 (D.C. Cir. 1995). In either case, *à la carte* proposals are extremely vulnerable to invalidation under the First Amendment.

**A. À La Carte Requirements Are Invalid Under Strict First Amendment Scrutiny**

A system of government-compelled *à la carte* distribution of multichannel programming adopted for any of the reasons motivating the Public Notice would violate the First Amendment because it would be content-based and thus subject to, and unable to survive, strict scrutiny. Indeed, content-based restrictions are rarely upheld.<sup>40</sup> Here, an *à la carte* system would not advance any “compelling” government interest, nor would it be the least restrictive means of advancing any interest. See *Denver Area Educ. Telecomms. Consortium, Inc. v. FCC*, 518 U.S. 727, 730 (1996).

**1. Proposed Regulations Are Content-Based**

There is no doubt that any regulations the government adopts imposing or compelling an *à la carte* system would be content-based and subject to strict scrutiny. Even if the rules made no explicit reference to content, and required only that multichannel programmers like AETN release cable and DBS operators from obligations not to offer their networks on an *à la carte* basis and/or specifying on what tier they must be placed, the regulations would still directly affect program content. The rules effectively would bar programmers from using their editorial discretion with respect to how they choose to package their offerings. See *Hurley v. Irish-American Gay, Lesbian and*

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<sup>40</sup> *Ashcroft v. ACLU*, \_\_\_ U.S. \_\_\_, 124 S.Ct. 2783, 2788 (2004) (“Content-based prohibitions ... have the constant potential to be a repressive force in the lives and thoughts of a free people. To guard against that threat the Constitution demands that content-based restrictions on speech be presumed invalid.”).

*Bisexual Group of Boston*, 515 U.S. 557, 570 (1995) (“Cable operators ... are engaged in protected speech activities even when they only select programming originally produced by others.”). Such interference with how a speaker combines its various messages is the epitome of content-based regulation.

That the government may advance purported economic motives for ordering MVPDs and/or programmers to take steps to offer *à la carte* programming does not necessarily preclude the application of strict scrutiny.<sup>41</sup> In most cases involving zoning ordinances, for example, restrictions that are designed to curb “secondary effects” are not subject to strict scrutiny. *Renton v. Playtime Theatres, Inc.*, 475 U.S. 41 (1986); *Young v. American Mini Theatres, Inc.*, 427 U.S. 50 (1976). However, “the lesser scrutiny afforded regulations targeting ... secondary effects ... has no application to content-based regulations targeting the primary effects of protected speech.” *Playboy*, 529 U.S. at 815 (citing *Reno v. ACLU*, 521 U.S. 844, 867-868 (1997); *Boos v. Barry*, 485 U.S. 312, 320-321(1988)). See also *Lorillard Tobacco Co. v. Reilly*, 533 U.S. 525, 573-74 (2001). Here, some of the proponents of *à la carte* rules are quite clear that their rationale is based on concerns about content. Obviously, adoption of *à la carte* requirements in response to the anti-indecency crusade at the behest of interest groups like PTC and CWA clearly would be content-based and subject to strict scrutiny. The regulation of cable programming in order to restrict the delivery of “indecent” programming, even in the name of protecting children, is a “content-based speech restriction

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<sup>41</sup> *Turner I*, 512 U.S. at 640, 661. Even if rules are defended on purely economic terms, various cases apply strict scrutiny to regulations that impose an economic burden on speakers. See *Simon and Schuster*, 502 U.S. 105 (1991); *Riley v. National Fed’n of the Blind*, 487 U.S. 781 (1988). See also *Minneapolis Star v. Minnesota Comm’r of Revenue*, 460 U.S. 575, 589 (1983) (content discrimination “is not the sine qua non of a violation of the First Amendment”).

[that] can stand only if it satisfies strict scrutiny.” *Playboy*, 529 U.S. at 813; *Sable Communications of Cal., Inc. v. FCC*, 492 U.S. 115, 126 (1989).

The same is true of any effort to impose *à la carte* requirements in the name of promoting “family-friendly” programming. As a threshold matter, any provision of that rationale by definition sets forth the content-specific nature of the regulation. Moreover, even if the regulation somehow managed to state its objectives without actually specifying the provision of a programming package that “contain[s] no elements the average viewer would find offensive,” and that “ideally embod[ies] an uplifting message,” see *Family-Friendly Programming* at 557 n.18, the regulation still would be subject to strict scrutiny, as “even a regulation neutral on its face may be content based if its manifest purpose is to regulate speech because of the message it conveys.” *Turner I*, 512 U.S. 645. Any regulation that actually required the creation of a family-friendly tier also would be content-based, not only facially, but also for all the reasons that an *à la carte* regime is content based, *i.e.*, it dictates how MVPDs and/or programmers must package content pursuant to a government mandate. Such compelled speech regulations are presumptively invalid. See *Riley*, 487 U.S. 781; *Secretary of Maryland v. Joseph H. Munson Co., Inc.*, 467 U.S. 947 (1984).

## **2. À La Carte Rules Would Not Survive Strict Scrutiny**

A government-mandated *à la carte* system would not withstand constitutional review under strict scrutiny because no interest that the government might advance would be compelling, nor would the rules be the least restrictive means of achieving them. See *Reno v. ACLU*, 521 U.S. at 874; *Sable*, 492 U.S. at 126. In this regard, the

government bears the burden of showing that the interest it seeks to advance is compelling, and that there are no less restrictive means of reaching its objective.

Putting aside that private and government analysts that have considered *à la carte* have concluded it would not lower cable prices for most consumers, there is no compelling interest in the government manipulating the MVPD market so that viewers can attempt to tailor the multichannel product they receive to their liking at a price point they are willing to pay. As noted, the market for multichannel programming is a properly functioning one, where if there were sufficient demand for *à la carte* options – both in terms of consumers wishing to purchase the product that way *and* willingness to pay the associated price that unbundling carries – such options would exist. See *Turner I*, 512 U.S. at 640 (“the mere assertion of dysfunction or failure in a speech market, without more, is not sufficient to shield a speech regulation from the First Amendment standards applicable to nonbroadcast media”). Notably, there is no government interest in price controls outside a “monopoly” context, nor is there a government interest in promoting more “choice,” where choice is promoted by competition and subscribers can block any channel they prefer.

There also is no compelling interest in the government protecting MVPD subscribers from “indecent” programming among the bundle of networks they elect to bring into their homes. As the Supreme Court held in *Playboy*:

Even upon the assumption that the Government has an interest in substituting itself for informed and empowered parents, its interest is not sufficiently compelling[.] The ... argument stems from the idea that parents do not know their children are viewing the material on a scale or frequency to cause concern, or if so, that parents do not want to take affirmative steps to block it and their decisions are to be superseded. The assumptions have not been established[.]

529 U.S. at 825. There also is no compelling interest in mandating a “family-friendly” tier when consumers already can construct one of their own by purchasing existing tiered options and using V-chip and channel-blocking technology to tailor the networks they receive, and where there a multitude of alternatives, including broadcast, on-demand and home-video options.

Moreover, an *à la carte* regime would not be the least restrictive means of achieving any of the interests the government might proffer. With respect to economic motivations, *i.e.*, keeping MVPD rates or the levels at which they rise within a range that consumers would find acceptable, the government could, as GAO recommended, take additional steps to foster competition among cable operators, GAO Report at 9-11, either by overbuilders or additional facilities-based competitors in addition to DBS providers. The government also could, if it deemed the ubiquitous availability of multichannel programming at certain rate levels to be sufficiently important, opt to subsidize multichannel programming just as it does with “universal service” in telecommunications. See 47 U.S.C. § 254. With respect to control over the content subscribers receive, the V-chip and channel-blocking options that preclude the government’s interest from being compelling also are less restrictive means of restricting content that a subscriber finds objectionable.

The Supreme Court most recently has reaffirmed the basic principle that, where less restrictive options are available, the government must rely on them rather than restricting protected speech. *Ashcroft*, 124 S.Ct. 2791-93. *Playboy*, 529 U.S. at 819. The Court made clear that the government must prove its proposed regulations are *more effective* than other alternatives, and that it is not enough simply to assert that

the rules would have some potential benefit. *Ashcroft*, 124 S.Ct. at 2791 (“the test does not begin with the status quo of existing regulations, then ask whether the challenged restriction has some additional ability to achieve Congress’ legitimate interest”). In this regard, the less restrictive alternative need not be a regulation at all, but may include such notions as more effective parental supervision. *Id.* at 2793 (“The need for parental cooperation does not automatically disqualify a proposed less restrictive alternative.”). Accordingly, the government cannot lightly decide to revamp the economic underpinnings of the video programming marketplace without first disproving the sufficiency of less drastic alternatives.

A forced *à la carte* regime designed to allow consumers to avoid unwanted multichannel programming, whether for economic or editorial reasons, would be comparable to the cable signal bleed regulations struck down in *Playboy*. *Playboy* addressed the unwanted content that entered subscribers’ homes as an adjunct to the service they elected to take. The law at issue required cable operators to solve the problem by taking special steps, including restricting the programming subscribers received, just as would be the case with *à la carte*. The government defended the regulation as a content-neutral measure that was intended only to enforce subscriber preferences and allegedly to protect children. In doing so, it compared the rules to zoning regulations targeted to secondary effects. The Supreme Court rejected that reasoning, and held that the regulations restricted too much speech to survive First Amendment review.

**B. À La Carte Requirements Are Invalid Under Intermediate First Amendment Scrutiny**

Even if a government-mandated *à la carte* regime were deemed content-neutral and thus not subject to strict scrutiny, it still would fail to withstand constitutional review under intermediate scrutiny. See *United States v. O'Brien*, 391 U.S. 367, 377 (1968). The government would not be able to show, with respect to any *à la carte* system adopted for the policy reasons underlying the Public Notice, that there is a substantial governmental interest, that the regulations would directly and materially serve that interest, or that the rules are narrowly tailored and will not restrict more speech than necessary. *Turner Broad. Sys. v. FCC*, 520 U.S. 180, 189-90 (1997) (“*Turner II*”). Notably, this standard, though not as stringent as strict scrutiny, is an exacting one that holds “[c]onstitutional authority to impose some [regulation] is not authority to impose any [regulation] imaginable.” *Time Warner*, 240 F.3d at 1130.

**1. There is No Substantial Government Interest to Support Imposition of À La Carte Requirements**

The government cannot demonstrate a substantial interest that justifies *à la carte* requirements. As with the strict scrutiny analysis above, there is no government interest in price controls outside a “monopoly” context, nor is there an interest in promoting more “choice,” where choice is promoted by competition and subscribers can block any channel they prefer. Indeed, the Commission has found that with the advent of DBS there is more competition than ever before, *2003 Video Comp. Report* ¶¶ 4, 6-7, and new broadcast subscription models and the burgeoning delivery of digital multi-casting will only bring additional competitiveness to the market.

Unlike the must-carry analysis that narrowly survived constitutional review, there is no suggestion of a “bottleneck” that gives any MVPD inordinate control over programming content. *Compare Turner II*, 520 U.S. at 222. Indeed, as noted above, neither lack of bargaining power nor any other impediment precludes an MVPD from offering programmers economic incentives that would facilitate *à la carte* offerings. No MVPD has found there to be sufficient demand that would deliver a competitive advantage from making *à la carte* options available beyond those that already exist with respect to “premium” channels, pay-per-view and video-on-demand.

## **2. À La Carte Rules Would Not Serve the Government’s Purported Interests**

Government-mandated *à la carte* requirements would not sufficiently advance any of the interests asserted for the policy proposals underlying the Public Notice. The GAO has cited – notably, in reporting the position advanced by advocates of *à la carte* – the “tremendous uncertainty regarding the outcome under an *à la carte* regime,” GAO Report at 91, and this burden of uncertainty weighs against the government. It has the obligation to prove that any policies it adopts will serve its interest in a “direct and material way.” *Turner I*, 512 U.S. at 664 (plurality opinion). Even where the government cites an economic basis for adopting regulations that have a drastic impact on multichannel speech, the constitutionality of its actions still has depended heavily on extensive congressional study, “unusually detailed statutory findings,” and substantial evidence for its conclusions, *Turner II*, 520 U.S. at 195-206; *Turner I*, 512 U.S. at 647, none of which exist with respect to *à la carte*.

In this instance, virtually all of the available evidence suggests that an *à la carte* requirement would not reduce rates. *See supra* at 29-31. The Commission, the

GAO, independent economists, and the cable industry all have examined the issues underlying *à la carte* channel offerings in depth, and none have reached the conclusion that requiring operators to offer an *à la carte* option would reduce rates. The GAO noted the effect on the dual revenue stream that supports most cable networks, and the increased marketing and equipment costs, among other factors, and found that “subscribers’ monthly cable bills would not necessarily decline under an *à la carte* system.” GAO Report at 36. Even for those who believe cable rates would be reduced under an *à la carte* scheme, the positive effect would be minimal, and may well be offset by increased equipment and other costs.

In this regard, it is noteworthy that the best evidence *à la carte* advocates can offer is uncertainty about the impact of regulations. They propose, in effect, to conduct a grand experiment to see how subscribers will react if given the ability to purchase channels individually. Even if most subscribers keep their current tiers and only a few purchase channels *à la carte* (as in Canada), they suggest that the experiment will have succeeded because those few subscribers will have exercised greater choice and saved some money. Such speculation, however, is wrong in every respect. It is the government’s burden to show that a rule will “directly and materially” advance its stated interests *before* adoption; it cannot simply enact regulations and hope for the best. *Turner II*, 520 U.S. at 195-206. Moreover, enabling a few subscribers to reduce their bills – which assumes a best case scenario for *à la carte* and no countervailing consequences – falls far short of the constitutional requirement that advancement of the government’s interest be *material*.

Compared to the general speculation as to whether an *à la carte* experiment would produce any benefits at all, there is one absolute certainty about the regulatory proposals – they would void existing long-term contracts and impose a wholesale revision on the way programming networks are developed and sold. For reasons previously explained by the FCC and GAO, this fact will preclude any *à la carte* rules from achieving their stated objectives. But more ominously, requiring such a drastic change is certain to harm programmers whether or not subscribers flock to the per-channel alternative. By voiding existing contractual arrangements, the government will prevent programmers from obtaining initial investments and advertising commitments that are necessary to launch and sustain channels.

### **3. *À La Carte* Requirements Would Burden More Speech Than Necessary**

There also is ample evidence that an *à la carte* system would burden far more speech than necessary. The detrimental economic impact of *à la carte* outlined above demonstrates just how overburdensome government interference in this area would be. *See supra* at 15-19. The loss of subscriber fee and advertising revenues would force virtually all programmers to cut back on the quantity and quality of original programming and ultimately would imperil a significant number of networks. The most likely first victims of the *à la carte* regime would be niche programmers who already subsist, by design, by appealing to only portions of the total available viewing market, and if they are not the first victims, it will be new networks that are in their embryonic phase or on the verge of launching. As a consequence, there will be less original programming, fewer options, and less program diversity under an *à la carte* system, and these are all serious burdens on protect speech.

It is a significant burden on First Amendment interests for the government to impose regulations that “prevent programmers from broadcasting to viewers who select programs day by day (or, through ‘surfing,’ minute by minute); to viewers who would like occasionally to watch a few, but not many, of the programs on the ‘patently offensive’ channel; and to viewers who simply tend to judge a program’s value through channel reputation, *i.e.*, by the company it keeps.” *Denver Area Educational Telecommunications Consortium*, 518 U.S. at 754. In *Denver*, the Supreme Court invalidated a rule that required an affirmative written request by subscribers for leased access channels dedicated to “indecent” programming. The same analysis applies to a rule that would require networks to be available *à la carte* because of its adverse impact on “spontaneous” viewing across cable channels.

The direct negative impact aside, *à la carte* rules also would overly burden more speech than necessary in that there are a number of obvious, less restrictive alternatives to government-mandated or -assisted *à la carte*. As noted above, fostering the already substantial competition between MVPDs, V-chip use, and channel-blocking promotion all are less restrictive means of meeting whatever interests the government might advance in support of *à la carte* requirements. In view of these “plausible, less restrictive alternative[s],” the government would not be able to demonstrate that they “will be ineffective to achieve its goals.” *Playboy*, 529 U.S. at 816. As a consequence, an *à la carte* mandate fails to satisfy intermediate First Amendment scrutiny. *Denver Area Educ. Telecomms. Consortium*, 518 U.S. at 758-759.



**ATTACHMENT**



## Davis Wright Tremaine LLP

ANCHORAGE BELLEVUE LOS ANGELES NEW YORK PORTLAND SAN FRANCISCO SEATTLE SHANGHAI WASHINGTON, D.C.

ROBERT CORN-REVERE  
DIRECT (202) 508-6625  
bobcornrevere@dwt.com

SUITE 450  
1500 K STREET NW  
WASHINGTON, D.C. 20005-1262

TEL (202) 508-6600  
FAX (202) 508-6699  
www.dwt.com

May 11, 2004

### **By Facsimile To (202) 226-0092**

The Honorable Edward J. Markey  
2108 Rayburn House Office Building  
Washington, DC 20515

Dear Representative Markey:

It has been widely reported that Representative Nathan Deal intends to introduce an amendment to the Satellite Home Viewer Extension and Reauthorization bill that would regulate whether cable networks must allow cable operators and/or other multichannel video providers (collectively, "Distributors") to offer video services on a per-channel or "à la carte" basis. Courtroom Television Network LLC ("Court TV")<sup>1</sup> and A&E Television Networks ("AETN")<sup>2</sup> vehemently oppose injecting federal regulation into the contractual relationship between networks and Distributors concerning the distribution of program services. As discussed in detail below, the proposed amendment would: (1) lead to higher prices for consumers; (2) cause some networks to go out of business or drastically reduce their programming budgets; (3) ignore studies by the GAO and FCC acknowledging these undesirable results; and (4) disregard the role of the marketplace and competition in the market for multichannel video programming.

Selling cable programming on an à la carte basis would dramatically change the economic model on which Court TV, AETN, and other cable networks have based their businesses. Virtually all commercial cable networks other than those that traditionally sell themselves as "premium" services (*e.g.*, HBO and Showtime) have been created on a dual revenue stream model: revenue will come from license fees paid by Distributors and from advertising. This model has allowed the development of hundreds of cable networks offering a vast array of original programming to consumers. In the absence of the bundled manner in which its programming is sold (*e.g.*,

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<sup>1</sup> Court TV provides a unique mix of gavel-to-gavel courtroom coverage and is the leader in the investigative genre of television with documentaries, series, original films based on real life justice system themes, and an all-original weekday primetime lineup.

<sup>2</sup> AETN distributes two basic cable programming services, A&E Network and The History Channel, as well as two primarily digital services, The Biography Channel and History International. AETN intends to launch The History Channel en Espanol (also a primarily digital service) in the next few months.

expanded basic packaging), Court TV and AETN's basic cable networks would never have developed subscriber bases of over 80 million subscribers and would never have survived.<sup>3</sup> Perhaps even more importantly, without the continued use of bundling, it is possible that Court TV and/or AETN's networks will not be able to stay in business.

Changing the rules in mid-stream to allow à la carte carriage of Court TV's and AETN's programming would have a devastating economic effect. The marketing strategy for a stand-alone network is substantially different from the strategy that Court TV, AETN, and other non-premium cable programmers have followed. An à la carte channel such as HBO uses advertising and marketing strategies focusing on consumer awareness so that subscribers know enough about a network to make the affirmative purchasing decision to select and pay for it on a monthly basis. HBO must then heavily advertise its individual program offerings to retain its subscriber base. The monthly "churn" in the premium business is well known and premium services experience high transaction costs of terminating and replacing customers each month.

By contrast, Court TV and AETN budget only a fraction as compared with premium services for advertising and marketing; they market primarily through cross-channel promotion on broadly distributed expanded basic cable networks. If Court TV and AETN were required to revamp their marketing strategies to survive in an à la carte environment, much of the millions of dollars that each company has committed to spend to develop original programming would be redirected for marketing purposes so that the services could survive. Rather than continuing to invest in original programming, the foreseeable future would be devoted to treading water in the television market and creating new brand identities. Both revenue streams at these networks would be adversely affected: license fees would likely decrease due to a dramatic loss of subscribers and advertising revenues would experience a significant reduction since rates are directly tied to ratings and demographics which would be altered tremendously if subscribers were cut by more than 85%.

Rep. Deal's proposed amendment would not only change the rules so as to destroy the economics of cable programming in the future, but it would also have a similar impact today, allowing the FCC to modify existing contractual arrangements between programmers and Distributors. By giving the FCC the power to suspend contractual provisions precluding a Distributor from offering programming on an à la carte basis for either one year or until after the FCC reports to Congress on the impact of à la carte carriage, the amendment would allow the FCC to abrogate long-standing contractual arrangements before there is any demonstrated need for such a remedy. The mere possibility that the FCC could take this step – the equivalent of "shoot first, ask questions later" – will require drastic changes in the programming industry and endanger the survival of many networks. Furthermore, programmers' needs for long-term marketing and business strategies means that a temporary suspension of contractual provisions

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<sup>3</sup> Even HBO, the leading premium service, which has been sold as a stand-alone network for its entire 30 year existence, is viewed in only about 27 million homes. *Multichannel News*, June 9, 2003.

would have the identical effect as a permanent, retroactive ban on the guaranteed broad distribution on which the contracts are based.<sup>4</sup>

Furthermore, with more competition than ever in the multichannel video program arena, due primarily to the increasing penetration of Direct Broadcast Satellite distribution, now is not the time for Congress to step in and tinker with a successful distribution model. Pricing and packaging issues should be decided in the marketplace and not by legislators. After all, consumers are always free to choose a low-cost broadcast basic package or an over-the air antenna to receive broadcast channels. An à la carte approach would undermine an effective marketplace model of packaging that has brought tremendous value to many subscribers.

The General Accounting Office (“GAO”), the FCC, numerous economists, and accepted business practices all counsel against federal regulations governing “à la carte” programming offerings. According to a recent GAO report,<sup>5</sup> implementing à la carte carriage is an unattractive alternative to selling cable programming in bundles, and may even cause cable rates to rise. According to the GAO:

- Diversity may suffer under an à la carte system because some cable networks, especially small and independent networks, might not be able to garner enough subscribers for the network to survive, and the quality of programming would be adversely affected.
- The loss of cable advertising revenues could lead to potential rate increases for consumers, since any movement of networks from such broadly distributed packages to an à la carte format is likely to result in reduced rates and revenue from advertisers.
- In order to carry networks on an à la carte basis, cable systems would need additional technology upgrades, requiring addressable converters to be attached to every television set used on the cable system.

The FCC has acknowledged the GAO’s findings. Last year, in its stated effort to take a broader view of the video marketplace in its annual video competition report and possibly establish the basis for future regulation, the Commission sought comment on the issue of à la carte carriage.<sup>6</sup> However, based on the comments it received and the GAO report, the FCC agreed that, “while

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<sup>4</sup> Furthermore, because the economic provisions in carriage contracts are conditioned on express packaging provisions, altering the packaging provisions would require a full-blown negotiation of every single carriage agreement. With each of over 150 advertiser-supported networks potentially having several hundred separate contracts, this could require renegotiation of 20,000-30,000 contracts, all for speculative purposes.

<sup>5</sup> U. S. General Accounting Office, *Issues Related to Competition and Subscriber Rates in the Cable Television Industry*, GAO-04-8 (Oct. 2003).

<sup>6</sup> See *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, 18 FCC Rcd. 16042, 16046 (2003).

an à la carte system might provide greater consumer choice, it would impose additional costs on subscribers and alter the current economic structure of the cable industry.”<sup>7</sup>

Cable television programming has generally been offered to customers in packages or tiers since the early days of the cable television industry and the reasons for doing so are as valid today as when the cable industry began. According to an economic study filed with the Commission in connection with its *Fifth Video Competition Report*,<sup>8</sup> which remains the most authoritative analysis of channel tiering which has been submitted to the Commission, bundling of goods is a commonplace occurrence in many different markets. Potentially distinct products are often bundled in order to lower transaction costs, benefit from economies of scale, and enhance the attractiveness or convenience of the product to consumers.<sup>9</sup> See Economists Study at 1.

Similar economies are realized by offering programming networks in broad service tiers. The advantages of bundling cable network offerings include lowering transaction costs and enhancing the value of cable or DBS service for consumers, providing synergies for Distributors and networks associated with selling advertising and promoting services, and enabling the launch of new and unique programming services. *Id.* at 2-5. Basic economic analysis confirms that the cost of service will necessarily increase if individual channels are sold in separate units.<sup>10</sup> The validity and value of this approach for selling video programming is confirmed by the fact that bundling is used by virtually every entity which currently provides multichannel video programming, including DBS providers, OVS operators, C-Band satellite providers, and wireless cable providers.

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<sup>7</sup> *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, 19 FCC Rcd. 1606, 1706 (2004).

<sup>8</sup> “How Bundling Cable Networks Benefits Consumers,” Economists, Incorporated, July 23, 1998 (“Economists Study”), filed with Comments of ABC, Inc., CS Docket No. 98-102, July 31, 1998.

<sup>9</sup> In the sale of newspapers, for example, the various sections and columns are bundled into a single product, even though not everyone who purchases a newspaper reads every part of it. But a newspaper is sold as a bundled product because: (1) of the economies of having all sections delivered at once rather than having separate distribution mechanisms for each section; (2) of the value to subscribers of having the option to look at all of the sections, even if they do not read all sections every day; and (3) bundling makes advertising more valuable and efficient because advertisers prefer paying a single price to reach all of the newspaper’s readers with a single advertisement, rather than placing an advertiser’s separate ads in each newspaper section. See Economists Study at 1-2. However, the same analogy does not apply to a magazine rack, where a consumer is presented with various choices and has the option of purchasing a single magazine or multiple publications. Purchasers in that context receive few benefits from bundling; a magazine rack gives customers the opportunity to browse through magazines and find different products in a single location, but patrons realize no discount from buying multiple magazines, they don’t have the ability to discover other magazines in their home after leaving the store, and advertisers can’t purchase space in a single magazine based on the readership of all magazines.

<sup>10</sup> See generally Bruce Owen and Stephen Wildman, Video Economics 219-20 (1992) (“Owen & Wildman”).

For new and niche programmers, obtaining carriage of a video program service in a tier with other more established programming services can mean the difference between survival and failure. A new program service's placement on a cable service tier, especially in proximity to the channel numbers of the most widely watched programming, will help ensure that the service gets introduced to an audience, in much the same way as broadcast networks choose to place new programs in time slots adjacent to established programs. As the Economists Study explains, "[i]t is through that association that new services have the greatest opportunity to be sampled and hence to find an audience." Economists Study at 4. Stated another way, "[b]y aggregating the demands of viewers who differ in their willingness-to-pay for different services, bundling makes it possible to supply program services that could not be supported on a stand-alone basis." Owen & Wildman at 134. Indeed, the high failure rate among cable services that have been offered on an à la carte basis, and the trend of program services to migrate from à la carte to tiers (e.g., Bravo and The Disney Channel), demonstrate the risks inherent in cable carriage without the benefit of bundling. Economists Study at 6.

In conclusion, while the argument has been made that the concept of à la carte programming means more consumer choice, when scrutinized, the argument is not a valid one. With à la carte, there would be a reduction in the number of cable networks, and the ones that do survive will likely cost more, so that the ultimate impact would be less choice and higher prices for the consumer.<sup>11</sup> The marketplace for cable programming has thrived and provided far greater consumer choice overall, due in significant part to the bundled manner in which cable operators and other multichannel video providers offer these services. This economic model has enabled programmers to invest in original programming, which in turn has attracted a growing number of viewers to cable and other multichannel media. There is no evidence that the marketplace is dysfunctional and competition among cable and other multichannel video providers has never been stronger; therefore there is no need for congressional involvement. À la carte channel carriage is a solution in search of a problem.

Very truly yours,

COURTROOM TELEVISION NETWORK LLC  
A&E TELEVISION NETWORKS



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Robert Corn Revere  
James S. Blitz

Their attorneys

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<sup>11</sup> Moreover, the benefits that are presumed to flow from giving cable subscribers more options might not even exist. According to one recent study, increased consumer choice does not necessarily equate to greater consumer satisfaction. See Schwartz, *The Paradox of Choice: Why Less Is More* (2004).